PRESIDENT'S FISCAL YEAR 2004 BUDGET WITH OMB DIRECTOR DANIELS

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

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PRESIDENT'S FISCAL YEAR 2004 BUDGET WITH OMB DIRECTOR DANIELS

WEDNESDAY, FEBRUARY 5, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to notice, at 2:05 p.m., in room 1100 Longworth House Office Building, Hon. Bill Thomas (Chairman of the Committee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
January 29, 2003
FC–2

Thomas Announces Hearing on the President's Fiscal Year 2004 Budget with OMB Director Daniels

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on the President's fiscal year 2004 budget. **The hearing will take place on Wednesday, February 5, 2003, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from the Honorable Mitchell Daniels, Jr., Director, Office of Management and Budget. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

On January 28, 2003, President George W. Bush delivered his State of the Union address in which he outlined a number of important policy objectives, including strengthening Medicare, reforming Social Security, and reducing taxes. The President's agenda will be detailed in his fiscal year 2004 budget, expected to be released on February 3, 2003.

In announcing the hearing, Chairman Thomas stated, "I look forward to Director Daniels' appearance before the Committee to hear details of the President's budget and policy initiatives."

FOCUS OF THE HEARING:

The Director will discuss the details of the President's proposals that are within the Committee's jurisdiction.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Due to the change in House mail policy, any person or organization wishing to submit a written statement for the printed record of the hearing should send it electronically to *hearingclerks.waysandmeans@mail.house.gov*, along with a fax copy to (202) 225–2610, by the close of business, Wednesday, February 19, 2003. Those filing written statements that wish to have their statements distributed to the press and interested public at the hearing should deliver their 200 copies to the full Committee in room 1102 Longworth House Office Building, in an open and searchable package 48 hours before the hearing. The U.S. Capitol Police will refuse sealed-packaged deliveries to all House Office Buildings.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. Due to the change in House mail policy, all statements and any accompanying exhibits for printing must be submitted electronically to *hearingclerks.waysandmeans@mail.house.gov*, along with a fax copy to (202) 225–2610, in Word Perfect or MS Word format and MUST NOT exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. Any statements must include a list of all clients, persons, or organizations on whose behalf the witness appears. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at http://waysandmeans.house.gov.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman THOMAS. Thank you, and good afternoon. Thank you, Director Daniels, for being with us. The U.S. economy has weathered the recession and survived the economic consequences of the terrorist attacks on September 11, 2001. In many respects, this economy has shown a remarkable resilience. Overall, the economy grew by almost 3 percent last year, notably more than the Congressional Budget Office (CBO) or the President's budget assumed a year ago.

Increases in the productivity of the American worker have been even more impressive, frankly, by growing 5 percent in the first three quarters of the last calendar year. We should not be satisfied with the current state of the economy, and for good reason. There are 1.8 million fewer jobs now than at the beginning of the recession, and the unemployment rate has climbed to 6 percent.

While a rise in unemployment is typical following a recession, overall economic growth is still below the potential for our economy. We need to continue to press for fiscal policy changes to make sure that we promote growth to create jobs and raise the standard of living for all Americans.

In fiscal year 2002, the government recorded a deficit of $158 billion. Our CBO estimates that under current law, the deficit this year will be $199 billion, which could be rounded off to $200 billion.

However, as we learned from our discussions with the Secretary of the U.S. Department of the Treasury yesterday, there is no real concern that deficits of this magnitude, in the short run, pose a significant risk to the economy, or will automatically lead to higher interest rates.

The largest cause of the current deficit projections is, in fact, the recession, which produces reduced revenue. Therefore, what we need to do is address this by making sure that we have economic growth.

The President has proposed a set of initiatives to strengthen the economy. He has also offered very important measures in the jurisdiction of this Committee in the area of modernizing Medicare, including prescription drug for seniors. The President has also addressed health insurance and a number of other issues that are in the broader area of health for all Americans. The President's budget also included initiatives aimed at reauthorizing and improving the Temporary Assistance for Needy Families (TANF) program and other related programs.

In addition, we are anxious to see how the new U.S. Department of Homeland Security is underway from a more narrow perspective, the Treasury with the changes in Customs and Alcohol, Firearms, and Tobacco. To provide us with such information, we have the Director of the Office of Management and Budget in front of us today. Rather than getting down in the weeds of the specific jurisdictional concerns as we normally would, I would urge you to provide for us the big picture of how the President's various budget proposals fit together and how collectively we will respond to the needs and concerns of all Americans.

So, I do welcome you again before the Committee, but before I recognize you for your testimony, I would recognize our Ranking Member, the gentleman from New York, Mr. Rangel.

[The opening statement of Chairman Thomas follows:]

Opening Statement of the Honorable Bill Thomas, Chairman, and Representative in Congress from the State of California

Good afternoon. Thank you Director Daniels for being here today.

The U.S. economy has weathered a recession and survived the economic consequences of the terrorist attacks of September 11th, 2001. In many respects the economy has shown resilience. Overall, the economy grew by almost 3 percent last year, notably more than the Congressional Budget Office or the President's Budget assumed a year ago. Increases in the productivity of the American worker have been even more impressive, growing by 5 percent in the first three quarters of 2002.

But we should not be satisfied with the current state of the economy. There are 1.8 million fewer jobs now than in the beginning of the recession and the unemployment rate has climbed to 6.0 percent. While a rise in unemployment is typical following a recession, overall economic growth is still below the potential for our economy and we must continue to press for fiscal policy changes to better promote growth, create jobs and raise the standard of living for all Americans.

In fiscal year 2002, the government recorded a deficit of $158 billion. The Congressional Budget Office estimates that under current law the deficit this year will be $199 billion. However, there is no concern that deficits of this magnitude pose a significant risk to the economy or will lead to substantially higher interest rates. The largest cause of the current deficit projections is the recession—not tax cuts—and part of the cure for these deficits is to increase revenue through economic growth.

The President has proposed a set of initiatives to strengthen the economy by reducing taxes, improve national security and homeland defense, combat HIV/AIDS in Africa, reduce the number of uninsured in the United States and strengthen Medicare.

The President has also called for important modernization of Medicare including a prescription drug plan for seniors. The cost of health care continues to rise and drug costs are no exception. The world of medicine changes rapidly and I applaud the President's commitment to helping seniors get better care and presenting a budget that allows for a Medicare prescription drug plan. The President's budget also includes initiatives aimed at reauthorizing and improving Temporary Assistance for Needy Families (TANF) and other related programs. Finally, the new Department of Homeland Security is now law and critical reorganizations are underway affecting numerous agencies including the U.S. Customs Service.

I would hope that today Director Daniels could pull together for us the "big picture" of how the President's various budget proposals fit together and how they individually and collectively respond to the real world needs of Americans. I would like to welcome Director Daniels back again and we look forward to your statement this morning. First I would like to recognize the Ranking Member, the gentleman from New York.

Mr. RANGEL. Thank you, Mr. Chairman, and thank you, Mr. Director, for once again sharing your views with us.

I am reminded of a director of Office of Management and Budget that served not too long ago that indicated after he left office, he said the best way to cut government programs is to cut revenues, and increase deficits and have the American people see that they are paying more for interest on the debt than they are for education and health programs.

I thought it was a mean-spirited thing to say, but it looks like we are walking down a road that is similar.

It seems like people are saying the deficit really doesn't matter that much, and that a $674 billion tax cut is for long-term economic growth and that this is good for the country and good for local and State governments. Yet, no one seems to appreciate or support this, not the governors, not my State, not my mayor, not the hospitals, not the educators, and the amazing thing is that the programs that have been targeted the most, Social Security and Medicare, the worst days from a budgetary point of view is yet to come. That is when the baby boomers become eligible.

There is no indication here as to whether or not the $1 trillion that the President estimates it would take to repair that is included in this, and while I hope and pray that we are not going to go to war, I don't see how anybody in charge of the budget cannot fold in that potential as a possible expenditure that we would have to pay for. Yet the Secretary of the Treasury said that was not included in what we are talking about.

So, having been one who has enjoyed borrowing all of my life, I hope that you can share with us how little we should be concerned about deficits and paying interest on the debt, because if that is the way for a great Nation like us to go, then we are going to need your guidance to share with our constituents and for those people who have programs that are going to be cut as a result of the crisis that we face as a Nation.

So, thank you for coming. I look forward to getting some of the answers from you this afternoon.

Chairman THOMAS. I thank my colleague. Mr. Daniels, any written testimony you may have will be made part of the record, and you may make any comments you wish to this Committee.

Mr. RANGEL. When you say any comments, you don't really mean that, do you?

Chairman THOMAS. I think that I am urging him to speak from the heart and the head.

Mr. RANGEL. Okay. Let us restrict it to the head.

Mr. DANIELS. Doesn't give me much to work with.

Chairman THOMAS. I will tell the director that the microphone is very unidirectional, and you need to speak directly into it.

STATEMENT OF THE HONORABLE MITCHELL E. DANIELS, JR., DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. DANIELS. Well, I thank the Committee, and I will—with respect to the Committee's time, if it will please the Chair, will stand on the written testimony I have submitted. It simply summarizes the President's priorities. He shares the concern about deficits, and places them near—but not at the top of his priority list, behind successful prosecution of the war defense, the homeland and growth of the economy, and these are—this is rank order that—about which honest people can differ, and I know we will. If it will get us more quickly to your questions, I will be happy to stop with that summary and await those questions.

[The prepared statement of Mr. Daniels follows:]

Statement of the Honorable Mitchell E. Daniels, Jr., Director, Office of Management and Budget

Thank you as always for the privilege of appearing.

This week we are presenting the President's program for fiscal year 2004. No such presentation lacks for long-term importance to our Nation's future, but few in our history have directed the Nation's public resources at more fundamental challenges.

The President plans to prosecute the war on terror relentlessly. There is no more effective way to protect Americans, or, as we now say, to provide "homeland security," than to root out terror and stop it before it can reach our shores. The President's budget provides $380 billion for the war on terror and the continued rebuilding of our national security capabilities. Spending on domestic homeland security is also given top priority, with spending rising at the fastest percentage rate of any major category.

The President's third priority is to reinvigorate an American economy that has grown for five consecutive quarters, but at a rate that he deems far too slow. To this end the President proposes a major growth and jobs plan, the third of his Presidency.

Below these three transcendent objectives, the President urges greater spending on a host of essential activities: veterans' programs, the education of our disadvantaged and disabled children, the alleviation of Africa's AIDS tragedy, research on a pollution-free automobile, and so on.

The budget has returned to deficit, a phenomenon that pleases no one, but which ought not be misunderstood or overstated. Today's deficit, while unwelcome, was unavoidable, and is manageable. In fact, given a sputtering economy, it reflects appropriate economic policy, as the President decided in advocating a bold economic plan.

The deficit's origins are no mystery. It was the product of a triple witching hour in which recession, war, and the collapse of a stock market bubble coincided, presenting our country and government with a radical change of circumstances.

Let me pause to dispel a persistent fiction, or, more accurately, misrepresentation. Note this fact: If there had never been a 2001 tax cut, we would still be experiencing triple digit deficits today. Let me repeat: if those who opposed tax relief in 2001 had succeeded, and no bill of any size had ever passed, the 2002 budget would have been $117 billion in deficit, and the 2003 shortfall would have been $170 billion.

Even if we had never been attacked, and incurred no costs of war or recovery from September 11th, and no tax relief had become law, we still would have gone into deficit, as a consequence of the recession and the popped revenue bubble. There is no question about what got us out of balance; what we should be debating is the right way, and right pace, for getting back in.

Deficits are not always unacceptable. The strongest proponents of balanced budgets routinely make exceptions for war, recession, and emergency—exactly the conditions we have experienced simultaneously. In other words, there are times when it is necessary for the Federal Government to borrow in order to address critical national priorities.

These are such times. In proposing an aggressive economic growth plan, the President was consciously opting to accept somewhat greater borrowing in order to put more Americans back to work.

He did so recognizing that today's deficit is moderate, and manageable. It is moderate by any historical measure: at 2.7% of GDP, the 2004 shortfall will be smaller than in 12 of the past 20 years, and less than half the largest deficit in that period. It is manageable, in fact highly so, in that the costs of debt service are extraordinarily low. Just five years ago, interest payments took up 15 cents of every budget dollar; this year, thanks to the lowest interest rates in 40 years, it will be just 8 cents.

A balanced federal budget is a very high priority for this President. It is not, and cannot be, the highest priority, let alone the only one. He does not place it ahead of our national security, the safety of Americans from domestic terror, or a growing, full employment economy.

If a balanced budget were all that mattered, it would be no great trick to accomplish. By either CBO or OMB estimates, all we would have to do is to stop where we are, to hold our spending growth to inflation for the next couple years. But that would mean no action to create jobs, no new action to defend our homeland, no further strengthening of our defenses, and so forth.

The most important objective in this context is economic growth, the wellspring of balanced budgets. No one saw the last surplus coming: not five years ahead, or three, or even one. In fact, four months into the year of the first surplus, both OMB and CBO were still predicting a deficit for that year. A strong economy produced that unpredicted surplus, and only a strong economy can bring a surplus back. If we balance our priorities, we will balance our budget in due course.

The costs of a potential conflict in Iraq are not included in this submission. We all fervently hope that no such event will prove necessary, but if it should, we would present to the Congress immediately a request for the funds estimated to be required to enable a decisive victory, a secure and compassionate aftermath, and the replenishment of stocks and supplies to prewar levels.

Our projections, which incorporate extraordinarily conservative revenue estimates, see deficits peaking this year and heading back down thereafter. To hasten our return to balance, the President proposes to restore the system of spending controls under the recently-expired Budget Enforcement Act. He asks the Congress to pass, along with this year's Budget Resolution, a reenacted BEA incorporating two years of caps limiting discretionary spending to the 4% path that would match government's growth to the growth of American family income. That renewed statute should also reinstate the so-called PAYGO system that limits the budgetary effect of entitlement spending and revenue measures.

Finally, no discussion of this or any future budget should take place without serious examination of the real fiscal danger facing our Republic. We will debate the right level of imbalance for this year and next, as we should. We will argue over the right amounts to be employed in defense reconstruction, or economic growth measures, or fighting the scourge of AIDS, as we must. But, from a financial standpoint, these are small matters compared to the looming, unfunded liabilities of our huge entitlement programs.

The unfunded promises of Social Security are some $5 trillion, more than the entire national debt outstanding. The figure for Medicare is even more staggering: its promises exceed its future receipts by more than $13 trillion, a figure more than triple the national debt and 40 times the deficit we will run this year. We cannot conceivably tax our way out of this dilemma. Only sustained economic growth, coupled with thoughtful reform of these programs, can secure to future generations the same degree of protection, or more, that seniors enjoy today.

This Committee, and its counterpart in the other body, have the first and fundamental role in helping the President determine the Nation's priorities. You also are the taxpayer's first line of defense against excess or misuse of the dollars which the government takes away from them. On behalf of the President, thank you for your service here and for your leadership in restoring an orderly, effective budget process during 2003.

Chairman THOMAS. With that, I would recognize the gentleman from New York for any questions you may wish to ask within the 5-minute period.

Mr. RANGEL. Okay. Well, I need some help with our Governors. They really believe that their revenues are going to be dramatically reduced as a result of this tax cut program. Have you shared—have you got a feedback from the Governors as relates to the deficits that they are going to face as a result of this, and the fact that they cannot balance their budgets the way we do, and that if you move the dividends—taxes from dividends, that it would be negative in terms of them raising revenues the way they have?

Mr. DANIELS. Obviously, everyone knows that the States are facing serious fiscal problems of their own. A starting point that surprised me and may surprise some Members is really to note how fast federal transfers to the States have been growing. It hasn't been enough, obviously, to head off the problems they have got, but over the last 4 years they have risen from $285 billion to, in the projection for 2004, $407 billion. They have been going up at a rate of 9 percent, which is a lot faster than State spending has been going up and, therefore, must have prevented the situation from becoming any worse.

On the tax proposals, there is, I know, concern. The estimates I think the Treasury has made are that the impact on State collections would be a few billion dollars, not an enormous increase in the problem they are facing. Offset against that, of course, is the hope of greater economic growth. The one way for States to quickly get back to a position of stability is for this economy to grow more and for their own taxes systems to start throwing off more revenue.

Mr. RANGEL. Let me ask, how in God's name can you prepare any budget with a war—the war clouds overhead, and in listening to the Commander-in-Chief, it looks like the war is evident? There has to be fantastic costs estimated and associated with the war. Why would that not be included in a budget?

Mr. DANIELS. Congressman, with you, the President hopes that there won't be a war. That war is avoidable today, tomorrow, any day, by Saddam Hussein who could comply if he chose with the demands the world community has been making on him to disarm now for 11 years. So, we hope it won't occur at all. If it does, we think we would be prepared as soon as the President told us the nature—and our military leaders told us the nature of the conflict that they expect, to bring the Congress a good-faith——

Mr. RANGEL. So, the answer to my question is in the hands of Saddam Hussein?

Mr. DANIELS. Well, it could be in his hands. He could certainly prevent the problem. Otherwise, I suppose the world community will take matters into its own hands.

Mr. RANGEL. So, the fiscal estimate of the costs of this, we would not project at this time because Saddam has not given us the opportunity to make that decision?

Mr. DANIELS. More or less, that is correct.

Mr. RANGEL. It seems like it is a lot more, less than more, but I will just hate to believe—well, suppose for a hypothetical since you have been at this a long time, that Saddam Hussein does not fulfill the wishes of the President and all of us and encourages an attack on—in Iraq. Then what would you think the costs would be?

Mr. DANIELS. Well, we don't have any single estimate, sir. The——

Mr. RANGEL. How about a guesstimate? The Pentagon has said from 50,000 to 200,000 troops. The Secretary of Defense said it may take 4 days, 4 weeks or 4 months. Doesn't this give you enough to work with in ballpark figures as to how much it would cost for 50,000 or 200,000 troops?

Mr. DANIELS. Well, those are the right variables, but the numbers you use illustrate how huge the ballpark is, and there is a very wide range of possibilities. As I said, we have done a lot of work on this. At a point at which the President made a decision, and we would ask the experts in the military for the likely parameters, number of troops, likely duration and so forth.

Mr. RANGEL. It would be premature to ask them now?

Mr. DANIELS. Well, yes.

Mr. RANGEL. Saddam hasn't decided, so we can't project it ourselves?

Mr. DANIELS. That is correct. It would be a very wide range of conflicts and, therefore, of estimates.

Mr. RANGEL. Thank you, Mr. Chairman.

Chairman THOMAS. Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman. I welcome you, Mr. Daniels, today. I want to congratulate you for having been one of the strongest proponents on behalf of fiscal restraint over the past several years. We are entering a period right now where it looks like we are faced with the prospect in the foreseeable future of budget deficits, and that is a concern to me.

The Administration has effectively made the point that the President's package will promote growth, economic growth and hopefully long-term recovery and increase job creation over time. In short, that it will be a decided plus to the economy, but in the interim, we are faced with the necessary increase in expenditures in areas like defense and homeland security. Any time you are faced with these kinds of problems, you must spend as much as you have to spend to try and maximize security.

There is also the request for a 4-percent increase in spending in other areas beyond defense and homeland security. Why 4 percent? Why not zero?

Mr. DANIELS. We did approach it much the way you described, Congressman. That is to say, the President did assign top priority to the life and death issues of national defense, a successful war on terror, and what we now call homeland defense. He told us that he wanted for all spending to decelerate substantially from the rate we have been running. That rate was running around 7 percent plus in the years right before the President took office. It slowed for the first year but then went up to 9 percent last year because of the costs of September 11. The President suggested—or chose, I should say, from a list of possible benchmarks the amount that the American family can expect its—a typical family can expect its own income to go up and said the government ought grow no faster. We were able by being selective about programs that could grow, programs that could stand still and some programs that could shrink, to put the whole package together at that 4-percent level.

The rest of government, aside from defense and homeland defense, you are quite close, but we measure its growth at 3.8. You say why not zero? I think the answer is that——

Mr. CRANE. Why not freeze it during this crisis period?

Mr. DANIELS. Obviously, a case could be made. The President believes that at least in certain areas—and he laid out many in the State of the Union, the rest are in the budget—that it was important to keep moving forward.

Mr. CRANE. Have you any idea what the dollar amount would be if we froze it versus that 4-percent figure?

Mr. DANIELS. It would be something like $10 or $12 billion. If you take defense and homeland out, you have a remainder that is, I guess, $360–$370 million something like that. So, take a little under 4 percent of that.

Mr. CRANE. The centerpiece of the President's growth package has been the elimination of the double taxation on dividends, and some have criticized this proposal, saying it doesn't do enough to help to boost the economy. Can you explain to me the effects that the dividends proposal would have on, one, the costs of capital; two, business and the economy—or business and investment, rather; and thirdly, the economy?

Mr. DANIELS. I can report that there was a strong consensus of many economists whose views were sought as the President looked at all his options last fall, that in addition to the correcting an unfairness in the Tax Code, that of double taxation, that this particular move would have a very strong positive effect on the factors you just mentioned, the cost of capital, therefore the investment climate, and it would also have a positive effect on individual investors, in the sense that strength and confidence in the market itself, we heard different estimates of how much and how quickly, but all these were positive factors.

I would describe this particular piece of the package as aimed more at the intermediate and long-term sort of balancing the package, along with those elements that would have immediate effect.

Mr. CRANE. Well, I thank you very kindly, Mr. Daniels, and I look forward to working with you.

Mr. DANIELS. Yes, sir. Thank you.

Mr. MCCRERY. [Presiding.] Mr. Stark.

Mr. STARK. Thank you, Mr. Chairman. Mr. Director, thank you. I am interested in your program for Medicare. I am afraid that just as you are manufacturing trumped-up danger in Iraq to send a lot of young Americans to get killed unnecessarily, you are also trumping up a lot of unnecessary alarms in terms of Social Security and Medicare, mostly because I am quite sure you would like to do away with entitlements. It is obvious that is part of the Republican policy and platform.

It doesn't do the Office of Management and Budget (OMB) much good when you keep bouncing around with your estimates. Now, in here you suggest—I don't know what you feel for Social Security, but you suggest that Medicare is going to exceed its future receipts by more than $13 trillion. That is a 75-year projection, Mr. Daniels. I am not even—I know I am not going to be around to call you on it, and you may not be here, but tell me this: If you want to use 75-year projections to scare the hell out of old people, which is a terrible thing to do, tell me how much the President's proposed tax cuts are going to cost us over 75 years.

Mr. DANIELS. Well, who is us, Congressman? That is money you would be taking away from the us——

Mr. STARK. Just project the cost of the President's tax cuts. How much will they cost over 75 years?

Mr. DANIELS. Well, there is no way for me to tell you that answer.

Mr. STARK. Of course there isn't. Only a hare-brained economist who didn't know his butt from his elbow would try an estimate like 75 years, but let us do this: How about the interest on the debt payments for 75 years, can you do that with your shoes and socks on?

Mr. DANIELS. One could make a good estimate of any one point like that. Just as the actuaries, we didn't invent the 75-year convention. We didn't do the numbers you are talking about. The actuaries who worked forever——

Mr. STARK. It has no relationship to the current deficit or the current tax cuts or anything else, does it? It is a figure picked out of the air, which, I might add, ignores revenues, general revenues, does it not?

Mr. DANIELS. It does not include them, so——

Mr. STARK. So, it would only be about half that didn't know. It would be about $11 trillion, actually. No, $6½ trillion if you used the continued rate of general revenue.

So, what I would like to suggest is that when you come out—when you are talking about a budget, you are talking about a $1.5 trillion tax cut, whatever you are talking about in lost revenues or deficits, to come out with this idea that there is something so brutally wrong with Medicare, which by the way has probably got the best short-run surplus, which you guys are spending, that it has had in its history. So, to suggest that $13 trillion in the context is terribly disingenuous and certainly not worthy of someone who would like us to accept these numbers and make any decisions on them, I just think that that is unprofessional and is tantamount to cooking the books and making up numbers. It would be very nice, and I would ask you if you would like to resubmit this testimony with 5-year Medicare shortfalls or 10 if that is what you choose to use. Let us get this into a realistic ballpark. Is that fair?

Mr. DANIELS. It is something we can clearly do. The people whose professionalism you are demeaning are the actuaries at the U.S. Department of Health and Human Services (HHS) who work on a nonpartisan basis for every Administration. They do these calculations routinely. Seventy-five years is the convention they have used. Just as any pension fund is required to do, one can make a projection and should over the long term of whether the promises made exceed the revenues that are currently coming in. In this case they do——

[The information follows:]

Medicare is a complex, long-term, intergenerational program. A consequence of this is that it can be very misleading to look at a single year, or even five or ten year forecasts when assessing the program and proposed changes such as a drug benefit or more fundamental reforms. We really have no choice but to assess Medicare using long-term forecasts, the norm being a 75-year forecast done by Medicare actuaries. Five or even ten year forecasts are flawed because they ignore critical factors about the program that threaten the financial health of Medicare for our children and grand children. The impact of the aging baby boomers is a good example. Medicare actuaries predict that the influx of baby boomers into the Medicare program will almost double enrollment by 2030, from 40 million to 77 million. It would be irresponsible for us to focus on short term forecasts that ignore the implications of swelling Medicare enrollment when assessing the program's financial health.

Mr. STARK. This $13 trillion is not what the actuaries presented. That is a manipulated figure. I just submit to you that using 75-year projections when you are mucking around badly enough; you are using 10-year tax projections and then you are using 5-year spending projections. So, there is a game called three-card Molly that you might care to indulge in, but it is a shell game. It is too bad, because you are harming those people in your budget who rely on Medicare and Social Security. To go beyond this is not worthy, and I am very disappointed.

Mr. MCCRERY. Mr. Houghton.

Mr. HOUGHTON. Yes. Thank you, Mr. Director. It is good to see you here. I don't believe you are using a show game. I think you are being honest, and I would prefer to consider all your statement in that light.

I have got to ask you, though, that—I have got some figures here from 1960 on, and of the 42 years we have had 6 years of surplus and 36 years of deficit. It took us such a long time to get out of the deficit situation. I would just like to have your feel about how that is going to come along, because there are other issues out there, whether it is the cost of the war or whether it is Medicare or Social Security or any other things. I am really sort of interested in sort of the long-term trends and how you see this?

Mr. DANIELS. Well, your figures are correct. We have been—we borrowed on a net basis far more years than we have paid down debt, and there is nothing at all unprecedented about the levels we see now. Even if the President's entire program is passed.

I should also add that we have the lowest, most pessimistic revenue figures around for this year and next year, because we have observed what has happened. Let us remember where the deficit came from. It is no mystery at all. It is entirely the product of the recession that was on in the first quarter of 2001, the war and the costs of recovery and the popping of the stock market bubble which took a lot of federal revenue—which inflated federal revenue in the late 1990s and took it away just as quickly in the last couple, 3 years. It is very important to note that if there had never been tax relief, not one dime of tax relief provided to the American people in 2001, we would have had a $170 billion deficit this year. So, we ought to, A, be accurate with our facts; and B, be talking about how to move out, get back to balance.

The other thing that is very important to note is that if there are those for whom balance in the federal budget is the overriding dominant federal priority, we can do it. We can hold spending to inflation for a couple years. We will project to be in balance, but we don't do anything new. The President believes that it is—a set of balanced priorities would include a growth package to put more people back to work, would include further strengthening of defense, would include more homeland defense, would include a start on Medicare reform and several other things. Honest people can differ about that. Please note that even with all his policies involved, we do see deficits peaking this coming year and then heading back toward balance.

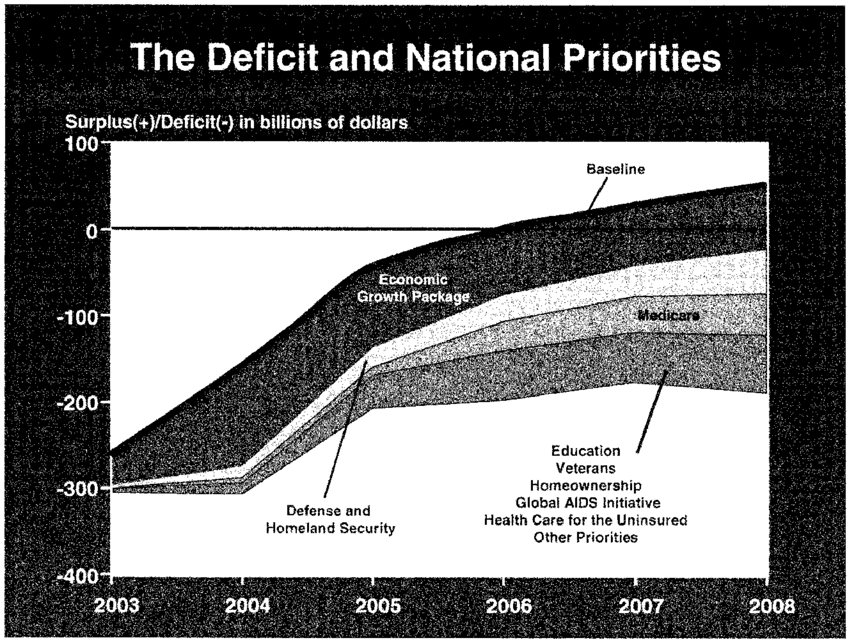
Mr. HOUGHTON. I think Common Cause has figured out that we may have something like $25 trillion in unfunded liabilities, and how serious—I don't know if that number is accurate or not, but assuming it is, it is a rather large number. Is that going to have an impact on our getting back to a surplus condition?

Mr. DANIELS. Concord Coalition's number is about $25 trillion, that more or less tracks with what we reported in the budget. They believe that is the honest and accurate way to account for our future unfunded liabilities, and so do we.

The answer is that it will have an increasing effect on our ability to have annual balance in the budget. If we don't do something about the fundamental structure of those programs, and we leave the promises at trillions and trillions of dollars more than the revenue coming to fulfill the promises, we will be stuck either with unthinkable increases in taxation, truly unthinkable of the kind that would stop the economy cold, or wrenching restructuring of the programs.

The real tragedy would be that if we blinded ourselves to this problem and waited and waited and waited as the political process is far too prone to do. The changes—instead of making moderate modest changes in the program, we would have to make very, very severe ones. So, let us hope we don't procrastinate.

[The chart follows:]



Mr. HOUGHTON. Thank you very much.

Mr. MCCRERY. Mr. Matsui.

Mr. MATSUI. Thank you, thank you very much, Mr. Chairman. Welcome, Director Daniels.

Mr. DANIELS. Thank you.

Mr. MATSUI. I want to refer you to the third page of your written testimony here in the next to the last paragraph where you state, the unfunded promises of Social Security are some $5 trillion.

From the actuary's point of view, they say it is actually over the 75-year period, $3.3 trillion. I gather where you may have picked up the additional $1.7 trillion. I think what you are probably excluding is the money at this moment anyway in the trust fund. We do have a surplus of about $1.2 trillion, and you may have added that on to the $3.3 trillion, and then you may have also add—maybe rounded it off to get 5 trillion.

The numbers that the actuary used is $3.3 trillion. The only reason I raise this is because it is my understanding if you read the President's budget, not you, but we all read the President's budget carefully, over the next 5 years, we are going to add to the national debt some $1 trillion, perhaps a little over $1 trillion, and that means that that entire surplus in the trust account, or at least from an accounting point of view, will be gone. So, we will have used about $2.6 trillion worth of Social Security surpluses over the last, well, 7 years if you count the last 2 years and then 5 years projected down in the future.

The reason I raise this is not to question you on that, but to make reference to the fact that the President has an initiative on Social Security. He had a commission come up with three proposals. Actually, it was in 2001, December 2001. He has spoken over this in the last 6, 7 months, most recently 3 months ago when he said every American should have a choice into where they put their investments and we should partially privatize Social Security. I think he used the word "personal accounts," and I will use that for his purposes.

The question I have is, how do we deal with the cost of privatizing Social Security, because we have eliminated the entire surplus? There is no surplus, so there is no opportunity. Even under the President's scenario, the best-case scenario, there is no money to finance a bridge loan to pay for these privatized accounts for the first 40 or 50 years. As a result, would we just have to go further into deficit spending to pay for the personal accounts, so long as we still want to maintain, as the President insists, disability and survivors' benefits and also benefits for every American at or near retirement. So, how does he intend to do this? I know he didn't spend much time on this in his State of the Union message. So, I assume he is not going to bring it up, but if he is not going to bring it up, I would like him at least then to explain how he will find the $3.2 trillion to pay for the privatized accounts that his own commission designed, because we are anxious to deal with this.

I wrote a letter to the President, along with Mr. Rangel, Mr. Doggett, Mr. Cardin, Mr. Pomeroy and Mr. Becerra on January 23, in which we suggested either we take this up now and debate it with the President in terms of his personal accounts so we can really deal with this. If not that, if he doesn't want to present us with a proposal, we should sit down without preconditions, without any preconditions and see if we can resolve this problem, because I personally, and all Members on my side of the aisle, think this is a very serious problem. We have to address it soon, but we shouldn't be addressing it with gimmicks. We should try to address it in a good-faith serious way, as I think all of us try to do when President Reagan was President, and he showed leadership on that in 1983. Perhaps you can respond to that.

Mr. DANIELS. Well, I know the President will read your letter carefully and will welcome your shared concern about this subject.

Mr. MATSUI. By the way, I have been asking for this for the last 2 years.

Mr. DANIELS. I would respond in this way. First of all, we have to be pretty careful about our language. The Social Security trust fund is there. Every penny of it is there, and there is exactly as much there as if we had a different fiscal outcome this year or any other year, it is exactly the same size. It has exactly the same assets, namely Treasury bonds, that it always has had, and it is paying exactly the same benefits. It will next year and in all future years.

Second, there are different ways of measuring the unfunded liabilities, as your question indicated, but all of them indicate a problem as large or larger than the whole national debt of today.

So, I think that the President would be eager to work with you on it. He did, both because of its size and because of the interest and momentum in Congress in recent years in Medicare, did decide to try to move forward on Medicare first, and that is a decision that most people that we have talked to believe is probably just tactically prudent.

Mr. MATSUI. Mr. Chairman, I know my time has run out and I know you want to move along, but——

Mr. MCCRERY. I would love to hear more, but we have a lot of people who want to——

Mr. MATSUI. I don't think he answered my question. I asked him how he was going to deal with the——

Mr. MCCRERY. He can submit it in writing.

Mr. MATSUI. Would you ask him to submit it in writing.

Mr. MCCRERY. Yes, sir. I am sure he will.

Mr. MATSUI. Perhaps you can look at the exact question and submit the exact answer to my question.

[The information follows:]

The Administration is committed to strengthening Social Security and to giving individuals the option of owning personal accounts. In May 2001, the President appointed a bipartisan commission to develop recommendations to modernize and restore fiscal soundness to Social Security. In December 2001, the President's Commission reported that reforming Social Security to include personal retirement accounts would lead to better long run outcomes for future beneficiaries, the Social Security program, and the economy as a whole.

It is widely acknowledged that corrective action must be taken to place Social Security on a permanently sustainable course. The short-term costs of any effort to strengthen Social Security must be considered in the context of the long-range gains to individuals and the federal budget.

Analysis by the independent Social Security actuaries has verified that the revenues required to fund a given level of benefits under a personal account framework will be substantially less than the revenues required to finance the same level of benefits—for retirees, survivors, and the disabled—under the current Social Security structure.

Personal accounts would thus be an important part of strengthening the Social Security system and would reduce long-term fiscal pressures relative to other available methods of funding Social Security.

Mr. MCCRERY. Sure. Yes, sir. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. Mr. Daniels, you just made a very important statement here about this Social Security trust fund, Medicare trust fund, all trust funds, but these two particular, are they not entitlements, they are entitlements by law, the benefits have to be paid as structured by law?

Mr. DANIELS. Yes, sir.

Mr. COLLINS. That means that these benefits will be paid prior to anything that is not structured by law or which is discretionary?

Mr. DANIELS. I think as a matter of law and as a matter of the commitment that we all feel——

Mr. COLLINS. They come ahead of any kind of discretionary spending?

Mr. DANIELS. Yes, sir.

Mr. COLLINS. Discretionary includes defense discretionary and nondefense discretionary; is that right? The Social Security and

Medicare benefits will be paid by law ahead of anything else that happens within the Treasury of the United States?

Mr. DANIELS. I think you can feel confident.

Mr. COLLINS. Very good. Well, I get tired of these people trying to scare our seniors at home that these benefits are not going to be paid, they are going away. That is absolutely asinine, wrong, and they should not be doing that. These benefits must and will be paid prior to any type of discretionary spending.

As far as this unfunded liability that is out there, when you talk to the seniors at home, $1 trillion, $3 trillion, $5 trillion, $10 trillion, that number just blowing their mind. What they are worried about, concerned about is their check. I think it has been pretty well put to the people in this country by this President who has really stepped up to the bar and says let us deal with this, that we are not going to do anything that is going to affect anyone who is in the structure today drawing Social Security benefits or covered under the Medicare fee-for-service system. Is that not true? Has he not said that?

Mr. DANIELS. Yes, sir.

Mr. COLLINS. That leaves two other generations, the generation behind the generations receiving benefits, today that is those of us who are baby boomers. I don't believe I have heard this President say it is going to be mandated that anything changes about my Social Security, has he? Have you heard him say anything is going to change, the baby boomer's generation Social Security, unless they opt to have some change? Should we make a change? Yes or no? Simple answer. The answer is no. I haven't heard him say it, because it would affect me.

There are another set of generations affected by Social Security and Medicare, and that is the generation behind me. That is my children and my grandchildren and yours and others and all in this room. They are the ones that are going to pay the bill. It is a pay-as-you-go system. They are going to pay the taxes and benefits of those and me who are receiving today. That is what the President is focused on. That is who he is focused on. That is who he wants to make sure they have something that is viable and real and lasting once they reach the age of eligibility. Is that not true?

Mr. DANIELS. That is certainly true.

Mr. COLLINS. Well, I like the concept he has put forward. I have been talking about it at home for going on 10 years, 8 years since I have been on this Committee. My seniors overwhelmingly support me because I talk to them in simple terms that they understand about how it is going to affect them, how it is not going to affect them, who it is going to affect, who is going to pay the bill and who is going to be receiving the benefits, are they going to receive the benefits that they have put into the structure for many, many years and there is no jeopardizing to their benefits.

We had a summit in 1995 on Social Security, one that the President called. As we were gathered around the big table the last day, the closing session, the Commissioner of Social Security pretty well pointed out, and I thought he did a really good job the day before, and I relayed this message to President Clinton at that time, the reason that we have such a problem dealing with Social Security or Medicare is that people on this Hill do not trust each other.

Members of Congress don't trust each other to deal with this because it is so political, whether it be a Democrat or Republican, the House or the Senate, and when it comes to dealing with Administration, there is just not enough trust to deal with something this important to the way the current atmosphere is in this town. If we don't correct that, we are not going to correct this problem. I wish the people in this body and on the other end of the hall would stop telling people at home that you are not going to get this, you are not going to get that, it is going to be cut out, they are spending your money on other things, which is absolutely not true.

I thank you for your presentation, your comments, your welcome work, and for the President and his focus on how we are going to deal with these two very important issues, as well as how we are going to deal with terrorism, Iraq and other things that have to be dealt with through this budget process. Thank you, Mr. Chairman.

Mr. MCCRERY. Mr. Levin.

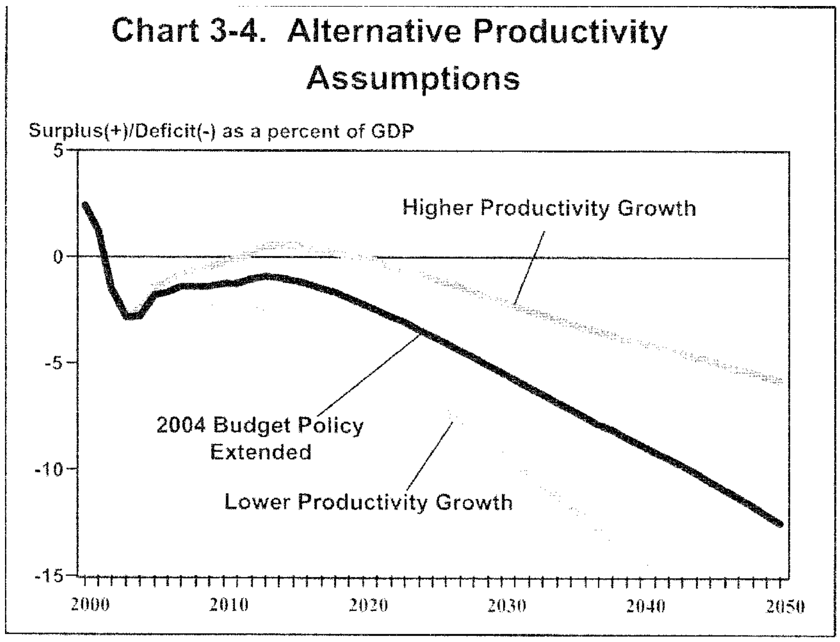
Mr. LEVIN. Thank you. Welcome. I have been looking at your testimony while the questioning has been going on. We didn't have a chance to hear from you. I think you are the first witness I can remember who has made your standing who did not have any presentation at the beginning. So, I have been trying to catch up. We just received your written testimony an hour ago, and it is interesting how you make so many arguments that minimize the deficits. We went through this with the Secretary of Treasury yesterday, and you talk about the 2.7 percent, it is smaller than 12 of the last 20 years. You don't look earlier than the 20 years when it was always lower, except 1 or 2 years. Of course, those were the years in the 1980s of deficits with those huge tax cuts that were supposed to grow us, and that didn't quite work out. Then you say no one saw the last surplus coming.

It is interesting to read all of your rationale for not worrying about the deficit very much, but I happen to be given chart 3.4 in your budget, the alternative productivity assumptions. Do you remember that chart?

Mr. DANIELS. Tell me more, Congressman. I am not sure which one it is.

Mr. LEVIN. I have the page, I think. It is on page 43 of the budget of the U.S. Government, and it has, as I said, alternative productivity assumptions. It shows that except for a few years between now and 2050, it is projected that there will always be a deficit. Do you remember that chart?

[The chart follows:]



Mr. DANIELS. Well, I think I know the one you mean. What question can I answer for you?

Mr. LEVIN. Well, if you yourself predict deficits except for a few years going out to the year 2050 and under 2004 budget policy extended, it goes down and down—actually, the deficit there goes up and up. The line goes down and down. The percentage of deficit to gross domestic product (GDP) goes up and up. That is your chart. Now, how do you mesh that with minimizing the significance of deficits?

Mr. DANIELS. First of all, Congressman, you can search my testimony. You won't find the word "minimize." You won't find the words "don't worry." I think that the concern is entirely proper.

Mr. LEVIN. Do you stand by this chart?

Mr. DANIELS. For what it is. It illustrates, if it is the one I am thinking of, the point made earlier about the—it is really not a prediction of where deficits can go. We know we can't tell, with much precision at all, about the next few years. One thing we know with some rough precision is what our current entitlement mismatch between revenue and promises is, and that is what dominates the chart you are looking at. It must be if it is the one that goes to 2050.

Mr. LEVIN. So, it shows when you look at the unified budget, you have this continuing deficit except for a few years through 2050. That is even if there is assumed higher productivity growth.

Look, we spent a lot of time with the Secretary of Treasury yesterday. I want to just ask you. You have your belief, your faith, and we are not going to shake it. Let me ask you about education. I think that your budget proposal is in terms of no child left behind less than was authorized for 2004. Do you remember about how much?

Mr. DANIELS. By some margin, but that is true of almost every appropriation compared to almost every authorization bill.

Mr. LEVIN. I think it is by $9 billion. Is that possible?

Mr. DANIELS. Yes, it is possible.

Mr. LEVIN. So, what do we tell my constituents who were promised in H.R. 1 a certain level of federal funding, and you come forth with a budget that is $9 billion below what was stated by this institution and the President of the United States?

Mr. DANIELS. First, you tell them that we doubled federal education spending in the last 6 years. You tell them it is going up at one of the most rapid rates in the budget this year. You tell them that what they were promised in H.R. 1 first and foremost was accountability. We have been spending more and more money per student for 30 years now with worse and worse results, and what they were promised most fundamentally was better results.

As the Secretary of Education and the President have consistently said, more money, yes, but results first, and so there is substantially more money this year as the President has provided in each year for education. If and when the system begins to perform, then he will certainly support still further increases.

Mr. MCCRERY. Mr. Lewis.

Mr. LEVIN. Thank you.

Mr. LEWIS OF KENTUCKY. Thank you, Mr. Chairman. Mr. Daniels, a little while ago you stated that if we froze spending at current levels, that there would still be a significant deficit, that the 4-percent increase in spending—in discretionary spending would basically increase the deficit by $10 to $12 billion; is that correct?

Mr. DANIELS. Well, it would increase what we call budget authority by about that much, and that would roughly be reflected in actual money spent.

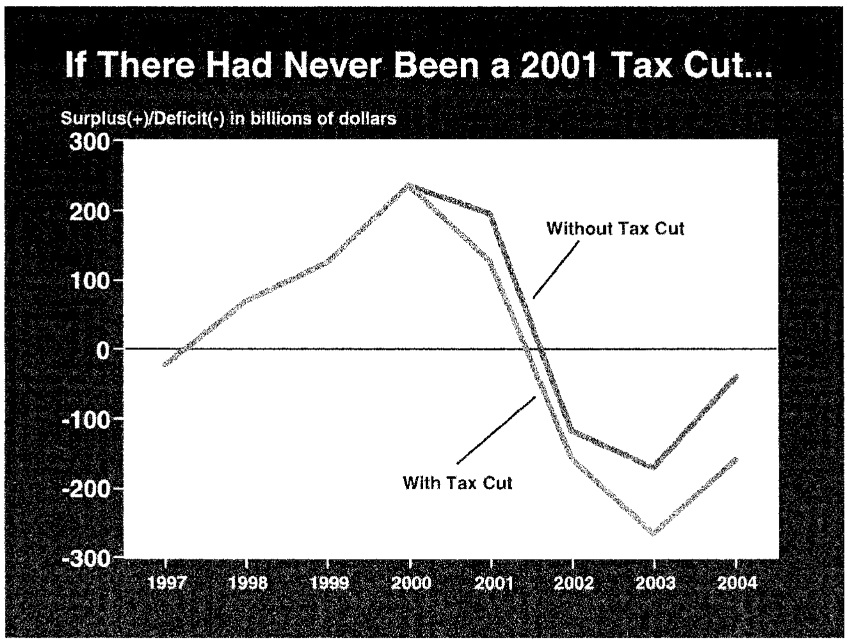
Mr. LEWIS OF KENTUCKY. What effect do you think the projected deficits will have on our economy?

Mr. DANIELS. It depends what they are used for or depends what their source is. As the budget makes plain, the deficit—projected deficit is, in substantial part, due to the—would be due to a major growth plan, which we hope would be very beneficial to the economy, both short term and longer term. If you are asking about the level of the deficits, and that is a very important question, how much is too much? A look at history says that this is a level at which the economy has succeeded in many past years and it is an acceptable level. Nobody is happy about it, but given its uses, number one, to defend the lives of Americans; number two, to try and create more jobs, the President believes it is the right balance of our priorities.

Mr. LEWIS OF KENTUCKY. The President's critics have accused the 2001 tax cuts as being a big part of the loss of the surpluses and now the projected deficits. Is that an accurate assessment?

Mr. DANIELS. It is a fiction. As I mentioned, if there had been no act at all in 2001, no tax relief at all—and there weren't very many people, as I recall, who favored zero. There were many who favored a smaller package of tax relief or different combinations, but let us just pretend that there had been zero. We would have had triple digit deficits last year and this year and next year, and that is because their origins lie in circumstance. They lie in the popping of the stock market bubble, in the recession, which was not seen at the beginning of 2001, although it was starting, and of course the events around the war.

[The chart follows:]



Mr. LEWIS OF KENTUCKY. Thank you.

Mr. DANIELS. Thank you.

Mr. MCCRERY. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman. Welcome. It is a pleasure to have you here. I want to just express my great concerns about the overall budget direction. I really do think we have to be more sensitive about the deficit, particularly as it relates to the spending and revenue side, and Mr. Chairman, with your permission, I would like to put an editorial from the Baltimore Sun Paper—it was in the Baltimore Sun Paper this morning—in our records, which I think express at least my view on the subject and would be helpful I think in our records.

Mr. MCCRERY. Without objection.

[The article follows:]

The Baltimore Sun
February 5, 2003

Reversal of Fortune

President Bush has hit on one way to try to control federal spending: grow the federal budget deficit so rapidly—by shamelessly providing so many tax breaks for the wealthy—there won't be that much money left to spend down the road. And what a masterful jump he's now gotten on this.

Mr. Bush took office with a projected budget surplus over the coming decade of $5.6 trillion—and there was talk of eliminating all federal debt by 2008 and maybe salting away some bucks for that fateful day, perhaps in 2016, when Social Security revenue will begin to fall behind its payments.

But in just 2 years—with his historic tax cuts, a sagging economy and the unforeseen costs of fighting terrorism—that surplus has suddenly evaporated, replaced by red ink as far as the eye can see.

In Mr. Bush's budget released this week, the deficits total a record $304 billion in 2003 and $307 billion in 2004. Over the next 5 years, the cumulative deficit runs to $1.08 trillion. On paper, that's a surplus-to-deficit collapse of almost $7 trillion in 2 years, and the reality appears to be far worse.

The Administration's deficit forecast paints a rosier picture by looking forward only 5 years, not 10. It doesn't take into account the cost of a war in Iraq. It also doesn't include $500 billion for Mr. Bush's plan to fix the Alternative Minimum Tax.

As a result, the liberal Center on Budget and Policy Priorities says the 5-year deficit projection is more like $2.3 trillion and the 10-year deficit likely exceeds $4 trillion. And that doesn't include Mr. Bush's latest proposed handout to the rich, his creation of new, non-taxable IRA-like accounts—likely to cost hundreds of billions of dollars more in lost tax revenue.

This is a stunning reversal of fortune—one largely driven by the Administration's aggressive tax-cut plans. It mortgages the future, making doublespeak of the President's promise in his State of the Union address last week to not pass along problems to other generations. Mr. Bush's radical tax cuts now make it far more likely younger Americans will later bear much greater tax burdens to provide Social Security and Medicare to aging baby boomers—or these safety nets will have to be drastically cut.

Of course, like President Ronald Reagan, Mr. Bush and his supply side economists believe his tax proposals will so grow the economy that there will be more than enough for all. This is uncertain at best; Mr. Reagan's similar agenda led to big deficits.

What's certain are big windfalls for the wealthy from his plans for tax-free dividends and those new savings accounts—as well as wide-ranging cuts in federal social programs. His 2003 budget plan essentially freezes spending on social and environmental programs, doesn't help slumping States and cities, and seeks savings by cracking down on recipients of Medicaid, school lunches and earned income tax credits. If Mr. Bush's tax cuts become law, you can bet much deeper cuts will come.

Some deficit spending might be justified if it provided immediate stimulus for the reluctant economic recovery. But Mr. Bush's proposals don't even pretend to do that. They mainly serve the economic interests of those with the very highest incomes—for which the vast majority of us could be paying for generations.

Mr. CARDIN. Mr. Daniels, I was under the impression that the Administration generally tries to avoid placing the burden of unfunded mandates on our States. Am I correct on that?

Mr. DANIELS. That would be correct.

Mr. CARDIN. Well, I am being told that it is likely we are going to take up the welfare reform bill directly on the Floor of the Congress next year. Our Chairman has indicated that it is not his preference. He would prefer the bill to come through our Committee, but it is likely that that is not going to happen and we are going to have it go directly to the Floor. I am also told that it is likely to be very similar to the President's proposal and very similar to the bill that we considered last year. The CBO estimates that for the States to implement that bill, it will cost them somewhere between $8 and $11 billion of additional State expenditures over the next 5 years. That is an unfunded mandate, isn't it?

Mr. DANIELS. I confess I haven't seen CBO's estimate of that.

Mr. CARDIN. Well, I will make sure you have a copy of this. It was in last year's bill that was, as you know, passed in the House of Representatives, but did not get through the U.S. Senate. We have had broad discussions in this body about the fact that we do not want to create unfunded mandates. We have letters from the Governors indicating that to implement the new work requirements, they are going to need significantly more money for child care because of the increased requirement that people work at traditional jobs where they will need to have more child care, and second, that in order to meet the work requirement many States are going to have to institute work fare type of opportunities which cost money to create.

So I think it is beyond question that there is an unfunded cost to the States. We may argue whether it is $11 billion or $8 billion or $15 billion, but it is going to cost the States additional money that we have not appropriated. My understanding is that your budget doesn't include any additional dollars in welfare funds for our States. Therefore, I think these changes to welfare meet the traditional definition of unfunded mandates, and I would ask that you look at that. If I am correct, I would hope the Administration would correct that before we bring it up on the Floor next week.

Mr. DANIELS. I would be glad to take a look at what they found, Congressman. I will simply observe that the President has proposed the same amount of money for fewer than half as many recipients, welfare reform having been probably the greatest social policy success in memory. As you know, caseloads are down 54 percent, and yet the funding has not reduced proportionately and the President suggests keeping it at the same level.

I know from the last couple years' experience there have been unspent so-called TANF money in most States that had leftover money, not money they had to make up. So we will sure take a look. It would appear that there ought to be enough give in the system because of its success to take care of this problem.

Mr. CARDIN. I appreciate your mentioning that. I would also hope you would go back and look at the law. The purpose of the 1996 TANF law was to get individuals off of cash assistance, specifically so that States would have less dependency upon cash assistance. We have been succeeding in doing that. Our States in 1996 spent 75 percent of their TANF funds on cash assistance. Today they are spending less than half on cash assistance. Exactly what we wanted them to do they are doing. They shouldn't be penalized for that. Once again I come back to the fact if the States are doing exactly what we anticipated they do, we should not now be putting additional burdens on them to change course without providing the dollars to do it.

One more point, since I have a few seconds left. This morning I was with the Mayor of Baltimore and our county executives on homeland security. Let me put a plug in. They are hurting. They are up against incredible cost issues of providing security for our ports, providing law enforcement, and we need to get that money released and monies provided for local governments on the frontline. I would just urge you to do everything you can to release the monies that Congress has appropriated and to make sure that the dollars are provided to our frontline State, county, and city needs in order to meet the security and safety of the people in our community.

Mr. DANIELS. We share that concern 100 percent, Congressman. As you know, we are trying to get the omnibus bill done so there will be money appropriated. We will release it as quickly as it can be. The President asked, as you know, for over $3 billion to help States and localities. We are eager to move that money.

Mr. CARDIN. Thank you.

Mr. MCCRERY. Ms. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman. We are happy to have you here to talk to us, Mr. Daniels.

I wanted to be more specific about an issue that is very important to the Pacific Northwest, and that is the endangered salmon. We have lived under a threatened warning for months and then under all the legalities that surround the Endangered Species Act with regard to the Chinook salmon. As you know, Washington State has worked very hard on salmon recovery efforts, on hatchery reform and a number of other issues that we believe will help to bring back the wild runs that will compensate for the loss of the salmon habitat and will replenish the runs, the wild runs.

I want to thank the Administration for your continued support for salmon recovery. This Administration has provided much more funding for salmon recovery compared to the previous Administration. This year the Administration has shown its commitment to salmon recovery by including $90 million in its fiscal year 2004 budget for the Pacific Coastal Salmon Recovery Program that serves Washington, Oregon, northern California and Alaska.

Another part of the recovery solution, of course, is hatchery reform. We have a project currently in its third year of funding. This is a process that is driven by science. It is reforming our hatcheries and providing for salmon conservation and sustainable fisheries in our State of Washington. It started in 2000 by our former Senator Slade Gorton and others, including Bill Ruckelshaus, who are very involved in the replenishment of the run.

I would like to give you the opportunity to comment on the Administration's support for environmental and fish programs that affect many of the Western States and most specifically in my area of interest, Washington State.

Mr. DANIELS. There is not much I can add except to admit that we didn't think all of this up on our own. We had good input and help from certain Members of the Northwestern delegation, specifically you. We appreciate you directing our attention to these problems and hope that the proposal addresses them adequately.

Ms. DUNN. I will keep my fingers crossed that the Senate is able to support your proposal. The House consistently has gone in at the higher level, which this year is the same level the Administration proposed.

Let me ask you about a question I have heard come up so far in this hearing many times and actually at home when I am in the district. There are lots of folks concerned about the deficits and particularly how the deficit will impact long-term interest rates.

I wonder if you could comment on how you believe the current deficit projections through the year, I understand, 2008, whether they pose a threat to long-term interest rates?

Mr. DANIELS. Long-term interest rates are a very important economic variable. One of the great strengths of the economy right now and in recent years, we are enjoying the lowest rates in decades. It is important that they stay under control for the long term. We actually hope to see them rise a little bit from today's very low levels, because that would presumably mean economic growth was strengthening.

We find no evidence at all that deficits on the order of today's have any connection. There is no historical effect we can find from these rather typical deficit levels, "X" percent of the economy, on interest rates.

I think long-term interest rates have a lot more to do probably with inflation or the expectations of inflation, and right now that is very low also. Now, our expectation is it stays in the neighborhood of 2 percent. That seems to be what other observers believe. If that is even close to right, then one, I think, should not expect any sharp departure from the low interest rate environment that we have seen, other than that that would be associated naturally with a growing economy. Let's hope that happens.

Ms. DUNN. I want to thank you, Mr. Daniels, and the Administration for working into your budget the permanency of the tax relief provisions that the President signed into law a couple of years ago. I frankly believe that is terribly important for predictability, particularly when it comes to the death tax, of course, that will help small businesses know what to plan for in the long run. To do a short-term tax relief package and then let those taxes come back at a time in the future I think is not good tax policy, and I don't think it contributes to the economic health of our Nation, which is, after all, what all of us are trying to do, whether it is through the growth package or in any other way. Thank you.

Mr. MCCRERY. Mr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman. Mr. Daniels, I have in front of me three articles, one from the New York Times, one from the Wall Street Journal and one from the Christian Science Monitor. The titles are, "Corporate Leaders Say Recovery Requires Middle East Resolution," "Bush's Best Economic Plan May Be to Resolve the War Issue," and "War Limbo Keeps Economy on Hold."

Now, when you write a budget, and having written a few when I was a State legislator, a balanced one, by the way, we wrote five of them, you always make some assumptions about what is going to go on.

Robert Hormat, who is the Vice Chairman of Goldman Sachs, sees three possible courses for the crisis. The first one he terms the Rumsfeld dream, a quick war with no oil disruptions. This is good for confidence, he said; he calls the second one the Colin Powell nightmare, a long, nasty war that saps confidence and keeps oil prices high; and the third he calls the Greenspan insomnia scenario, no war, no peace, high oil prices and more hesitation to invest.

Which of those assumptions did you build this budget on?

Mr. DANIELS. Well, not consciously any one of those. That is a formulation, of course, that appeared after our budget was written. I would suppose you would say our budget is closer to the last of those. It presupposes an environment more like the present. As I indicated, I hope, candidly, we will be prepared if the President orders a change in the situation, but we didn't write a budget in the expectation of war.

Mr. MCDERMOTT. So you say no war, but no peace, and oil prices going up?

Mr. DANIELS. Well, I said closest to the last of those. Mr. Hormat had not written the article at the time we wrote our budget.

Mr. MCDERMOTT. When did you start writing this budget?

Mr. DANIELS. The last quarter of last year.

Mr. MCDERMOTT. Well, we have been talking about war since last September. The President has had the authorization in his pocket for 3 months. You didn't take that into account when you wrote the budget?

Mr. DANIELS. The budget clearly contemplates a funding of the current war on terror, which is a new feature in the last year, and we incorporated the cost of that into both the 2003 and 2004 requests.

It has been the policy of this Administration, and I hope it will remain, not to build into the base of the defense budget what may be one-time costs of events or hostilities. When I look back at the history of defense spending postwar, I see a constant recurrent pattern of mistakes in which we have built, maybe overbuilt, the base of defense for conflict, and then we have built it down rather sharply. We have wasted money usually on the way up and the way down.

The policy we are trying to follow is to gradually strengthen defense, and if there are events like Afghanistan, or potentially Iraq, to fund them on a one-time basis so they don't have to later on be removed from defense, possibly in a mistaken way.

Mr. MCDERMOTT. Am I taking the assumption from what you say that you think the expenditures in Afghanistan are kind of a one-time event? I mean, the fact we have Green Berets as the protection for Mr. Karzai, that is just—when is that going to end? Are we going to hand it off to the North Atlantic Treaty Organization? How are we going to get out of that?

Mr. DANIELS. Well, that is a question I will leave for the Secretaries of State and Defense. I will say there were one-time costs associated with those. We did not put those, embed those, in the base of defense. We have made a calculation of the ongoing month-on-month cost of the war on terror, which does appear to be an indefinite enterprise, and that is in the request that is in front of you.

Mr. MCDERMOTT. You keep making a distinction which I guess I am confused about. Do you think the war in Iraq is not a part of the war on terror? Do you separate those two?

Mr. DANIELS. No, it will be very much a part of the war on terror. I just don't know yet that there will be a war in Iraq.

Mr. MCDERMOTT. So you made the assumption that there would be no war when you made this budget? This budget is about to be broken before it ever gets resolved before the Congress, because we are hurdling toward it.

Mr. DANIELS. There is nothing unusual, sir, about supplemental requests for war or emergency, and we made supplemental requests after we were attacked to mount the large-scale activity in Afghanistan. We might have to again.

Mr. MCDERMOTT. That was after we were attacked. This is planning going forward. This isn't like you are blind about what you are about to do, or what your President is talking about doing. Mr. Lindsey got let go after he let the cat out of the bag and said that $100- to $200 billion was going to be the cost over the next 2 years. I can't believe that you put this budget together with no concept of planning what might happen or what was going to happen in a war.

Mr. DANIELS. We did contingency planning. I think if we brought you a budget that priced out a war on Iraq, I think you would have found it unusual, and I think you would have asked me why we were declaring war in the budget of the U.S. Government instead of in the conventional way.

Mr. MCDERMOTT. I just wondered if in the office you were doing some thinking about it, but it sounds like you haven't done any.

Mr. MCCRERY. The question has been asked and answered. Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman. Mr. Daniels, it is great to have you here as Director of the Office of Management and Budget, not as Chairman of the Joint Chiefs.

I would like to, first of all, state that I absolutely agree with the President that the federal budget should not grow by a percentage greater than the typical American family's budget, because those working men and women, after all, pay the bills around here, and I wish Congresses in the past had taken that same very commonsensical approach to our federal budget.

At a recent civic club lunch back home in Missouri, I posed this question to those attendees, and it was as follows: Did the national economy grow or shrink during the calendar year 2002? Not surprisingly, since a lot of people believe that our economy goes as the stock market goes, a lot of those attendees answered that they believed the economy most assuredly contracted.

As you pointed out through your testimony, however, at least on the national level, that we saw almost a 3 percent rate of growth, roughly $220 billion more to our GDP this year than last. Understandably, too, however, not all sectors have done as well, agriculture, manufacturing and a number of others, and unemployment continues to be high. As President Harry Truman from Missouri once said, it is a recession when your neighbor loses his job. It is a depression when you lose your own. There are a lot of displaced workers out there.

What I would like to ask you, sir, there are a lot of proposals about the economy. There are some short-term ideas, things like a payroll tax holiday and a number of really very short-term proposals, and then there are some of the ideas that look longer, have a longer view down the road. I guess just a general question: Do you believe or does the Administration believe that the economy needs a short-term boost or really long-term reform?

Mr. DANIELS. Both. I think this distinguishes the President's proposal from some others that have been offered up which are, I would say, more or even purely short-term.

The President did—first of all, the President looked, I am confident, at every option, certainly every one I have seen anybody else put forward, and selected the package that he has now proposed only after a careful review of all his choices.

When I think about the proposal he has made, I would sort of array it this way. At the short end, the immediate impact end, I would imagine that the acceleration of the rates would have the greatest, the most immediate effect; more money in the pockets of taxpayers, but also in small businesses, many millions of which pay at those rates. Those are the job creators in our economy. So I think that might have the most short-term impact, along with the small business expensing and the child credit acceleration, which again would deliver immediate cash to particularly low- and middle-income Americans.

I think down at the other end comes a proposal like the dividend exclusion, which is more geared to the long term.

Mr. HULSHOF. Certainly I know that the Federal Reserve and the monetary policy, I think they have done about all that they can do as far as trying to create some exuberance in the economy, and so I really do think it now comes to the fiscal side, that is policy changes we might make. I know there was a lot of hand-wringing back in the spring months of 2001 when we were first talking about the President's tax relief measures. Now, looking back, most mainstream economists believe those $300 and $600 checks that went out over the summer actually did mitigate the depth of the recession and got us back on track much more quickly.

Just in the couple of minutes I have remaining, I want to echo and associate myself with the remarks of Ms. Dunn from the State of Washington. Paul Ryan and I in the last Congress introduced the bill that would have made the 2001 tax relief measures permanent.

Can you in the remaining moments I have talk briefly about the economic effect of actually making permanent those tax relief items of 2001?

Mr. DANIELS. The President believes for the reasons Ms. Dunn gave that it is important to do, for predictability and reliability.

Now, I am moved to say that there has been nothing very predictable or reliable, a steady state about our tax system in any year I can remember. There have been frequent changes, and I think that does sometimes disorient businesses in planning. So, simply voting to make these permanent doesn't mean over the years ahead there would not be attempts to change them again, but it would be a good step.

Mr. HULSHOF. Well, as a concluding comment, an old Farmer's Almanac saying says that if Patrick Henry thought taxation without representation was bad, he ought to see it with representation. I yield back.

Mr. MCCRERY. Mr. Neal.

Mr. NEAL. Thank you very much, Mr. Chairman. Mr. Daniels, as you know, I have been pursuing legislation to deal with those companies that set up phony headquarters in places like Bermuda for the purpose of avoiding corporate income taxes. Are you familiar with the expatriation problem?

Mr. DANIELS. In general, sir.

Mr. NEAL. Do you agree that these moves are both unpatriotic and unhealthy financially for the Treasury?

Mr. DANIELS. I certainly agree that they could be.

Mr. NEAL. We could collect $4 billion over the next decade. Don't you think that is a reasonable idea in this atmosphere?

Mr. DANIELS. My impression is there have been abuses here. It is a subject well worth exploring.

Mr. NEAL. There is one company that I would point out that I believe is doing some work on the Capitol, and at the same time their headquarters has been moved to Bermuda. Do you see an inconsistency in doing work on the Capitol and trying to get away from the Capitol when it comes to paying their fair share?

Mr. DANIELS. It seems a logical question.

Mr. NEAL. We need a logical answer.

Mr. DANIELS. Well, I don't know the situation in question, but I certainly agree that it raises a question of for what purpose, whether there is a good economic purpose or even a legitimate business purpose for doing this.

Mr. NEAL. What about alternative minimum tax (AMT)?

Mr. DANIELS. Your leadership here has been important and will remain. This is a problem that will recur every so often. It will have to continue being addressed. It is part of the President's proposal this time to correct for the AMT, if the Congress were to agree to support another measure for growth, and it is something we are going to have to keep working together on so we don't cancel out the effects of tax relief when Congress decides to extend it, or that we don't have more and more average Americans drawn into a system that was originally designed for a small percentage at the top.

Mr. NEAL. Thank you, Mr. Daniels. Thank you very much, Mr. Chairman.

Mr. MCCRERY. Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman, and thank you, Mr. Daniels, for being with us.

I just would like to begin by making a comment. One of my comments was alluding to the fact that perhaps in the TANF, Temporary Assistance to Needy Family, our welfare reform legislation that passed last year, which is basically the same proposal of the Administration, that there were some unfunded mandates as far as work requirements were concerned. I would like to respond to that by noting that the Congressional Budget Office, CBO, issued a report last year which would be, again, basically the same, I am sure, for our current proposal, which is about the same, that the increased work requirements did not constitute an unfunded mandate.

So, I would like to clarify that. The same argument was made back in 1996, and again I might say that not only is that not the fact, but we have some $7.4 billion in surplus TANF funds that remain unspent by the States.

My question to you has to do with the President's unemployment administration financing reform plan. It calls for reducing federal unemployment taxes. If you could provide us with the background on the Administration's view of the need to reform our Nation's unemployment compensation program and what effect you project that reducing these payroll taxes might have on businesses and their ability to hire new workers?

Mr. DANIELS. The President does re-propose this reform. This is one I really hope—I know not too many people have paid close attention; a couple Members of this Committee have, but many have not had the chance. This is one that I would hope perhaps we could work on on a bipartisan basis. I don't really see anything philosophical about it. We have an antiquated system that raises more money than is necessary, collects it at the federal level, and it is sort of dribbled out to States for the administrative portion of the system that we run.

It would be much more straightforward and better for all parties to let the States set the rate, collect the amount they need, and not go through this complex process of passing it back and forth. Winners in the process would, first of all, be businesses, who would probably, almost certainly, see a reduction in this payroll tax, and therefore could hire more workers; States, who would have more flexibility, wouldn't have to crawl to Washington and ask for these occasional extra disbursements that we make; and workers, because I believe States would have a more effective administration, employment training service at the local level.

So, I really think this is about simple better practice and administration. I can't find really a philosophical argument in it. I hope that some folks will pay a little attention to it. It might be a matter of really good housekeeping we could get done.

Mr. HERGER. I appreciate your comments, and I have to agree. Right now the Federal Government, as you know, is collecting almost or about twice as much as we are actually spending as far as the administration of these programs. If our employers were able to keep that, certainly that would be dollars that they could invest in new equipment and hiring new employees.

Another question, a point that has been made by some, is that in 2003 OMB is projecting a deficit of $304 billion. If I could ask you, Mr. Director, how does this deficit compare as a percent of GDP to the deficits of the last 25 years?

Mr. DANIELS. Well, at 2.8 percent, it is smaller than 11 of the last 20. I didn't look back further than that. It is interesting, if you take the average deficit, including the surplus years, that we had for the last 25, you get about 2.5 or a little more than that. So it is sort of around the average experience that we have had during that timeframe. Again, it doesn't mean it is not—that we are happy about it. It doesn't mean we ought not work to reduce it. That puts it in some context.

Mr. HERGER. Also, in recognition of the fact we are in a war on terrorism, we are in a recession, and a number of other factors.

Mr. DANIELS. The President sees it that way, that there are some extraordinary circumstances right now that make this the right set of choices.

Mr. HERGER. Thank you very much.

Mr. DANIELS. Thank you.

Mr. MCCRERY. Mr. Becerra.

Mr. BECERRA. Mr. Daniels, thank you very much for being here. I appreciate your testimony.

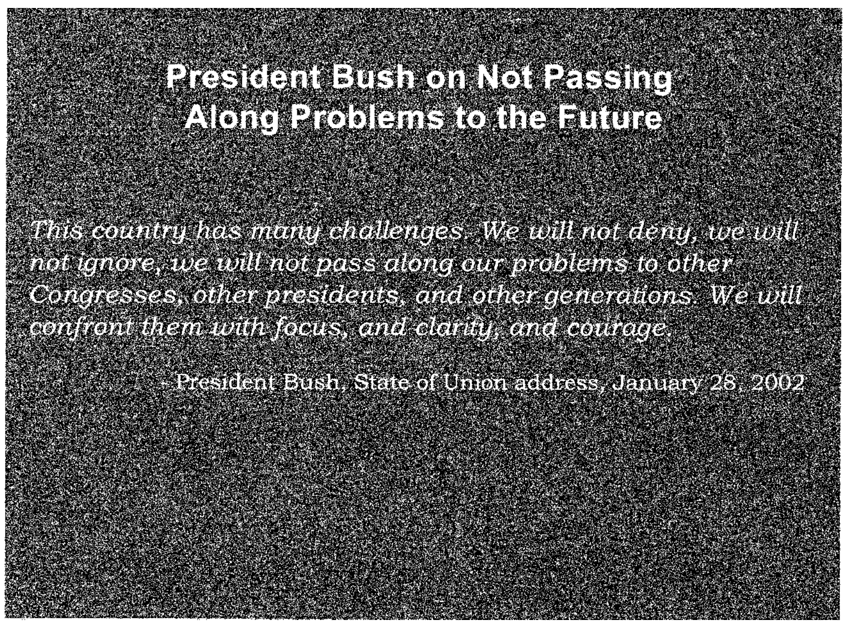
I would like to ask a couple of questions with regard to the budget and Social Security. In the budget the President states today's seniors and near retirees are counting on Social Security and Medicare to provide retirement income and health insurance. They should never doubt that promises made will be promises kept.

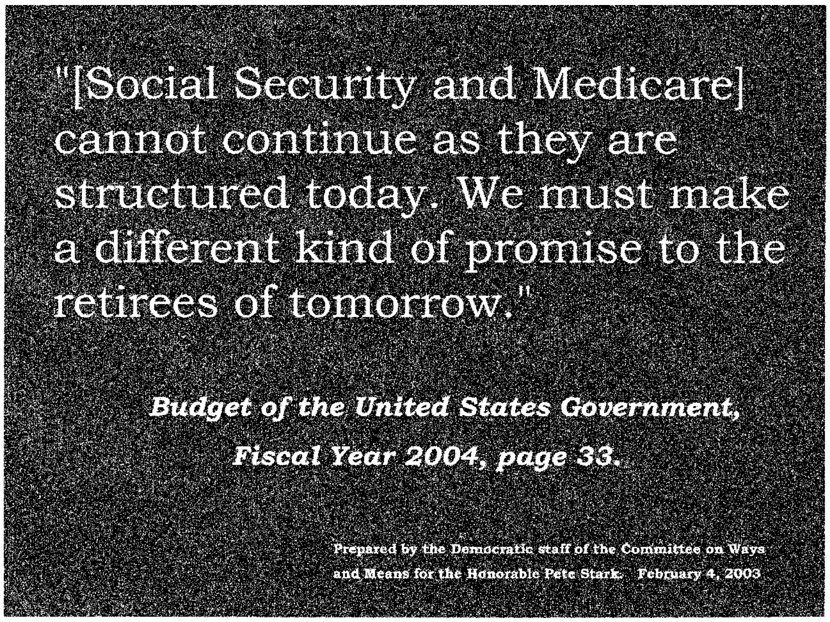
Then on the same page in the budget, if I could have someone move to the second chart that we have, where he makes another quote in the budget that says Social Security and Medicare cannot continue as they are structured today. We must make a different kind of promise to the retirees of tomorrow.

I get the sense that the President is saying that we can make a commitment based on current Social Security to today's retirees and near-retirees, but we are going to have to make some real structural changes, a different promise to tomorrow's retirees.

I was wondering, first, if you could tell me how you distinguish between a near-retiree who would get current Social Security benefits and tomorrow's retiree. What is the difference?

[The charts follow:]





Mr. DANIELS. The first principle that the President has consistently set for changing Social Security is that those who are now in retirement or very close should see no change whatsoever, at least none that they don't personally opt for.

Mr. BECERRA. What is very close? How close?

Mr. DANIELS. Typically it has been age 55, but I think that is something the President would be glad to work with the Congress on and make some difference when we get around to it. As I mentioned earlier, one of the ironies of this situation is the longer we put it off, the more difficult the choices will be. If we act—the sooner we act, the more moderate and gentle any change might have to be.

Mr. BECERRA. This to me, plus what the President said at the State of the Union, sounds a lot like the privatization plans we hear for Social Security that are sort of crouched in the shadows in this whole Social Security reform debate.

If we are going to have a different kind of promise for retirees of tomorrow, and you are saying somewhere from the age of 55 and below, does that different promise mean that the promise of a guaranteed benefit is no longer there?

Mr. DANIELS. Oh, not necessarily. I think the promise ought to include the possibility of a much better return than Social Security now stands to deliver, a very low return, especially to retirees of the future; probably the promise of some ownership and control, not simply being—just simply being the recipient of a check, but some——

Mr. BECERRA. The private account. A personal private account?

Mr. DANIELS. Some portion at least.

Mr. BECERRA. Does the different promise guarantee a disability benefit? Right now under Social Security, if you are disabled, you will receive a disability benefit.

Mr. DANIELS. Yes. I think the President's objective would, of course, be to continue that.

Mr. BECERRA. Continue it. Would he also continue as a promise the guarantee of a survivor's benefit for spouses and children?

Mr. DANIELS. I am sure this would be the goal. Again, all these details will have to be worked out by people of goodwill across the spectrum, and the President has, I think, advanced this argument a long way. It was said over here this whole issue has suffered from a lack of trust, people misusing sometimes the argument for cheap political gains. I am more confident than that. We are starting to move beyond that.

Mr. BECERRA. I think the problem that folks have, you are right, seniors should not be fooled into going a particular direction or not knowing where we are going to go. When you say we have a goal of providing a survivor's benefit, that is very different from what we have right now. Right now it is guaranteed. You can't take that from someone. That is in the law, you are guaranteed a benefit for your spouse or child should you happen to die. It is not a goal. We are not going to try to shoot for that. If our budget deficits are massive, maybe we could reach that goal. It is not, to use your word, a possibility. Right now a disability benefit is not a possibility if you should become disabled when you are a worker under Social Security. You are guaranteed that.

So I think seniors are legitimately concerned because they are hearing all sorts of messages out there. I think they would like to know, if we are going to go to a privatized system of Social Security, what are the guarantees and how does it differ, how does this new promise, this different kind of promise, compare to the promise that they have right now? If you are going to talk to those who are 55 and under, today the stock market doesn't promise them a whole lot. Today's retiree at least knows that he or she will receive a benefit that can never be taken away.

Mr. DANIELS. Yes, and that is completely so with the President's position.

Mr. MCCRERY. Before I recognize Mr. Portman, let me acknowledge and ask everyone to help me welcome back to the Committee, Clay Shaw. Welcome back, Mr. Shaw. Mr. Portman.

[Clapping.]

Mr. PORTMAN. Thank you, Mr. Chairman. Now that Mr. Shaw is back, we will get some good straight talk on entitlement reform. We are happy to have you back.

I noticed earlier Mr. Stark addressed the issue by saying that somehow his reading of the budget meant that Republicans didn't care about entitlements, and Mr. Becerra asked some good questions. The fact is, and correct me if I am wrong, Mr. Director, the reason the President is eager to look at the Medicare program and Social Security program is to save our entitlement system. I agree that there are seniors who are nervous about various proposals out there. There is also a lot of nervousness among policymakers and those in the younger generation who are looking at the future of

Social Security and Medicare, wondering how it is going to be there if we don't live up to our responsibilities.

I thought one of the best parts of the President's State of the Union was to say we are not going to leave these challenges for future Congresses and future generations. We need to face them.

So, I applaud what you have done on Medicare. I would like to see you be even more aggressive on Social Security. I know it is difficult to do too much during one Congress or one session, but I applaud you for addressing it for exactly the opposite reason that Mr. Stark indicated, which is that we need to save these programs for the future.

With regard to the growth package, you have had great testimony today. I appreciate your educating the Committee a little further about what is in the growth package and why it is so important.

As I look at the package, I think it has a good balance in terms of short and long term. I wonder if you could talk a little about that, what you see in the economy going forward and how this growth package addresses it. We have an economy growing. It is sluggish. I think your numbers were 2.8-percent growth in 2002, unemployment went up some. The recession, I hope is over, but it is still very sluggish.

What does the economy need, and how does the Administration's proposal address those needs?

Mr. DANIELS. Again, I believe the President feels the economy needs help immediately, particularly help that is likely to increase the rate of job creation.

We have had a somewhat anomalous situation of growth, 2.8 percent, as you said. That in some eras would have been seen as reasonably healthy and would have created a significant number of net new jobs, but it didn't because of this really tremendous rate of productivity improvement that we have been seeing and are continuing to see. I think that surprised a lot of people, and long term that is a very positive thing for the economy.

It does mean, however, that the economy can grow without adding jobs. So, I think the President first emphasized small business expensing and particularly the rate reductions, the acceleration of rate reductions, which, as I said, yes, have some real impact for consumers who might spend a little more. Maybe the most important impact for the whole economy could be its effect on smaller businesses, a little immediate cash flow.

Mr. PORTMAN. I missed some of your testimony, I apologize. I didn't hear it come up when I was here. Tell me how the rate cuts will affect small businesses.

Mr. DANIELS. Millions of the small businesses pay on the individual rates as opposed to the corporate tax.

Mr. PORTMAN. Do you have any sense of the percentage or the numbers of those who would benefit from the rate cuts who are subchapter S owners, who are sole proprietors or partners, who are business people but pay their taxes through the individual income tax system?

Mr. DANIELS. It is many millions, Congressman. I have seen this expressed in different ways. I think if you count every last sole proprietorship, it approaches—it is in the high teens of millions. It seems to be a reliable number.

Mr. PORTMAN. I think at the top rate most of the benefit goes to business people.

Mr. DANIELS. Yes, that is correct. So this being the job factory of the American economy, that, plus the expensing, I think probably has the most immediate-term potential. Also bringing forward the child credit would be tantamount to immediate cash in the pockets of families who are likely to need and spend it.

Mr. PORTMAN. So there is short-term stimulus as well as long-term growth through the double taxation of dividend prohibition, through some of the other business investment, including the depreciation, increasing expensing for small businesses under section 179.

One final note and question. With regard to the retirement security provisions that are in the budget, again, I want to commend you for raising the issue, particularly talking about simplification and its importance. I think we all share that across the board, that if we don't simplify the system, it is going to be harder to cover those people that do not currently have retirement savings, which is, unfortunately, about half the work force.

With regard to being able to let people save more, raising the limit from—we are approaching $5,000 over the next several years to $7,500 is also good policy. I do hope that you will continue to work with us on this Committee. This Committee has taken the lead on that over the last 5 years, and we have simplified and increased limits using the existing system and are beginning to consolidate, as you propose. I think it is entirely consistent with where we have been, and I hope you will continue to work with us on that.

Mr. DANIELS. Absolutely.

Mr. MCCRERY. At this time I am going to claim my time, which actually occurred several people ago, and yield to Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. Mr. Daniels, I want to thank you and the President for your commitment to the taxpayers and to our seniors by increasing the Social Security Administration's administrative budget by 7.5 percent compared to the average about 4 percent of all the other agencies.

On January 30, the General Accounting Office placed the Social Security Disability Insurance Program on their high risk list. This, of course—the problem is going to be compounded with the baby boomers, the aging of the baby boomers and generally the graying of America.

My question is will the President's budget allow SSA to address these serious management changes we are seeing with also the aging of the work force within the Social Security Administration?

Mr. DANIELS. Congressman, it will, and it better, I would say. Those problems are severe, but the current Administrator and her team there are working very hard and really should be commended, and that very large increase that we propose for them is in recognition of the way they are attacking this problem. I am sure you have been briefed on it, but many Members would be astonished to know how antiquated the system for judging and eventually paying those who are entitled their benefits has been over there.

The vast majority of the hundreds of days it takes from the filing of the claim to eventual payment, the vast majority of that time, nothing is happening. Paper is sitting, or literally paper is moving from one place to another. It is a dinosaur system, and they are moving very aggressively to bring it into even the last century, and quickly this one. We wanted to back that up every way we could. People who need these benefits and are entitled to them deserve a much better shake than they are getting now.

Mr. SHAW. Yes, they do. We have already shortened the time somewhat, but there is a lot of work to be done. I agree, I think the Social Security Administration is committed to that, and I am pleased to see the support of the President.

I want to comment just very briefly on something Mr. Becerra was talking about a few minutes ago. A government-insured Social Security pension system is not necessarily and does not have to be incompatible with investment and private accounts. They can work together, and it still can be a government-guaranteed system, as I intend to work for. Thank you. I yield back.

Mr. MCCRERY. Thank you, Mr. Shaw. It is nice to have you back. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman. Mr. Daniels, you, of course, appear here on a day that a very important presentation has been made up at the United Nations to justify military action against Iraq, and yet if I understand your answer to Mr. Rangel, it is that you and your office are incapable at this point of providing a credible estimate of the cost to American taxpayers of a war with Iraq; is that correct?

Mr. DANIELS. I wouldn't use that word, no. I think we are capable of providing an estimate, but first we would need to know what the President, what the military, has decided, and what they therefore expect.

Mr. DOGGETT. I see. So, I guess if you can't provide an answer to Mr. Rangel today, you don't have any basis for questioning the accuracy of the estimate that the President's top economic adviser Mr. Lindsey gave before he was fired, that it could run up to $200 billion?

Mr. DANIELS. First of all, if Larry was here, he would repeat, as he did many times, that wasn't an estimate. He was simply remarking that some past conflicts—he gave a quick answer based on a percent of GDP, and that is what some past conflicts had cost. He did not pretend that he had an ability or even tried to estimate this one.

Mr. DOGGETT. Was that the type of estimate you gave on December 30th to the New York Times when you said it would cost about $60 billion?

Mr. DANIELS. Actually, what I told the New York Times was that that was what the Gulf War cost.

Mr. DOGGETT. That is what you thought was a reasonable estimate for this one; isn't that what you also told them?

Mr. DANIELS. I said it was a closer range than the number—they were asking me to react to the number that had been associated with Mr. Lindsey.

Mr. DOGGETT. Does that figure include the Nation-building that the President is committed to after any conflict in Iraq?

Mr. DANIELS. Any request that we would make would include both the estimated cost of the conflict, which with all the uncertainty that would be around that——

Mr. DOGGETT. I am not asking the specific figure that you used. It didn't include the Nation-building because we didn't have that in the first Gulf War.

Mr. DANIELS. That is correct. It also, of course, did not include the contributions of allies, which brought that figure way down.

Mr. DOGGETT. Yes, sir, which we probably won't have this time. Well, how soon after the bombs start dropping, if they do, do you think it would be reasonable for you to have an estimate of the cost?

Mr. DANIELS. Immediately.

Mr. DOGGETT. Okay. So it certainly will be possible to you before this dividend tax cut passes the House, if we proceed with military action in March, to give us that figure, including the Nation-building?

Mr. DANIELS. If the President made a decision in March, and hostilities started, we would owe the Congress and we would bring the Congress an estimate based on whatever decision he made.

Mr. DOGGETT. I appreciate that. In January, last month, you also told the New York Times that you would expect us not to be back in a surplus in this budget for a decade; is that correct?

Mr. DANIELS. Well, no. I don't have any such expectation. In fact, I have every hope that we might be.

Mr. DOGGETT. This was the January 16 issue. "Mr. Daniels suggested today the budget was not likely to be in surplus in the next 10 years." Is that not your position?

Mr. DANIELS. It is my position that I don't know and that no one can know. Just as we didn't know the last surplus was coming, we didn't know the events that took us back to deficit were coming, we cannot know with any confidence even 3 or 4 years ahead.

Mr. DOGGETT. You are not retracting those comments?

Mr. DANIELS. You notice that was not a comment. Somebody said I suggested. Maybe they drew an inference I didn't really mean to give.

Mr. DOGGETT. Well, did you suggest it? Did you suggest the budget was not likely to be in surplus within the next 10 years, and, if so, is that your position today?

Mr. DANIELS. No, it isn't.

Mr. DOGGETT. Did you suggest that then?

Mr. DANIELS. No. My position is I don't know.

Mr. DOGGETT. It is like the war; you don't know what the situation is going to be with the surplus?

Mr. DANIELS. I think we can have some assurance, maybe a year, maybe 2 ahead. As experience has taught us, we are kidding ourselves if we think we know much further out.

Mr. DOGGETT. What we can be sure of though is that under your plan, you are going to add at least $1 trillion in public debt, aren't you, under the projections that you have given us that you do feel confident on, just looking over the next 5 years, with the largest deficit this year in the history of the country, in absolute terms?

Mr. DANIELS. I think the right way to think about it is the way our colleagues at the Congressional Budget Office do, and they will always—they look back and see an average miss one way or another over the last couple, three decades, of over $200 billion. Nobody is able to see all the changes that can come in circumstances, or just simply economic changes, and, therefore, the way to think about 5 years from now is in terms of a very broad range that could go from substantial deficits into surplus again.

Mr. DOGGETT. Under the plan you presented to us, don't you have $1 trillion? That is all I am asking you, sir. If you can't answer it, I understand.

Mr. MCCRERY. Mr. Johnson. Everybody is adhering to the 5-minute limit very nicely today.

Mr. JOHNSON OF TEXAS. Glad to have you here. It is always good to deal with you. Thank you for being with us. I am sorry you are getting some of the chastisement you are getting.

Mr. DANIELS. I hadn't noticed.

Mr. JOHNSON OF TEXAS. It is not warranted, but I know your skin is thick. I would like to ask you, I recall when there was a Democrat Congress that we had huge deficits, and it seems to me that often they exceeded 5 percent of GDP. In the projected deficit that you have proposed, is it not much smaller than many of them in the last 25 years, even in spite of all the extra war and other talk we have got?

Mr. DANIELS. It is smaller than most of the last 20 years, again, before the cost of any war, it is perfectly fair to say, and it is less than half as large as the largest of those deficits.

Mr. JOHNSON OF TEXAS. That is great. I think you all have done a super job with that. Can you tell me, did you use at all or consider using any other cost estimate in determining whether or not a tax reduction would improve our position? Because, you know, everybody talks about how you are going to put us in deep debt. It seems to me that that may decrease the debt significantly once they take effect.

Mr. DANIELS. Right. All the estimates here, of course, are on the conventional so-called static approach. That is, they assume that the President's full proposal is enacted, and absolutely nothing changes. We know that is wrong. We know that some substantial amount of the revenue that was left in the pockets of taxpayers would come back through greater economic activity, but no one is quite sure how to predict that in advance.

Mr. JOHNSON OF TEXAS. Did you try to do any dynamic scoring?

Mr. DANIELS. We did not. Our colleagues at the Council of Economic Advisors have estimates as much as 40 percent would be recaptured. I have heard other estimates of 30 percent and so forth. So, this would amount to a very large reduction in the deficit that is forecast here, but we have taken, as I say, what is the conventional route and made no such assumption.

Mr. JOHNSON OF TEXAS. So, if their estimate of 30 percent, which is the lower number that you just mentioned, reduction were to occur, does that mean the deficit would be 30 percent less than what you are estimating?

Mr. DANIELS. It means it would be less by 30 percent of the amount of the growth package. So, if our growth package, the President's growth package, is $415 billion over 5 years, you could take 30 or 40 percent off of that.

Mr. JOHNSON OF TEXAS. Which puts the deficit at a reasonable number that could turn into a positive number within 5 years maybe?

Mr. DANIELS. Yes, that is, again, what CBO's so-called fan chart, which I don't have here to show you, but they have published often, that just looks back at history, looks at the extent of uncertainty around any of these estimates, and shows how wide the range of possibilities is. It ranges from deeper deficits than we expect all the way into surplus.

Mr. JOHNSON OF TEXAS. That is good. I think that is the positive answer we are looking for. Let me ask you on a different subject, U.S. General Accounting Office study that just came out indicated that personal account plans in Social Security would strengthen the system and increase benefits for low-wage and disabled. Do you have a comment on that?

Mr. DANIELS. I haven't seen this particular report, but that would be consistent with many, many others that have been done of the concept.

Mr. JOHNSON OF TEXAS. That is part of the President's proposal; is it not?

Mr. DANIELS. The President hasn't made a specific proposal yet, but he certainly indicated his belief that some personal account, some degree of personal ownership of people's retirement future, ought to be part of the reform we seek. One reason for that is it would certainly project to improve the return they can expect to get overall.

Mr. JOHNSON OF TEXAS. Thank you very much. Thank you, Mr. Chairman.

Mr. MCCRERY. Mr. Pomeroy.

Mr. POMEROY. Thank you, Mr. Chairman. Mr. Daniels, I would like to have my questions predominantly address this new retirement savings proposal advanced in the budget.

As I understand it, under the RSAs proposed, retirement savings account, an individual will be able to put $7,500 in, their spouse would also be able to put $7,500 in, and thereafter there would be no tax on any earnings generated in those accounts; is that correct?

Mr. DANIELS. That is part of it, yes, sir.

Mr. POMEROY. It is part of it. I also understand if the kids, for example, had a summer job, they probably would be able to get one of these accounts, too, and $7,500 more could be invested for RSAs for the kids if they had some participation in the work force. Is that your understanding?

Mr. DANIELS. I believe that is consistent with the concept.

Mr. POMEROY. Then in addition to that, there are what is called lifetime savings accounts (LSAs). These, as I mention, are in addition. You would be able to put $7,500 into these for each Member of the family, and thereafter there would be no tax on any earnings that might accrue in those accounts; is that correct?

Mr. DANIELS. That is correct.

Mr. POMEROY. Well, just quick and simple math, you have got a family of four, let's say. You get $15,000 going in for Mom and Dad, and under the LSAs you have $15,000 going in for each of the four. You have $45,000 annual investment opportunity right there, and no tax thereafter on any of their earnings; is that correct?

Mr. DANIELS. Thereafter.

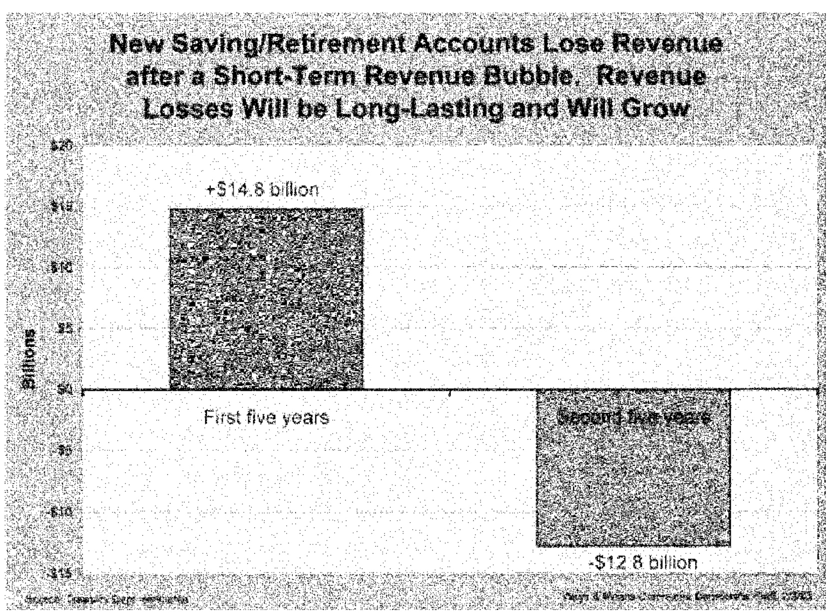
Mr. POMEROY. This appears to me to be a very significant change in tax policy, a major step toward a policy position of the government where we won't tax investment income. Do you see it in that light?

Mr. DANIELS. I do think it represents a very fundamental concept, I would agree with you on that, both in terms of the treatment of investment income and simplification of the Code both.

Mr. POMEROY. In looking at the long-term budget costs of this, it is kind of a—actually while we don't have specifics in terms of costs, we do kind of get the picture in terms of how this is going to work. If I might have that one chart. The proposal is actually projected to generate some revenue in the early going. Can we tilt that a little bit so they can see it?

As revenues flow out of traditional individual retirement accounts (IRAs), not the Roth IRAs, but the traditional IRAs, and is taxed before it is placed in these accounts, never to have earnings taxed again, but the longer out you go, you begin to experience revenue loss, because you have these sums that presently are taxable no longer taxable because they exist within these accounts; is that correct?

[The chart follows:]



Mr. DANIELS. Yes. That is the way the Treasury would look at it.

Mr. POMEROY. Mr. Daniels, my real anxiety, I am concerned, of course, about several facets of this plan, but I believe that in the next decade to follow you would have even more pronounced revenue loss under this plan than is reflected in the second 5-year experience. You would have this revenue that otherwise would have been taxable, the earnings, now not taxed. You would have greater and greater amounts sheltered in that way.

The next decade's fiscal problems involve the retirement of the baby boomers. So as you move from tax on investment income to an increasing dependence upon tax on wages, you have got to look at where your work force is going, and we are going to have a work force retiring, which is going to drive up spending in the Social Security and Medicare area while generating fewer workers per retiree.

Now, doesn't this put us on a long-term problem in terms of making this all work out?

Mr. DANIELS. I don't think so, Congressman. These are important questions. First let me say that I do believe that this proposal ought to start a very serious conversation; it ought to be seen, as you portrayed it, as an important new concept or new way of thinking about future savings policy, and we ought to approach it very carefully.

As your chart indicates, nobody sees it, at the moment at least, not Treasury and I guess not the preparer of that chart, as much of a fiscal event for quite a long time. These numbers are pretty small compared to the other ones we talked about today, $14-, $15 billion here and $12 billion there. So it is kind of a fiscal nonevent for quite a long time.

I think the motivator behind the policy is that if you fundamentally encourage more savings you may do some wonderful things for the economy. It may be very beneficial for interest rates in the future investment climate, not to mention the retirement security of the people who do save more than they otherwise would have. All of those things are going to have to be considered, not just look at this through any one dimension of what it might or might not do in the second or third decade out.

I think you raise important questions, and I think the proposal was meant to stimulate just that kind of discussion.

Mr. MCCRERY. Mrs. Johnson.

Mr. POMEROY. I will conclude in 20 seconds.

Mr. MCCRERY. We have to move on. Mrs. Johnson. Everybody else has abided.

Mrs. JOHNSON OF CONNECTICUT. It is a pleasure to have you before our Committee, and I commend you on the many, many initiatives in the budget on the area of health care. You are really taking on pretty much all of the major problems, and I think we do have to think that way. Many of them in regard to Medicare, Medicaid and NIH are not before this Committee, but there are many that you have talked about before this Committee.

First of all, let me say thank you for the $400 billion figure for Medicare. That is a higher figure than any President of either party has ever put in the budget to strengthen Medicare. It is desperately needed. It isn't just a matter of prescription drugs, it is a matter of better integrating care, and, indeed, if we provide seniors with prescription drugs without some better ability to prevent them from getting drugs that interact poorly or that are representing overprescribing, we will cause a fair amount of harm as well as a fair amount of good.

So I appreciate your strong proposals in the area of strengthening Medicare, including the immediate expenditure of $84 million to help with the information technology we so desperately need to help the small providers develop, as well as to help the government develop.

There are several other areas that nobody is talking about that I think it is important to note, and it not clear to me from your summary as to whether you expect these to start in the second 5 years of a 10-year period or the first 5 years.

Your initiative on long-term care is one that the preceding Member who questioned, Earl Pomeroy, and I have worked on for many years. It has to do with incentivizing the purchase of long-term care insurance by allowing a deduction of the premium. You do have that in your budget, for a cost of $28 billion.

You also have a benefit for families, caregivers, who provide family members with long-term care at home. This is extremely important as people get older. I appreciate your providing that in the budget, although, again, it isn't clear to me when you expect to start that.

Thirdly, you do have $87.6 billion in your budget for refundable advanceable credits for the uninsured. At this point if we don't do something to begin covering all Americans, it is not only not fair to the Americans who don't have access to affordable insurance, but it is going to be catastrophic for the providers, because no payer anymore is willing to cross-subsidize other folks, and the uncompensated care issue is reaching truly a critical proportion.

So, I am very pleased that those three initiatives are in there. Could you talk a little bit about when you expect them to go into effect? Could we do those this year, and would there be room to get those initiatives started? All of them will take a while to set up.

Mr. DANIELS. Thanks. First, let me just commend you for your leadership in this area for a long time. A lot of these ideas came from you, or at least were shaped in conversations with you. So I am pleased that we are able to incorporate them, too, and I hope it is a good starting point. In most cases you mentioned, the budget assumes that we move quickly into these areas, such as the tax credit for the uninsured. Now, this is the third time the President has proposed it, and so it didn't happen in each of the first years, and each year it becomes more urgent that we do it.

The Medicare proposal is phased in and would start in 2004. That is the first year after enactment, but it does not become what I would call a substantial program until about the third year. So in 2006, it rises to $33 billion.

The general answer to your question is the President would like to move on these fronts and move on them as fast as he and Congress can agree.

Mrs. JOHNSON OF CONNECTICUT. Thank you very much. There are some very good aspects to your budget that I won't take time to go into here, but I would ask you to look back at an Environmental Protection Agency/U.S. Department of Housing and Urban Development (EPA/HUD) proposal that you have where you eliminate HUD's brownfields cleanup money and keep EPA's. The HUD's leverage is a lot of private investment. Well, it is $25 million versus 10, and so I like the higher money. It also does function to help communities rehabilitate old industrial properties and therefore affects the ability of communities to redevelop their economic potential, but also thereby to reduce the incentives for sprawl. So that is an issue that I hope we will be able to talk about.

Mr. DANIELS. Well, the brownfield idea has been a major theme of the President's for some time. He thinks it is a very high-yield environmental initiative, and we will look at where it could best be housed.

Mrs. JOHNSON OF CONNECTICUT. Thank you.

Mr. MCCRERY. Now I would like to recognize my neighbor from east Texas Mr. Sandlin.

Mr. SANDLIN. Thank you, Mr. Chairman. Thank you, Mr. Daniels, for coming today.

I noted that the President's budget has about $400 billion for Medicare, but not much detail. Could you tell us how much of that will be spent on a drug plan, particularly as it affects America's seniors?

Mr. DANIELS. First of all, I hope the details will be available to you within the next weeks, Congressman. It is being worked on very hard and we are trying to produce a plan which is really well thought through and also has been—is thoughtful from the standpoint of costs and so forth. Most of the—I am quite confident that most of the costs of the proposal will be taken up in providing prescription drug coverage, although it is far from the only thing we need to do with Medicare. I think that——

Mr. SANDLIN. Let me ask you this: When you talk about Medicare, will there be a prescription drug plan in Medicare, or will this just be another example of the government giving money to health maintenance organizations (HMOs)?

Mr. DANIELS. Yeah. I would not expect HMOs to figure much into this.

Mr. SANDLIN. The seniors would have to leave Medicare to enroll in a private plan for drug coverage?

Mr. DANIELS. Seniors will be in Medicare come what may. The President's notion here is to dramatically expand the choices available to seniors, including to stay right where they are, to make sure they have as wide a choice of doctors as possible.

Mr. SANDLIN. If they stay right where they are, though, will they have a prescription drug plan in Medicare?

Mr. DANIELS. Well, this is being worked on at the moment.

Mr. SANDLIN. Do you know how—let me ask you this: How much would be provided for provider payments? Do you know that?

Mr. DANIELS. We haven't reached a final determination.

Mr. SANDLIN. You haven't?

Mr. DANIELS. We have not. As we have worked with Members of this Committee, the President certainly believes that on the physicians' side at this point there is simply an inaccurate and unfair level of payment being made, and this is important because——

Mr. SANDLIN. Would his position be the same on the reimbursement or provider payments to the hospitals?

Mr. DANIELS. Well, we are looking carefully at the other providers. The one area at this point that the President and that our friends at HHS have certainly agreed needs immediate attention is physicians. As you know, we are beginning to lose some physicians, or patients are beginning to lose access in Medicare today.

Mr. SANDLIN. Could you tell us where the $400 billion figure came, if we don't know how much would be toward a drug plan and we don't know how much will be provider payments? Did the $400 billion just come from the ether, the land of Oz? How did you figure that internally?

Mr. DANIELS. I looked at a Powerball card.

Mr. SANDLIN. Good. That is a good plan.

Mr. DANIELS. No. It is a good faith, admittedly, round-number estimate. We looked at programs similar to the one that the President has outlined, and this seems to be certainly in the neighborhood, I hope an adequate amount. Again, when we look at similar programs, they cost about that, maybe a little less.

Mr. SANDLIN. Let me move on to something else. My good friend, our Ranking Member, Mr. Rangel and Mr. Doggett asked you about the war, and clearly that hasn't been figured into the budget. I am a little confused. In looking at your testimony today, your two-page testimony about the budget, you indicate the deficit's origins are no mystery. It was the product of a triple witching hour in which recession, war and a collapse of the stock market bubble coincided. Later you said deficits are not always unacceptable. The strongest proponents of balanced budgets routinely make exceptions for war.

It appears to me that you figure in the war and you use the war for excuses for the deficit, but then you fail to use the numbers to fund the very war that you think is imminent.

Mr. DANIELS. No, sir. We are at war today, and the defense budget for 2003 and again for 2004 was increased specifically to take account of the fact that Afghanistan and the defeat of the Taliban was not the end of that war. Now, there may be an expansion. There may be a new theatre to the war on terror. We don't know——

Mr. SANDLIN. Do you feel like a war with Iraq is imminent?

Mr. DANIELS. I don't know.

Mr. SANDLIN. Well, you know we have troops there, don't you?

Mr. DANIELS. I sure do.

Mr. SANDLIN. You know that the Roosevelt carrier went there today to join others, right?

Mr. DANIELS. Yes, sir.

Mr. SANDLIN. You say Mr. Blix said we are 5 minutes to midnight. I mean, it appears that war is imminent. Assuming that threat to be real, it seems inappropriate and misleading and negligent not to include budgeting for the war in a budget that you submit to the U.S. Congress, doesn't it?

Mr. DANIELS. We think it would have been inappropriate to include it, because the President continues to hope it will not be necessary, but we will be ready.

Mr. SANDLIN. We all hope it won't be necessary, but you know local governments, cities, counties, they all budget for unanticipated expense, and they budget for unanticipated but probable expense, and we have not done that, have we?

Mr. DANIELS. Well, we will be prepared very quickly if the need is there, and we have certainly thought ahead about it, I think, in the way you would want us to.

Mr. SANDLIN. Well, my time is up. As Mr. Gutknecht said, this budget is a tough pill to swallow, isn't it?

Mr. DANIELS. These are tough times.

Mr. MCCRERY. Mr. English.

Mr. ENGLISH. Thank you, Mr. Daniels. As someone who actually had a career in local government at one point, I want to salute you for as many contingencies as you have taken into account in this budget, as tight as it is and as challenging as it is.

I have some other questions, and I know my time is limited, but let me see if I can take a moment to explore, to my better understanding, the scope of your negligence here, and that is you have not budgeted for a war in this budget, that may not occur, the scope and tactics of which at this point are undetermined, the duration of which is impossible to determine, and the question of nation-building, which of course is usually an enthusiasm on the other side of the aisle, is still to be specified. In all of that you are unable to attach at all a figure to this potential conflict?

Mr. DANIELS. We chose not to attach one to a hypothetical conflict. If that conflict becomes real, then we will—you have just named very, very perceptively the most important variables, and we will get guidance and quickly develop a request consonant with it.

Mr. ENGLISH. Well, in that case, sir, I would like to in my remaining questions retreat out of the partisan ether and head toward something a little more concrete. I am concerned about our budget deficit, and some of the functions that you fund, not necessarily the largest functions in the Federal Government, but nevertheless very important ones, are critical to the operation of our trade policy.

Now that the Customs Service has been transferred to the new Department of Homeland Security, what proposed budget changes have been made for all of Customs statutory functions that have been transmitted in the current budget? Recognizing that Congress directed in the homeland security bill that those trade functions and staffing to certain trade revenue-collecting offices not be diminished, does this budget faithfully reflect that objective?

Mr. DANIELS. Yes. I believe it does.

Mr. ENGLISH. Similarly, the Department of Commerce plays a critical role in enforcing our trade laws and in overseeing many issues that relate to our markets. Have you provided adequate funding for the Department of Commerce for its international trade functions?

Mr. DANIELS. I hope so. Commerce is in for about a 5-percent increase this year, which I must say is better from their standpoint, more than we proposed in previous years, and there are certain aspects of their activities which we think are very important. We gave—we proposed a significant increase with our statistical service, for example, upon which a lot of business and governmental decisions rely, and they have been doing a good job, and it looks like they could do more with more money.

Mr. ENGLISH. Similarly, the U.S. Trade Representative's Office is a small one in terms of the overall size of the Federal Government, but absolutely critical in its efforts to open up international markets and create opportunity for American products and to ensure a level playing field for American companies and American workers. This Administration has launched an extraordinarily aggressive and broad trade agenda, I think far beyond the scope of anything we have seen in a prior Administration, with the acquisition of trade promotion authority. Does the U.S. Trade Representative's Office, in your view, have adequate funding to meet those challenges?

Mr. DANIELS. I think the next time you see the U.S. Trade Representative, you will find a very happy person. He and I discussed—you are right. It is a very, very small, but also very, very important piece of the government. He and I discussed his situation directly and in detail, and he went away with a very large increase.

You know, after the passage of Trade Promotion Authority, as well pointed out it is only a hunting license, and what matters really now is if it is translated into new agreements that open up markets to our products and bring down barriers and help consumers in both countries. So he needs more people to make the potential of trade promotion authority real.

Mr. ENGLISH. I will see him in about 5 minutes, so I will test your theory. Thank you. Thank you for your testimony.

Mr. MCCRERY. Now the distinct privilege of wrapping up today's hearing falls to Mrs. Tubbs Jones.

Ms. TUBBS JONES. Thank you, Mr. Chairman. Good afternoon.

Mr. DANIELS. Yes, ma'am.

Ms. TUBBS JONES. I am the last one up to bat, and let me say this, that none of my questions are intended to necessarily be partisan. I am here to represent the people of the 11th Congressional District of Ohio, and I am required to make inquiry as to this particular budget.

Let me—I am going to ask as short a questions as I can, and I hope that you will give me short answers so we can get through the process.

The Senate passed an omnibus bill that provided a provision that fixed the physician payment in Medicare as a stopgap measure for the balance of this year. Would you support such a measure, sir?

Mr. DANIELS. Well, yes. The President would support any of a number of measures that would try to address the problem we talked about earlier, which is a real one, physician reimbursement.

Ms. TUBBS JONES. Let me move on to another statement that you made in your written statement. You said a balanced, fair budget is a very high priority for this President. It is not and cannot be the highest priority, let alone the only one. He does not place it ahead of our national security, the safety of Americans from domestic terror, or a growing full employment economy. Does he place it ahead of the need for health care for all Americans?

Mr. DANIELS. No, and that is why his budget includes the tax credit. That is not a small matter that Mrs. Johnson asked about, why it includes Medicare enhancement, Medicaid and so forth. There are——

Ms. TUBBS JONES. In order to have a health care tax credit, you have to have money to buy it, and if we contemplate that there are numerous people, such that Medicare costs are as high as they are, out of jobs, a tax credit—health care tax credit does very little for that population.

Mr. DANIELS. Well, it is refundable, so it could help anybody who——

Ms. TUBBS JONES. Who has money to pay.

Mr. DANIELS. Takes advantage of it. Of course, it is only one of several proposals in this budget. You——

Ms. TUBBS JONES. I am specifically asking about the health care tax credit. If I don't have money to pay to get refunded, it doesn't help me; is that correct, sir?

Mr. DANIELS. Well, actually it can be structured so that the person can be advanced the money ahead of the credit.

Ms. TUBBS JONES. That is not in the proposal as it currently exists. It could be structured.

Mr. DANIELS. Well, let us work together if you think that is——

Ms. TUBBS JONES. Answer my question, sir. I am short on time.

Mr. DANIELS. Your question was does he place this ahead of—a balanced budget ahead of this, and obviously he doesn't, or he wouldn't have included these proposals.

Ms. TUBBS JONES. Does he place it in front of the need or the right to every child to have a good education in the United States?

Mr. DANIELS. Oh, obviously not, because once again, education is proposed to have a very large increase, and the biggest increases, bigger than any President has ever proposed before, for Title I and for the Individuals with Disabilities Education Act, $1 billion each.

Ms. TUBBS JONES. If all of that is tied to the performance of the school system, and in light of the fact that the performance of the school system is not the responsibility of any child, it is going to be difficult to say to a child, we are going to fund education based on the performance of the school.

Mr. DANIELS. Actually, no. Title I funding is not all tied to the performance of the school system.

Ms. TUBBS JONES. Okay. Let me move on. You keep talking about the typical American family. Can you tell me what a typical American family is, sir?

Mr. DANIELS. Well, we meant that the family at the average or median income.

Ms. TUBBS JONES. What is that, sir?

Mr. DANIELS. Oh, I think it is in the neighborhood of $50,000. Again, it depends on what family size you are talking about.

Ms. TUBBS JONES. Well, I am asking you. You keep using the term when you describe the typical American family should not—we should not spend any more in terms of increases than—in Federal Government than the typical American family that is only getting 4 percent. I want to know what that typical American family is, sir.

Mr. DANIELS. Measured in per capita income, so whether it is a single person or a family of four, if you measure on a per capita basis, any——

Ms. TUBBS JONES. What is that per capita income, sir?

Mr. DANIELS. Well, the point is whatever a family's income is now, they can expect about a 4-percent increase; some more, some less.

Ms. TUBBS JONES. Let me move on. Will the typical American family benefit from the dividend tax cut based on your description of making less than—for four it is $50,000?

Mr. DANIELS. Well, the President certainly believes so. Millions and millions——

Ms. TUBBS JONES. No. I am not asking what the President believes. I am asking you as the head of the Office of Management and Budget, can the typical family benefit from a dividend tax cut?

Mr. DANIELS. Sure. Same answer.

Ms. TUBBS JONES. How?

Mr. DANIELS. Millions of those families——

Ms. TUBBS JONES. If they don't even make $7,500 or whatever amount it is to invest.

Mr. DANIELS. Millions of those families, of course, will receive dividends in the first instance, and many others would benefit from the job creation, the new investment and the stronger stock market.

Ms. TUBBS JONES. I asked about the dividend tax cut. Can you tell me how many average American citizens currently have dividend income, sir?

Mr. DANIELS. About 35 million families.

Ms. TUBBS JONES. No; 35 million families, but those 35 million families are not included in the typical American family that you have discussed, sir, are they?

Mr. DANIELS. I have trouble following your question, ma'am.

Ms. TUBBS JONES. That is because you don't want to follow my question. The 35 million people that you talk about benefit from a dividend tax cut, are they part of—are all 35 million of them the typical American family, sir?

Do you want me to say it again?

Mr. DANIELS. You can try.

Ms. TUBBS JONES. That is all right, sir. I understand why you are not answering my question, and I hope that I can submit it in writing to you and you can respond. You didn't have a problem answering the questions on the other side, sir. Thank you, Mr. Chairman.

[The information follows:]

The President's dividend exclusion proposal will directly benefit 35 million taxpayers. More than 40 percent of the people who receive taxable dividends make under $50,000 per year, and three-fourths make less than $100,000 per year. Further, almost half of all savings from the dividend exclusion under the President's plan would go to taxpayers 65 and older. The average tax savings for the 9.8 million seniors receiving dividends would be $936.

According to a variety of outside experts, the dividend proposal will also produce an increase in equity values, which means that each of these dividend-receiving taxpayers will receive an important and near-term second benefit from the proposal. And the proposal will reduce the cost of capital to business investment, which means that future productivity growth and hence future wages will rise more rapidly under the President's proposal.

As Federal Reserve Board Chairman Alan Greenspan commented, "In my opinion, the elimination of the double taxation of dividends will be helpful to everybody. This particular program will be of net benefit to virtually everybody in the economy over the long run, and that is one of the reasons I strongly support it."

Mr. MCCRERY. Thank you very much. Mr. Daniels, thank you very much for your patience today.

Mr. DANIELS. My pleasure.

Mr. MCCRERY. I want to thank all the Members of the Committee for so—for being so nice and adhering to the 5-minute rule today. It did enable us to get through every Member of the Committee within almost 2 hours, 2 hours and 15 minutes. So great job, everybody.

Thank you for your testimony and your responses, Mr. Daniels, sir. We look forward to seeing you again. The hearing is adjourned.

[Whereupon, at 4:19 p.m., the hearing was adjourned.]

[Questions submitted from Chairman Thomas to Mr. Daniels, and his responses follow:]

Office of Management and Budget
Washington, DC 20503

Question: Given that the Customs Service has been transferred to the new Department of Homeland Security, what proposed budget changes have been made for all of Customs' statutory functions in the current budget? Congress directed in the Homeland Security bill that trade functions and staffing to certain trade revenue collecting offices not be diminished. How does the budget reflect this?

Answer: The budget does not propose to change statutory functions related to customs. It does display the Administration's request for the Department of Homeland Security, including customs functions, in the structure that the President proposes for the Department on a going-forward basis. Modifications to organizational units in the Border and Transportation Security Directorate were detailed in the Reorganization Plan Modification for the Department of Homeland Security submitted by the President on January 30, 2003, pursuant to section 1502 of the Homeland Security Act of 2002. Consistent with the Homeland Security Act, the budget maintains the Department's trade functions and staffing for certain trade revenue collecting offices.

Question: In crafting the reorganization legislation, Congress left the organic authority for Customs within Treasury, creating a presumption that the authority should not be delegated and Treasury would continue to perform its role in international trade. Will the Department of Treasury retain this authority, and will the Department remain fully staffed and funded in order to continue to perform its oversight role? What office within the Department of Treasury will be charged with the oversight of the revenue collection functions of the Customs Service?

Answer: The Departments of Treasury and Homeland Security will be discussing these issues with you in the near future.

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