AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

TREASURY DEPARTMENT FISCAL YEAR 2008 BUDGET

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, FEBRUARY 7, 2007

Serial No. 110–5

Printed for the use of the Committee on the Budget

Available on the Internet:
http://www.gpoaccess.gov/congress/house/budget/index.html

U.S. GOVERNMENT PRINTING OFFICE

33–752 PDF WASHINGTON : 2007

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

COMMITTEE ON THE BUDGET

JOHN M. SPRATT, JR., South Carolina, *Chairman*

ROSA L. DELAURO, Connecticut,
CHET EDWARDS, Texas
LOIS CAPPS, California
JIM COOPER, Tennessee
THOMAS H. ALLEN, Maine
ALLYSON Y. SCHWARTZ, Pennsylvania
MARCY KAPTUR, Ohio
XAVIER BECERRA, California
LLOYD DOGGETT, Texas
EARL BLUMENAUER, Oregon
MARION BERRY, Arkansas
ALLEN BOYD, Florida
JAMES P. MCGOVERN, Massachusetts
BETTY SUTTON, Ohio
ROBERT E. ANDREWS, New Jersey
ROBERT C. "BOBBY" SCOTT, Virginia
BOB ETHERIDGE, North Carolina
DARLENE HOOLEY, Oregon
BRIAN BAIRD, Washington
DENNIS MOORE, Kansas
TIMOTHY H. BISHOP, New York

PAUL RYAN, Wisconsin,
Ranking Minority Member
J. GRESHAM BARRETT, South Carolina
JO BONNER, Alabama
SCOTT GARRETT, New Jersey
THADDEUS G. MCCOTTER, Michigan
MARIO DIAZ–BALART, Florida
JEB HENSARLING, Texas
DANIEL E. LUNGREN, California
MICHAEL K. SIMPSON, Idaho
PATRICK T. MCHENRY, North Carolina
CONNIE MACK, Florida
K. MICHAEL CONAWAY, Texas
JOHN CAMPBELL, California
PATRICK J. TIBERI, Ohio
JON C. PORTER, Nevada
RODNEY ALEXANDER, Louisiana
ADRIAN SMITH, Nebraska

PROFESSIONAL STAFF

THOMAS S. KAHN, *Staff Director and Chief Counsel*
JAMES T. BATES, *Minority Chief of Staff*

CONTENTS

TREASURY DEPARTMENT FISCAL YEAR 2008 BUDGET

WEDNESDAY, FEBRUARY 7, 2007

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

The committee met, pursuant to call, at 10:00 a.m., in room 210, Cannon House Office Building, Hon. John Spratt (Chairman of the committee) presiding.

Present: Representatives Spratt, Edwards, Cooper, Allen, Schwartz, Kaptur, Becerra, Doggett, Blumenauer, Berry, McGovern, Sutton, Andrews, Scott, Etheridge, Hooley, Moore, Ryan, Barrett, Bonner, Garrett, Hensarling, Lungren, Simpson, Conaway, Campbell, Tiberi, Porter, Alexander, and Smith.

Chairman SPRATT. I call the hearing to order, and welcome our witness today. He happens to be an old personal friend. About 30 years ago, or longer than either one of us care to admit, I was working at the Office of the Secretary of Defense, for the Comptroller, when a young JG in the Navy by the name of Hank Paulson joined us in the office there. We worked together at their for the next 18 months, two years as part of the defense effort. And I, for all these years since had not had an opportunity to continue our friendship, but have enjoyed renewing it since he is come back to Washington. And I was never surprised by any of the many achievements that he has racked up in the course of his career. And the President could not have chosen better in selecting Hank Paulson to be Secretary of the Treasury. So we are very, very pleased to have you here today to talk about the President's budget.

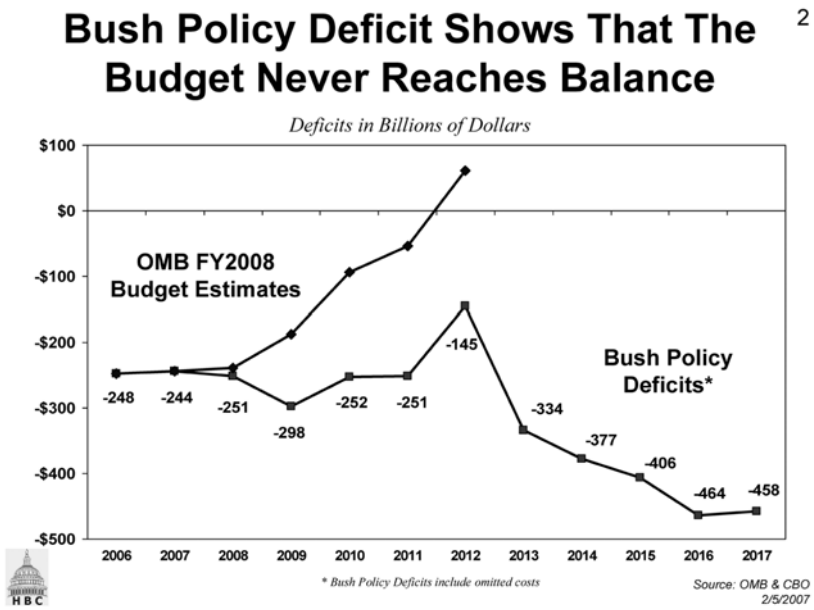
Mr. Paulson, you have expressed some concern, like Mr. Bernanke and others, having become part of the administration's economic team, about the entitlement obligations of this country into the future. And we understand those concerns and we share those concerns, but just as a matter of background, since you weren't here, what happened before you came, let me bring you up to where we have been over the last six years.

Six years ago, as the economists at OMB looked out over the next 10 years they foresaw nothing but surpluses coming up, $5.6 trillion in all. We had a tentative understanding in both houses and both parties of Congress that as we got to this point, with unprecedented surpluses, we would make unprecedented use of the surplus we had in Social Security. We would forswear ever borrowing against that surplus and spending it.

Instead, what we wanted to do was to take the surplus in Social Security and use it to buy down outstanding debt, reduce the debt owed by the Treasury to the public so that over time we would add to net national savings, lower the costs of capital, and by 2020 or so, when Social Security went cash-negative, the Treasury would be in better shape than ever, with less debt otherwise to pay the public, would therefore be better situated to meet its obligations under Social Security and for that matter, Medicare, too. The idea that I am talking about had a corny name, "black box," but had a serious substantive core to it. And that was the core idea of reducing the publicly-held debt.

We implore President Bush to embrace this idea, adhere to this idea in the budgets he sent us, and not to continue borrowing and spending the Social Security surplus. I have made the response to the President, for example, on his Saturday morning address the weekend after he sent his budget up here. That was 2001. I said, Mr. President, it may seem like we are sitting on an island of surpluses, but we are surrounded by a sea of debt, long-term debt. And at least part of the largess that we find, the $5.6 trillion in surpluses ought to be used to retire some of that long-term debt so we can make assuredly solvent the obligations of Social Security and Medicare well into the future.

The Bush administration took a different path, one occurred mainly by substantial, some would say massive tax cuts, $1.7 trillion in all, over a period of 10 years. Well, it turned out that the 10-year surplus of the $5.6 trillion was overstated by as much as 25, 35 percent. When other factors began to take a toll; recession, terrorism and other things began to take their toll on the budget, the Bush administration did not make any kind of mid-course correction. They went full speed ahead. And as a consequence we have seen debt accumulations on a scale that has not been experienced since the Second World War. If I could have chart number eight, I think it is, Chris.



This is just a simple back-of-the-envelope way of looking at the debt accumulation over the last six years. When President Bush came to office we had outstanding debt, subject to limit, total statutory debt of a $5.7 trillion. That debt today, six years later, is $3 trillion greater, nearly 60 percent greater. The debt that will be incurred under this budget, in the remaining two years of the Bush administration, is indicated by the home budget deficit, which is about $450 billion in each of the four coming years. Even if your budget submitted today is adopted, that means we will add about $4 trillion in debt during the course of this administration, as compared to or contrasted with $5.7 trillion outstanding at the time the Bush administration took office.

That is a concern to all of us and I am sure it is to you. And the ways to mitigate it by saying, "Well, we have to look at it as it pertains to GDP"; one way to look at it is by looking at what it has done to debt service, because of all the entitlements of all the mandatory spending items in the budget, this one is truly obligatory. The others can be manipulated, with great political expense. But debt owed, the interest that has to be paid to service the debt, is substantial and it is crowding out the resources that we might otherwise use for reform of Medicare and Social Security.

So that is where we are. And the budget we receive today we hope might be at least a first step towards a change in course, but we have been through this budget and you will forgive our skepticism, but we think the revenues are overstated, and we think the spending is understated, and therefore we think the goal, a balanced budget in 2012, is doubtful at best.

Here are the major concerns we have: this budget assumes that the alternative minimum tax will remain in full force and effect from 2008 on, through most of the forecast period, for most of the time frame of this particular budget. The AMT will be there collecting money like a vacuum cleaner. CBO says over a 10-year period of time, the AMT, Alternative Minimum Tax, if not adjusted, if not indexed to inflation, will collect $1,041,000,000,000 more than the regular tax system would collect.

In addition, we find as we look through the budget that everywhere that an assumption is made about economic conditions, OMB is a bit more optimistic than CBO as a consequence. When you accumulate all those differences, carry them out over time, the difference in the year 2012, the target year, is $608 billion in GDP and about $155 billion in revenues. That means that the $61 billion surplus that you are forecasting for that year, if it were derived by using CBO numbers would instead be $94 billion deficit. So these are the reasons we are concerned.

4

Statutory Debt	
Debt When Bush Took Office	$5.7 Trillion
Debt Today	$8.7 Trillion
Debt Added So Far	$3.0 Trillion
Debt Projected At The End of Bush Presidency	$9.5 Trillion
Total Bush Increases To The Debt	**$3.9 Trillion**

Deficits Without Social Security Surplus	
On-Budget Deficit, 2007	$427 Billion
On-Budget Deficit, 2008	$451 Billion

Cost of Debt Service	
Net Interest, 2002	$171 Billion
Net Interest, 2008	$261 Billion

HBC

2/5/2007

Let me show you our next chart. This is where we plot the likely course of this budget. Assuming that something is done to neutralize the effect of the AMT, so that it is not paid by middle income taxpayers for whom it was never intended, and assuming that war costs continue after 2009, your budget has a placeholder of $50 billion after providing a supplement of $170 billion and a supplemental of $140 billion, it drops off precipitously to $50 billion, without any real information as to why. It has been described as a placeholder, or a plug. And that in 2010, 2011, and 2012 there's no provision made for the incremental costs of deployment in Iraq, the Persian Gulf, or Afghanistan, or North American air defense. There is nothing incremental in there, and that is hard for us to believe. Would that it were so. I hope it happens, but I don't think it is realistic forecasting to drop it out.

When we adjust your numbers for two things, an assumption that the AMT will be neutralized one way or another, will not collect that trillion dollars in additional revenues; and an assumption that war costs will continue at a declining, diminishing rate per the CBO's model which assumes that they will drop off, the number deployed will decline to 75,000 in the year 2013 in those two theaters; the divergence in curves is dramatic. You can see it here. Instead of moving the balance in 2012, the budget is in deficit by $145 billion, and over the next five to six years, it goes deeper into deficit such that at the end of the time frame it is $460 billion in debt.

This is a matter of major concern to us because we do not believe the budget achieves its tagline which we heard repeatedly yesterday; namely, we balance the budget but don't raise taxes. The AMT does raise taxes by a substantial amount. And if you factor in the AMT and war costs, you don't achieve balance, it seems to us. If you disagree, we would love to hear your construction of what you think the likely events are going to be.

We are concerned too about some of the cuts you made. Let me give you one for example. It is a small cut that accumulates to a big factor, education and job training, function 500 of our budget. You will be up there with the President in just a few weeks asking for an extension of fast-track trade negotiating authority. We think one complement to fast-track negotiating authority is to have in place a robust job retraining program, educational program, so that we will have a workforce that is proficient, sharp, well-educated, competitive with anywhere in the world. In other words, we believe we have got to make those human capital investments to achieve that goal if we are going to have a global free-trade economy.

We do not see that commitment to investing in human capital. The function that deals with education and job training is cut by nearly $4 billion next year and by more in the out years, $4 billion. Education, the Department of Education is cut by $1.5 billion. You can say that is not a lot, but there are lots of us believe that one way to make our entitlements more affordable is to make our workforce, our people more productive. And we don't see that thrust in this budget, and we have a great concern that this budget is going to accumulate more debt and not achieve the other answer we think the budget should be striving for.

So we have got a common problem in front of us. We have got problems like cost of entitlements well into the future that only we working together can settle. The difficulty of resolving them is such that unless we sit down at a table, put everything on the table, bring everything to the table, we will never work the problems out. we can make nickel-and-dime changes to Medicare, as I think you are doing here, but we will not really resolve the problem until we work together.

Unfortunately I don't see this budget that is submitted today as kind of a common ground. We are starting at a long way apart, but we are still committed to working together with you to achieve the goal we all seek and want, that is a balanced budget as soon as possible, where we begin saving instead of dis-saving, and we begin making the investments in human capital that we think are necessary as a complement to our economic policy.

Thank you for coming here today. We look forward to your answers, your testimony. But before we do that, I want to turn to Mr. Ryan for a statement on his part.

Mr. RYAN. I thank the Chairman for yielding. And I want to welcome the Treasury Secretary. This debate we are going to have about the budget is a good debate, it is going to be a healthy debate. It is going to be about how we balance the budget. I think both sides are going to agree the need to balance the budget. Then the question then comes down to how we balance the budget. The administration has made a proposal to balance the budget without raising taxes by controlling spending. That means this is going to be a big dialogue about taxes. And I think it is important as we move forward in this dialogue to let us just look at what the tax cuts did, what are the tax cuts, where are we with respect to these tax cuts? And I am going to go through a few charts and talk about this, and how it relates to spending.

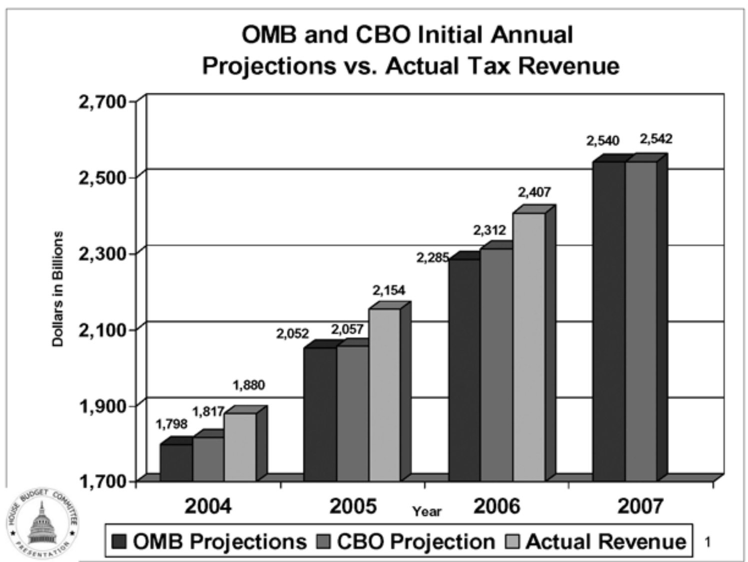
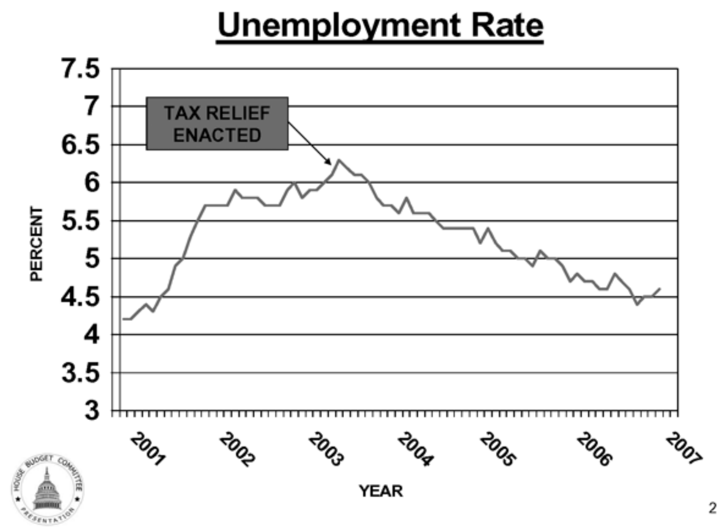


Chart number one, which you see here, this simply shows you the difference in projections. And we are going to hear a lot about differences in projections between OMB and between CBO, how OMB has a slightly higher revenue projection than CBO. If you look at that last three years, the blue line is OMB projections; the red line is CBO projections; the green line is what actually occurred. Both CBO and OMB have underestimated the revenues that have come into the Federal Treasury. We will only know what happens in 2007 after we go through 2007, but the point is that both of these estimating agencies have under-scored what revenues actually come in. Go to chart two, please.

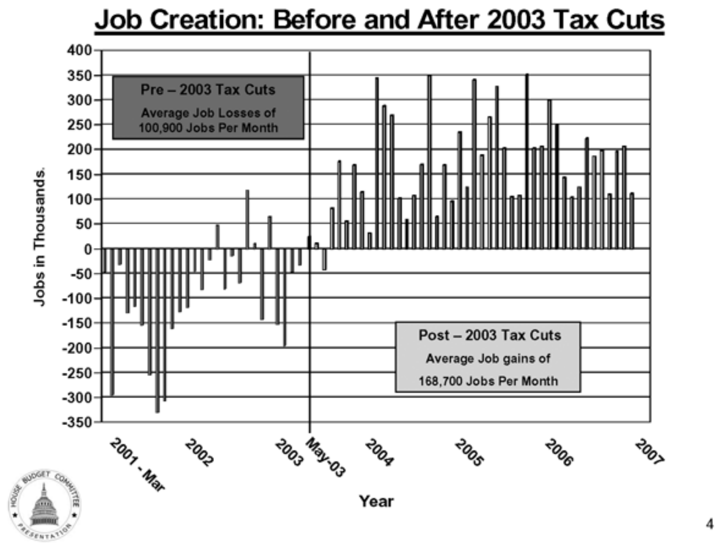


Now let us take a look at what these tax cuts actually achieve. What good are these tax cuts? Why are these tax cuts important?

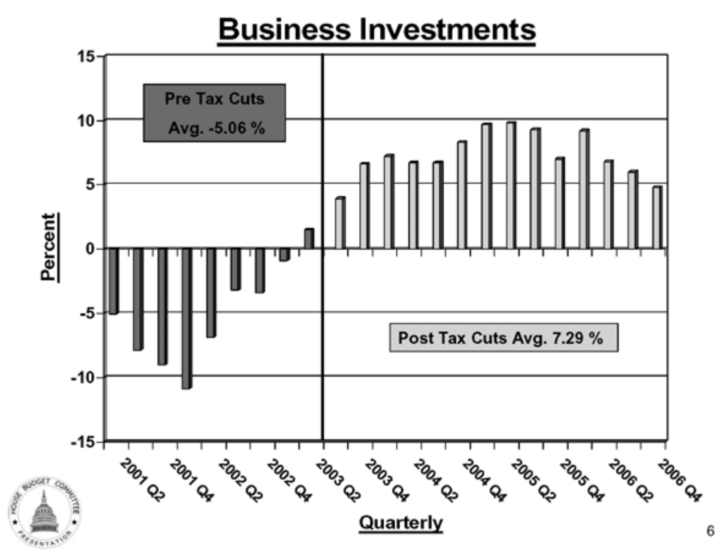
When the tax cuts occurred, we had high unemployment and when you take a look at the so-called surpluses that the administration inherited when they came into power in 2007, let us remember that there were some actualized surpluses that actually came in. What happened? Congress and the White House paid down $600 billion in debt, gave people back some of their money.

The rest of the surpluses were projections. Those projections did not anticipate or foresee four things happening in the next year that actually happened. They did not foresee the 9/11 attack. They did not foresee the dot-com bubble coming. They did not foresee the recession that happened. They did not foresee the Enron scandals that happened, that crashed our markets and reduced our revenues.

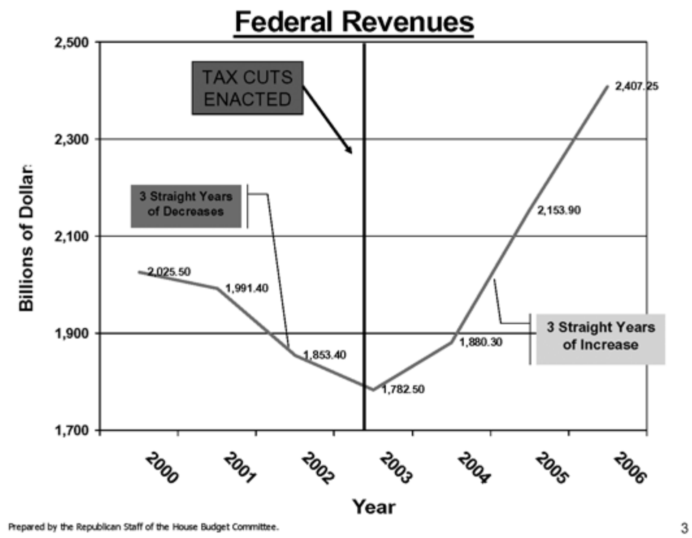
And so you had an economic perfect storm which was not projected and therefore those projected surpluses turned into actual deficits. But when those tax cuts kicked in and when those tax cuts happened, you can see the peak of unemployment at about 6.3 percent. Unemployment moved down precipitously. Go to the next chart, please.



When you take a look at the tax cuts, before and after tax cuts, look at job creation. We were losing about 100,000 jobs a month before the tax cuts. After the tax cuts we had record job growth to the point where we have now 7.4 million jobs created since those tax cuts. Next chart, please.



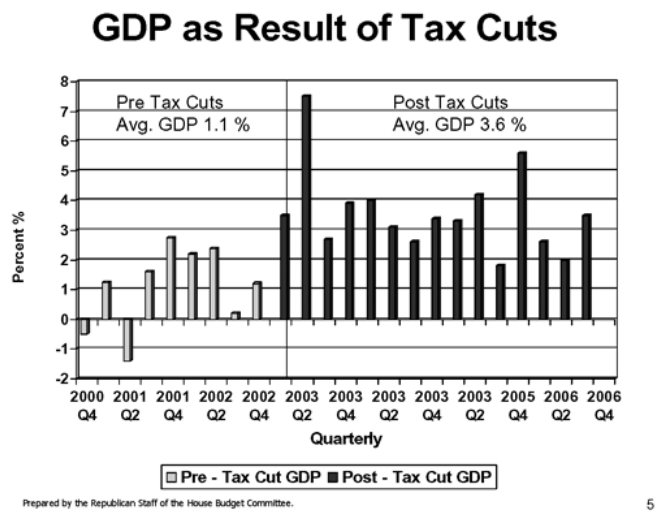
Take a look at business investment. Business investment in the prior 10 quarters before the tax cuts shrunk on average 5.9 percent a quarter. Business investment after the tax cuts grew on average 6.9 percent a quarter. Next chart please.



Revenues. Now this is the real untold story. When we cut these taxes—I served on the Ways and Means Committee, was one of the authors of these 2001, 2003 tax cuts. We really believed, because all of our estimators at CBO, at joint tax, at OMB, at Treasury were telling us: "you cut taxes it may help the economy, it may produce jobs, to get us out of the recession, but it is going to drive us deeper into deficit. It is going to cost us revenues." That is what all the estimators told us.

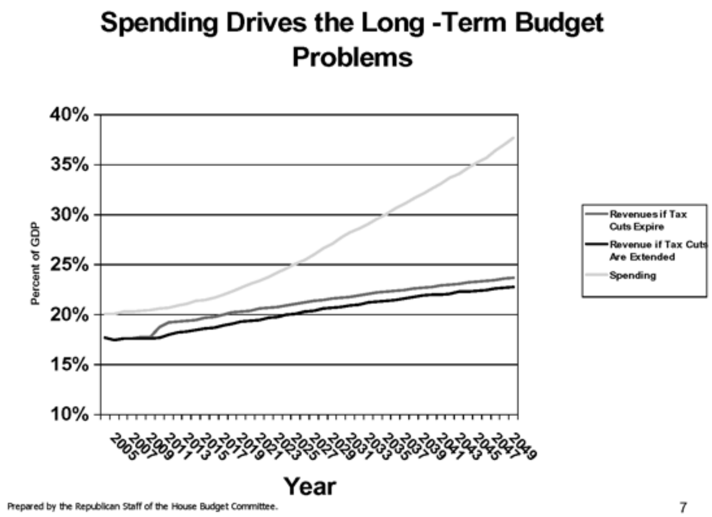
Well, let us take a look at what happened to federal revenues after we cut tax rates. We cut tax rates on incomes across the board. We doubled the child tax cut. We get rid of the marriage penalty. We repealed or put on a glad path to repeal the death tax. We reduced capital gains taxes. We reduced income taxes. We increased expensing for small business for three years.

Look what happened after all those tax rate were lowered. Tax revenues boomed. Tax revenues did not go down. The deficit did not go up. Tax revenues went up. Look at the next chart.



What did it do to the economy? What did these tax cuts do to GDP growth and employment? Look at the GDP growth before the tax cuts. Look at all those quarters going from 2000 to 2003. GDP growth averaged 1.1 percent. From the tax cuts on, GDP growth has averaged 3.6 percent.

And I want to conclude with this. You can go to the next chart please.



As we have heard from nearly every witness who has come before this Committee in the past few weeks, our biggest budgetary challenge is on the spending side, our massive entitlements programs are simply growing too fast to be sustained.

Take a look at this chart. This chart shows you that if we keep the tax cuts permanent, which is the black line, the bottom line, throughout our baseline period, that is where revenues ought to be as measured by CBO. If we get rid of those tax cuts and allow those tax cuts to expire, that is the red line, the red line as scored by CBO. Not a lot of daylight in between the two of those. But if we do nothing about spending, if we do nothing about entitlements, that is the green line.

So even if we get rid of all these tax cuts, which produced all those excellent economic growths; 7.4 million new jobs, higher business investment, better international competitiveness in the global marketplace; if we get rid of all those tax cuts, we still have this spending problem. Without reform by the year 2040, when my kids will be exactly my age, Social Security, Medicare, and Medicaid will consume 20 percent of our economy. That is equivalent to the cost of the entire federal government today. In fact, even if we raise taxes to balance the budget in the short term, as you can see, we will go right back into deficits.

So with retirement of the baby boom generation, the situation will just keep getting worse, even if we raise all these taxes. So the question is, are we going to balance the budget at a higher level of spending and a higher level of taxes today, which would we know we will have much more spending in the future because of these entitlements? Or do we want to balance the budget at a lower level of spending rather than a higher level of taxes and spending, so we would be in better positions going into the future?

The question comes down to this. We have two fiscal challenges. We have got this out-of-control spending with these entitlements that we have to, on a bipartisan basis, come together to figure out how to fix these problems, how to fix these programs. We also have globalization. We also have incredible pressures, incredible economic challenges unlike any we have seen before, from countries like China, from countries like India, that we have to be prepared for. We can no longer take for granted that we are the leading economic power in the world.

And so if we simply say we will meet the challenge of these entitlements by just raising taxes, we will lose our economic standing in the world and our children will not have the standards of living that we now enjoy, let alone being better than what we have right now.

So it all points to spending. Do we want to balance the budget by controlling spending? or do we want to balance the budget by raising taxes? Because even if we balance the budget, that way or the other way, we are going to go right back into deficits if we don't fix these entitlement programs.

This is the context in which this debate will occur. I want to welcome the Treasury Secretary for coming with us today, and I hope that his perspective adds a little bit to this debate. Thank you.

Chairman SPRATT. Mr. Secretary, welcome again, and let me say that your statement can be entered in the record. You can summarize it as you please, and you can go beyond it. The floor is yours, and we welcome you, and we look forward to your testimony.

STATEMENT OF HON. HENRY M. PAULSON, JR., SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary PAULSON. Well, thank you very much, Mr. Chairman. Let me begin by saying I too remember fondly those days 32 years ago in the Pentagon. And then we both had more hair. It was my first job——

Chairman SPRATT. And I had less girth. [Laughter.]

Secretary PAULSON. Me too. And it was my first real job. And I got some great mentorship from you. And I very much look forward to working with you over the next couple of years.

Let me go a bit beyond my statement, and I will shorten it a bit, because I did it twice yesterday and you've got a copy of it in the record. But I am very pleased to be here to give you an overview of the budget.

We do start from a position of strength. Our economy appears to be transitioning from a period of above-trend growth to a more sustained level of about 3 percent growth, and as Congressman Ryan mentioned, more than 7.4 million jobs have been created since August of 2003. Our unemployment rate is low at 4.6 percent, and as something that is very important to me, over the last 12 months real wages have increased at 1.7 percent. So we are seeing these gains begin to translate themselves into higher income for the average worker.

Strong economic growth is also benefiting the government's fiscal position. In the first quarter of fiscal 2007 budget receipts totaled $574 billion, an increase of 8 percent over the same period in fiscal 2006. You know, as a result of the revenue, increased revenue over the last two years, we have brought the federal budget deficit down to 1.8 percent of GDP.

Now, the President's budget really reflects key priorities: continued job growth, wage growth, economic expansion, energy security, the importance of healthcare, and having a strong economy, which is going to let us take on entitlement reform. As Congressman Ryan mentioned, the budget also emphasizes fiscal debt discipline.

I would like to say a word or two about the healthcare proposal. Under the current law the tax subsidy of health insurance purchased through employers will average more than $300 billion a year for the next 10 years. That is the largest tax expense that we have. And for that huge expenditure, we have got a system in which rising costs are a burden to families and businesses, and which millions of people have no insurance at all. The President's proposal would make healthcare more affordable and more accessible. It will give all taxpayers who buy health insurance, whether on their own or through their employer, and no matter what the cost of the plan, the same standard deduction for health insurance: $15,000 for a family, $7,500 for an individual.

The President's proposal will help hold down healthcare costs by removing the current tax bias that encourages overspending. Costs would become clearer, giving patients more power to make informed choices about their healthcare spending. The proposal would also help jumpstart individual insurance markets, so consumers have more choices than are available today. Healthcare would be more consumer-driven, more affordable, and more accessible for millions of Americans.

Energy security is another concern of the American people, and it is a priority that is addressed in the President's budget. President Bush has put forth an ambitious goal of reducing America's projected gasoline consumption by 20 percent over the next 10 years. We can achieve this goal by dramatically increasing the supply and use of alternative fuels, and improving fuel efficiency by reforming and increasing CAFE. The expanded fuel standard will provide entrepreneurs and investors a guaranteed demand for alternative fuels, which will accelerate private investment and technological development. Reforming CAFE will allow us to increase the fuel economy of our automobiles as fast as technology allows. With a more diverse fuel supply and a better fuel efficiency we can make our economy less vulnerable to supply disruptions, and confront climate change through technologies that reduce carbon dioxide emissions.

Now, I will submit the rest of my statement for the record. And Mr. Chairman, just to respond a bit to what you said: we can talk about the differences in revenue projections and I would be perfectly happy to discuss that. We put forward what I believe are some reasonable estimates, you know, very similar to the Blue Chip consensus. CBO has got a different estimate, as you mention, that they—one results in 155 billion less in revenues. The biggest difference in those projections really have to do with the inflation rate. When you look at the numbers, that is the most of it. And we are assuming 2.2. I think they are at 1.8. CBO is 2.1. I have been in the business world and in financial markets long enough to know that no one has got a crystal ball. Both of these estimates are within the realm of reason, they are both reasonable estimates. We think ours is a reasonable estimate. But what they both show to me is the importance of keeping the economy growing, and how dependent, you know, what a big driver of the budget, resolution of the budget issue, the economy is. And growth is very, very important, and these assumptions are important. But really, what is important is to keep this economy growing and thriving.

I also will welcome the discussion of AMT. I am sure we will get questions on that. You know, I am looking for ways to bridge the gaps, and you mentioned at the end, we have got differences on the budget, we have got the same goal. And that same goal is dealing with these longer-term issues that are going to be staring us in the face very soon, of entitlement reform. And I do believe we wouldn't be too concerned about the fiscal deficit we have right today, if it weren't for the big problem staring us in the face.

A deficit of 1.8 percent GDP or, you know, I notice with all of your assumptions you said—you took a look at the administration's proposals and you thought that there would be a deficit of 145 billion. That would be eight tenths of a percent of GDP. I think we can balance the budget, and it is important we work toward balancing the budget, and that is a very important goal for both parties, and I think we can be successful in doing that. And we have provided a budget that will help us do that, but even if your forecast was right we still had a deficit of $145 billion. That is eight tenths of a percent of the GDP, and again, the major issue we have to deal with is a big one; entitlement reform, and I know you agree with that.

And so in any event, that is my statement and I stand ready to take your questions. And again, thank you very much for your gracious introduction, Mr. Chairman.

[The statement of Henry M. Paulson follows:]

PREPARED STATEMENT OF HON. HENRY M. PAULSON, JR., SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Chairman Spratt, Ranking Member Ryan, Members of the Committee: I am pleased to be here today to provide an overview of the President's budget for fiscal year 2008. As the Secretary of the Treasury, my top priority is keeping America's economy strong for our workers, our families, and our businesses. And the President's budget supports that goal.

We start from a position of strength. Our economy appears to be transitioning from a period of above-trend growth to a more sustainable level of about three percent growth. More than 7.4 million jobs have been created since August 2003. Our unemployment rate is low at 4.6 percent. And over the last 12 months, real wages have increased 1.7 percent. Economic growth is finding its way into workers' paychecks as a result of low inflation. That means family budgets are going further.

Strong economic growth also benefits the government's fiscal position. In the first quarter of fiscal year 2007, budget receipts totaled $574 billion, an increase of 8 percent over the same period in fiscal year 2006. As a result of increased revenue over the last two years, we have brought the federal budget deficit down to 1.8 percent of GDP.

The President has submitted a budget that reflects our strong economy and our nation's priorities: continued job creation and wage growth, vigorous prosecution of the war on terror, increased access to affordable health insurance, improved energy security, and a strong fiscal position from which we can address long-term challenges such as strengthening Social Security and Medicare for future generations.

This budget supports a strong economy by maintaining fiscal discipline. It maintains our current tax policy, which has helped our economy rebound from recession to its current robust health. With a steadily growing economy, tax revenues combined with fiscal discipline should bring the federal budget into balance in five years. In fact, we are submitting a budget that includes a surplus in 2012, which is achievable if we keep our economy growing. While no one has a crystal ball, our economic assumptions are close to the consensus of professional forecasters.

The President's budget addresses important domestic priorities. Health care is high on this list. Under current law, the tax subsidy for health insurance purchased through employers will average more than $300 billion a year for the next ten years. For that huge expenditure we get a system in which rising costs are a burden to families and businesses, and in which millions of people have no insurance at all.

The President's proposal would make health care more affordable and more accessible. It would give all taxpayers who buy health insurance, whether on their own or through their employer, and no matter the cost of the plan, the same standard tax deduction for health insurance—$15,000 for a family, or $7,500 for an individual. The President's proposal would help hold down health care costs by removing the current tax bias that encourages over-spending. Costs would become clearer, giving patients more power to make informed choices about their health care spending. The proposal would also jumpstart the individual insurance market, so consumers have more choices than are available today. Health care would become more consumer-driven, more affordable, and more accessible for millions of Americans.

Energy security is another concern of the American people, and it is a priority addressed in the President's budget. President Bush has put forth an ambitious goal of reducing America's projected gasoline consumption by 20 percent over the next 10 years. We can achieve this goal by dramatically increasing the supply and use of alternative fuels, and improving fuel-efficiency by reforming and increasing CAFE.

The expanded fuels standard will provide entrepreneurs and investors a guaranteed demand for alternative fuels, which will accelerate private investment and technological development. Reforming CAFE will allow us to increase the fuel economy of our automobiles as fast as technology allows. With a more diverse fuel supply and better fuel efficiency, we can make our economy less vulnerable to supply disruptions and confront climate change through technologies that reduce carbon dioxide emissions.

Finally, the President's budget, by emphasizing fiscal discipline and economic growth, lays the right foundation for dealing with entitlement reform—a challenge we all have a responsibility to address. Strengthening Social Security and Medicare is the most important step we can take to ensure the retirement security of our children and grandchildren, the long-term stability of the federal budget, and the continued growth of the American economy. I look forward to sitting down with Democrats and Republicans, without pre-conditions, and finding common ground on these critical issues.

Mr. Chairman, the President's budget priorities—a strong economy, national security, fiscal discipline, health care and energy innovation, and laying the groundwork for entitlement reform—are the right priorities for America and for the workers, businesses, and investors who drive our economy.

I am confident that, working together, we will keep our economy strong and chart a course for maintaining our global economic leadership in the years ahead.

Thank you for the opportunity to discuss this today—and I now welcome your questions.

Chairman SPRATT. Thank you, Mr. Secretary. What struck us in comparing OMB's economic forecast, its baseline forecast, with CBO, was that with every indicia, OMB had chosen a slightly better number than CBO had used. Granted they were different, they were seemingly small differences like two and three tenths of a percentage point, but cumulatively, over time they amount to a substantial impact on the bottom line of the budget. That was our concern. When you put them all together, the impact as I said was $155 billion in the target year, versus a surplus of $61 billion to a deficit of $94 billion, which is a big swing. Maybe small changes, interest rates, job growth, inflation, each of these. But nevertheless, the net effect, cumulatively, over time, is significant and that gives us a little concern about the validity of the bottom-line number.

The administration's tagline yesterday, which came across repeatedly in the testimony and in the questions put to Mr. Portman is that "we are balancing the budget without raising taxes." But when we unpacked this budget that was sent to us two days ago to see what the underlying assumptions were, we found that to our surprise it was assumed that the AMT would go into full force and effect after 2007. The patch that we would put into place would not be renewed, and it would collect taxes to the tune of a $1,041,000,000,000 more than would otherwise be collected under the regular tax code.

Isn't that an increase in taxes, moving you towards the goal of a balanced budget in 2112? And a big increase of $1 trillion?

Secretary PAULSON. Let me address that, but let me—coming back, just one other comment on the projection.

Chairman SPRATT. Sure.

Secretary PAULSON. Because you look at the projection, there's two aspects to it. The biggest piece of it has to do with the inflation rate. And there's another piece that has to do with differing assumptions as to how long the baby boomers will work. And you know, again, our estimate is very comparable to many private-sector estimates. But you know, who knows? No one has got a crystal ball. I think the message there is to keep the economy growing. I would say the area that I just call your attention to was the rate in which the tax receipts are coming in. And I think people were surprised—I wasn't here a number of years ago, when they came in at 14.6 percent. And then in 2006 up 11.8. You know, the last quarter, the first fiscal quarter of 2007, they came in at up a little bit over 8 percent.

And we were assuming 5.4 percent growth over this budget window. In the last 20 years they have grown at 6 percent. So there may be some room for some optimism there, on that part of it.

Now in terms of your comment about the AMT—I am sure Rob explained that yesterday, but let me explain what we did. I think we were very transparent about this. We agree, I believe this is the way you feel and other members of the Committee feel, that the AMT would be, if it went into effect, would be an unintended tax. It would be a cruel tax. It would hit the middle-class hard. It would surprise a number of people who wouldn't even see it coming.

What Congress has done, what the administration has done over the last six years is patch it for one year. And what we have done is just, what we have proposed is an additional—which is in the budget—one year of AMT tax relief, and then the assumption is that we are going to work together and we are going to work on a bipartisan basis to solve this problem. And I am not saying it is easy, it is a tough one.

Chairman SPRATT. We had other witnesses from your administration going back two, three years who said that it can be done within the context of the tax code in a revenue-neutral manner. In other words, you can go to deductions and credits and preferences and what have you, and change these, to raise enough revenues to neutralize the impact of the AMT. Could you give us some idea of what these deductions and credits and exceptions might be?

Secretary PAULSON. Well, first of all in terms of fundamental tax reform, maybe we will get to do that over the next two years. As you probably noticed, our priorities, you know, you can see in the budget, which is entitlement reform, healthcare, you know, the incremental tax changes, I think that the one regarding health insurance is a very important and big incremental change.

So we don't have a fundamental tax reform proposal we are coming here with. And so all I would say to you is that this is something that we will need to work on together, and to solve the problem.

Chairman SPRATT. But in the meantime, without even having a solution proposed you are assuming there will be a solution, we will come together on some kind of a solution. It is a big one particularly for an administration which has an aversion to tax increases. You will have to increase some taxes in order to offset the otherwise tax impact of the AMT.

Secretary PAULSON. I am not assuming a tax increase, okay? When I look—and I know that we have differences with some people up here on that, but when I take a look at the way this economy is growing right now, and the way revenues are flowing in, I want to keep this expansion growing. I just see working with the budget numbers has just convinced me how sensitive all these numbers are to growth of the economy.

And so I think continued fiscal discipline and keeping the economy growing are what is baked into our proposal. And again, all of it underpinning, saying if we have a strong economy and a fiscal position which is strengthening, this puts us in a good position to look at some of the bigger structural issues which are the entitlement programs.

Chairman SPRATT. Well, I would agree with you about the differences between CBO and OMB being within a band of reason. The only problem we had was it seemed like Treasury OMB were cherry-picking in each instance, each indicia, you were picking a somewhat higher ranking, as opposed to lower range. And I have great respect for your professionals over there. I think they do good work over there and I am glad we have got them. This is just an impression we had.

But it seems to me we start off with higher growth in revenues based upon the economic forecasting conditions that you assume, and now we are adding another level to that higher growth in revenues based on the sort of visceral expectation that things are good and you expect them to be even better than what you projected here. And you use or dedicate those revenues somehow to the repeal—the revision of the AMT.

Secretary PAULSON. Yeah. I am not projecting revenues to be better than we have here. Our projection is a projection. It is an inexact science. I don't think there is cherry-picking done. It was very close to the Blue Chip consensus forecast. But again it is hard to know. We don't know with certainty what is going to happen next quarter, let alone four, five years from now. So all we can do is make the best revenue projection we can. And again, what they illustrate to me, when I looked at them, is just the importance of how sensitive this fiscal situation is to a growing economy where we have got revenues coming in at the rate they are. That is key to the whole thing.

Now, I can't—both, as you said, are within a realm of reasonableness. And again, which interested me was——

Chairman SPRATT. But if it is not going to be this additional spurt of revenues over and above what you have already assumed, how do you replace the $1,041,000,000,000 in revenues that AMT will collect if it is unadjusted and not indexed? How do you replace those revenues elsewhere within the tax code without raising taxes?

Secretary PAULSON. I would say I even have a higher number, because I am looking at them relative to the policy baseline. So I have even got more with the——

Chairman SPRATT. What is your number?

Secretary PAULSON. It is 1.2. But looking at it over the period which we are looking at it, it is a tough issue, and I have got no answer other than that. It is one we have got to work on together, and I think we can do it, you know, and——

Chairman SPRATT. But it would mean repealing, trimming, revising some deductions, credits, exceptions, maybe raising rates or something like that, would it not? Otherwise how do you coax more revenues out of the code?

Secretary PAULSON. I have got to tell you I am not talking about coaxing more revenues out of the code, okay? And so we need to do this together. I would say to you that there are enough moving pieces that I would be hopeful that we could work together and achieve a balanced budget in 2012, and I would say even your projections which we don't agree with, you know, what I look at as a tough case, shows a strong fiscal situation in the short term. And again, what we really need to do, I think, is to focus on some of the longer-term structural issues.

Chairman SPRATT. Well, this is a common problem. The AMT is one of many we have got. It is a big one.

Secretary PAULSON. Yeah.

Chairman SPRATT. A trillion-two, by your calculation, over the next 10 years. And we have got to work together to resolve that. We don't have a rabbit to pull out of a hat, either, but we look to Treasury for its expertise to come forward with proposed solutions. It has got to start with you.

Secretary PAULSON. Well, I sure look forward to working with you on this, and I would say you are going to be strong partners, including, you know, my friends at the Senate Finance Committee, and the House Ways and Means. Because, you know, we will have to do this together.

Chairman SPRATT. We will be looking to you for the ideas to get this negotiation rolling. Thank you very much for your testimony, and now, Mr. Ryan.

Mr. RYAN. Thank you, Chairman.

We are going to have a long talk about revenues, I think this year, first half of this year, and projections. First of all, I think it is great that both CBO and OMB are basically showing us very low inflation in the future. That is good. That is good, basic fundamental.

Secretary PAULSON. A high-class problem. Would we be so lucky, right?

Mr. RYAN. Yeah, exactly. I mean, it is a luxurious problem we have. So that is a good thing.

A couple points, and then I want to ask you questions. Number one, we are going to look at different parts of this tax package of the 2001, 2003 tax cuts. And I think there are those who just believe that there is really no effect on the economy if we just raise taxes, there is no effect on personal behavior, or decision-making or on capital markets, if we just raise tax rates, and that at will only get more revenues with no other adverse consequences.

That is the way, that is the lens that we look at these things through. Just take a look at capital gains taxes. According to the Joint Committee on Taxation, when we wrote this bill in 2003, they were telling us that over the following three areas, you know, 2003, 2004, through 2006, that we would lose $5.4 billion. Instead of losing $5.4 billion in capital gains taxes over that period, we gained $133 billion over that period. Similarly, the CBO forecast a loss of revenue, and actually their forecasts were off 68 percent on capital gains, because what we realized is if we taxed capital formation less, we got more capital formation, we got more realizations, we get more tax revenue. Higher revenues.

So when we go through this debate about just raising taxes on this program or raising taxes on this class of assets, or these investors, or these workers, it is very important to note that reality and history has shown us over and over and over again that tax rates do have consequences, that we don't just bank the money and have no collateral damage in the economy. I think the underlying point that is being made here is the eye on the ball is to keep the economy growing. When our constituents are working, our constituents are paying taxes, they are collecting unemployment, and the fiscal situation is brighter.

So with respect to taxes, I think one of the things we are going to have a big debate about here is the so-called tax gap. And this is something that all of us are interested in. We are going to have some hearings in Ways and Means on this, I think. I know you probably testified on this yesterday with Finance. Can you get into the challenge of closing the tax gap? Can you basically define the tax gap for those of us who aren't really into this issue as well? We obviously want Americans to pay their taxes. We want them to comply with the law. We want for everybody to pay their fair share of taxes. We have very complex code. Some of it is innocent noncompliance because of confusion; some of it is people just cheating on their taxes. How do we get that money, how do we get at that, and what is the administration's proposal to address that? What is the score associated with that proposal? And what else would you have to do with respect to the IRS compliance and what kind of things would you have to do to our constituents basically to totally close this tax gap?

If you could discuss that I think it would be very enlightening because we are going to have a long talk about the tax gap as this year goes on.

Secretary PAULSON. Okay. Well, we had a conversation about that yesterday at the Senate Finance Committee. Let me just say first of all we need to begin by defining the tax gap. And I would define it as a difference between the taxes that are owed and the taxes that are paid, because every now and then you get proposals to close the tax gap which are really just changes in the law in terms of increasing taxes.

The next thing I would say is that the data we have is not as good as we would like. The last research that was done on it really goes back to 2001, and we will be doing more research on it under my direction.

Now we have all got to start by saying that this tax gap is worse than irritating to all the Americans that pay their full share of taxes, because those that don't pay their taxes create a burden, and a greater burden for the all those that do. And so it is something that is really worth focusing on and it is something that when I came here, you know, Chairman Baucus made such a big point to me about the importance of this that I spent a lot of time about it, working on it with Commissioner Everson at the IRS.

Now, we have a proposal which I think is a credible proposal, which has got 16 legislative proposals, which if enacted into law would for the most part require greater information reporting—and I will get to that in a minute—and we believe that that would would raise roughly $30 billion, 29 and a half billion dollars, over a 10-year period. We also have a full IRS budget with—you know, we are going to continue to invest in auditing and you know, the Commissioner has done a very good job of going after abusive tax shelters, and going after people that are underpaying their taxes. And we are going to continue to do that. There is an IT component. There is a service component to it, a research component, and so on.

But the point that I made, which I think you are looking for me to get to, is that when we have done the research, our research shows that the tax gap comes from under-reporting, underpayment, and non-filers. But by far the biggest part of the tax gap, just by far the biggest part, is under-reporting by individuals. And when you look at this, it is under-reporting of business income. And so, to a large extent these are schedule C filers. These are small businesses, farmers, and as you said, you don't know whether it is with malice aforethought, or whether they just don't understand what they need to do. But there is a big cash-based economy out there. And so when you look at closing that, you know, the conventional wisdom when I came down here was you simplify it. You simplify the tax code and you will close the tax gap. That I think is the best way to do it because you will get a portion of that. But actually what you need to do if you are going to go after these big dollars would be something I wouldn't recommend by and large, because I think it would be bad policy, and I don't think any of us would like it, which it be to make it more complicated, and would be requirements for more information. And so these would be the kinds of things——

Mr. RYAN. Like what?

Secretary PAULSON. I will give you four or five examples. One is just reporting, 1099s. If you are paying your plumber, you know, filling out a 1099, having him fill out a fill out a 1099 send it to the IRS. We could go through all kinds of examples that are very similar to that.

Then, another example is just to mandate that we use electronic payments, whether it is credit cards or electronic payments, and get the electronic receipts and send that to the IRS. A big one which was tried when I researched it, I think back when Dan Rostenkowski was running Ways and Means 25 years ago, he got the idea of withholding. And so this was withholding on capital gains and interest and you could do it on pension payments, you could do withholding on everything. And I think that was in force only for a short time, because members of Congress got many postcards and nasty telephone calls and letters. So that is another way.

But my point is not to say this is not important and we shouldn't go after it. My point is that we shouldn't look at this as a pot of gold that we are going to use to tap into to fund everything anyone wants to fund. We need to keep working on it, and the proposals put forward are very serious proposals that are not without controversy. There will be people that will not like the amount of reporting we are suggesting in a number of areas, but it is a way to make a dent and it.

So what I said to Chairman Baucus, if we can get—you know, he has got to hold some hearings and we are going to come forward with our proposals which we have, and we would like to get those enacted. And the other thing I would like to do is to demystify all of this, so that we are not looking at it as where we understand that we could have policies to go after all of these things. I think they would be bad policies in a number of cases, and I wouldn't recommend them. But at least we can have a discussion about which kinds of policies make sense, and how we could go after the tax gap.

Mr. RYAN. I want to get on because I know we have a lot of questions. I just simply want to bring up one more chart again, just to try and drive home a point, chart number seven.

And this just simply says, shows you, the black on this is all the percentage GDP. If we just keep tax cuts in place and grow revenues, we will still have revenue growth. We will still have more money coming in—even under these OMB or CBO. This is CBO, which has underestimated revenue growth lately, as has OMB. We will still have more money coming into the Treasury. If we let all the tax cuts go away, if we bring the marriage penalty back, cut the kids credit in half, bring the death tax back in full force, raise taxes on capital gains, raise taxes on dividends, and raise income tax rates up across the board, we do all that and let the AMT hit everybody unabetted; that is the red line.

The Green line is the spending line. This is the CBO baseline. And so the green line shows that spending is the problem. So even if we raise all the taxes that we have out there, expiring provisions, and don't fix AMT, we still have got to deal with spending. And so I simply want to encourage you because as the Treasury Secretary, you know, the tax code runs through you, a lot of entitlement programs run through you. We need to have a better tax code that is going to better position us for the global marketplace, be efficient in its collection of revenues, but if we don't begin to reform these entitlement programs, all of that is for naught and we'll go right back into deficit. And with that I yield.

Chairman SPRATT. Thank you, Mr. Ryan.

Mr. Edwards of Texas.

Mr. EDWARDS. Mr. Secretary, thank you for your distinguished lifetime of public service to our country. I respect that, and thank you for that.

My problem with this budget as well, as it has been presented by you and other administration officials, and listening to it being presented by my colleague, Mr. Ryan, is that with all due respect it sounds like more of the same. The same failed promise we have heard each year for the last six years; that we can have a major defense build-up—which I support—fight a war on terrorism, balance the budget, in spite of having massive tax cuts.

The problem is those promises haven't proven to be true despite the best of intentions. The reality is, just like in the 1980s when we tried to fund massive tax cuts, under the Reagan administration, we saw huge deficits. And the same thing is happening 20 years later now.

I think the problem is this. The administration comes in with a budget every year, says "we are going to be able to balance the budget in five years." and then the administration puts proposed spending cuts in that budget proposal that don't have a chance of a snowball in Hades of passing. Even under a Republican-led house. So I hear Mr. Ryan saying we have got to balance the budget by spending cuts. Well, for 12 years, Republicans passed partisan budgets through this very Committee. And guess what, they never had the courage—I think that Mr. Ryan and Mr. Hensarling, and others in this room might have, but they couldn't muster enough courage among Republicans in the House to pay for their tax cuts by cutting spending. So after all the deficit hawk speeches are finished and concluded, we get a lot of deficit dove votes on the floor of the House.

This is happening again this year. The administration's budget proposes an effective $1.9 billion tax increase on military retirees, men and women who served our country for 20-plus years, many of them in combat, and they are going to be asked to pay, for example, up to $1000 more a year for their healthcare premiums even though the same budget doesn't ask members of Congress, or members of the President's Cabinet, to make that kind of sacrifice.

So once again we are seeing a false promise, a well-intentioned but false promise. And at some point, as you would have in business, we would have to judge an administration or a party in the House of Representatives by their record, not by their other well-intentioned promises. And all the theories of Mr. Ryan that we can cut spending and balance the budget and pay for tax cuts and fight a war in Iraq just have not proven to be true. The result has been my nine- and 11-year-old sons are going to face a $3 trillion higher national debt, that they will have to pay interest on till they day.

Mr. RYAN. Will the gentleman yield for——

Mr. EDWARDS. Not right now.

So my question to you, Mr. Secretary, is what would you say to Republicans in the House who repeatedly vote for every single one of the administration's proposed tax cuts, but they refuse to vote for the spending cuts such as the cuts in military retiree healthcare the administration is proposing this year, to pay for those tax cuts? What would you say to those members of Congress?

Secretary PAULSON. Let me begin by responding to your overall point, which is again, I think we have all got the same goal, which is fiscal discipline. We have got the goal, as you talked about——

Mr. EDWARDS. If I could interrupt just a second.

Secretary PAULSON. Yeah.

Mr. EDWARDS. Since time is running short. I know we all have the same goal, fiscal discipline and balanced budgets. The problem is that if this Congress and the Republican leadership for the past 12 years were accused of wanting to balance the budget in a court of law, there wouldn't be enough evidence to convict them. We have had the largest deficits in American history. Please proceed.

Secretary PAULSON. Let me say this, because I will say I wasn't here two and three years ago, but I remember reading about the debates. And I remember reading where the President put forward a plan to cut the deficit in half. And I think there is a lot of skepticism down here, a lot of skepticism from Democrats. Frankly I wasn't that close to it, but I had skepticism from where I was sitting. And so I think one of the—and just take it, one of the pleasant surprises that we all have is what has happened to the fiscal situation—in the short term, granted, because we have the long-term problem of entitlements. But in the short term, I believe that with the constraint that has been shown in Congress—and there has been some constraint. Not as much as we would like—but with the constraint, coupled with the revenues coming in, there has been an improvement, and a marked improvement in our fiscal deficit.

Mr. EDWARDS. The deficit will be 240-something billion dollars this year proposed, and the largest deficit in American history, prior to this administration, was 292 billion. But with time being up, could you answer the question, what would you say to Republican House members that vote for the tax cuts, but don't vote for the proposed administration's budget cuts to pay for the tax cuts?

Secretary PAULSON. I would say to encourage them, I would encourage them to vote for the budget cuts to pay for them, obviously.

But I want to come back and again, I think it is—with an economy that is growing, growing, and growing, it is unfair to talk about deficits in absolute terms rather than as a percentage of the GDP. Just as someone who makes $100,000 can afford a bigger mortgage on a home than someone who makes $25,000 or $50,000. And I would say when you look at this deficit in the context of the size of this economy, it is—I would like it to be smaller, and the reason I really want it to be smaller is because of the big problem we see coming down the road.

Chairman SPRATT. Mr. Barrett of South Carolina.

Mr. BARRETT. Mr. Chairman, thank you, but in all due respect I would yield my time to some of the members that were here on time. So I will ask my question a little bit later. But it will yield 30 seconds to the Ranking Member.

Mr. RYAN. The member from Texas just mentioned—look, I just make a point to clarify. The case I made and the charts I used used aren't theories. They are facts, actual data that occurred. The last chart I used—I guess you could call it a theory. It was a projection into the future, but it wasn't a Republican projection of the future.

It was the Congressional Budget Office protection of the future that Peter Orszag, your nominee, produced for us.

So these weren't theories. These are facts and data of information that actually occurred, as the case——

Mr. EDWARDS. As is the $3 trillion national debt over the last six years.

Chairman SPRATT. Mr. Garrett of New Jersey.

Mr. GARRETT. Thank you. And we all can hear the phrase, "pay for tax cuts." Just remember, the flip side of that. Who pays for tax increases? And that is the American family. So the groundwork always seems to be laid on the other side so far, in the hearings that we have here, that we need to pay for the tax cuts. Just remember that at any time you talk about paying for tax increases it is going to be our constituents, our families, and our district who are going to be paying for that, every dollar coming out of their paycheck and sent down here to Washington.

That being said, Mr. Secretary, thank you. I appreciate your coming here today and it is commendable the way that you and this administration, the President have addressed the, I will say, the revenue side of the fiscal picture in this budget. You know, many naysayers have been declaring for years that the tax cuts just as we have heard right now, the 2000 and 2001, 2003 were unsustainable. And these same people have been saying that the only way to bring back the budget into balance would be to rescind them, which is a tax increase. But I believe and I think you would agree with me, Mr. Secretary, that such an action would negatively impact upon the American economy. And that this budget lays out a different, and in my opinion, better approach than that.

I would like to just quickly address two points, though. One is with the AMT, the alternative minimum tax, which I believe the Chairman has spoken about already, the alternative minimum tax. I might call it the alternative maximum tax, the way it impacts upon families and their budget. It hurts American families. I come from the fifth District in the State of New Jersey, the Northeast, which is an affluent State. It is a donor State. And my district in particular, because of high State and local taxes, while counted as a deduction against the normal tax code they are not counted, as you know, with regard to AMT. So in 2004, one out of every four tax returns in my district were subject to the AMT, raising taxes for these folks by over $4000. So I am just curious as to your thoughts, again, on AMT relief and specifically related to the whole aspect of a State and tax deduction, that was the first question.

And the second question, totally switching gears for you to something else that probably hasn't come up here so far, and that is GSE and GSE reform. This is an issue very important to me. I want to compliment yourself and the administration on a tougher tone that you have struck in pushing for a brighter or clearer distinction that is being considered in the primary mortgage market activities and secondary mortgage market activities.

That being said on a positive note, I am disappointed in what appears to be a softening, however, on your position on portfolio limitations, and what that may mean as far as risks, overall, to GSEs and risk to the economy as well. In addition to that, I know you are in negotiations right now with House leaders on the other side of the aisle attempting to find a compromise with regard to a housing fund in GSEs. This housing fund would drive the market of Fannie Mae and Freddie Mac as well.

We have seen this as being nothing more than a tax on middle-class America in the sense that they will pass these costs, whether it be before taxes or after taxes, to the people that use GSEs, use Fannie Mae and Freddie Mac. Ambassador Portman was here the other day and made the point that what we need to do is keep our taxes low, not raise any taxes, and I commend the administration for doing that. But in the defense of negotiations that are going on right now, we may be seeing that in one critical portion of our economy, the real estate and housing market, we may be seeing a tax increase looming, if we have these negotiations go down that road.

So if you could address those two points for me, with AMT and the State and local tax aspect on it, and more specifically on the GSE reform and where your negotiations may be headed?

Secretary PAULSON. Okay. Well well, thank you. First of all, on the AMT, I see it the way you do. This was an unintended tax, going back to 1984. And it just wasn't indexed, and so we have the problem we are in right now. That is why we have proposed the one-year relief, and what I have said, it is something we really need to work on and solve.

In terms of GSE reform, let me say you are right; we are in negotiations. I feel very strongly that we need a regulator that is independent, got more muscle, and a number of other changes. I also know people feel very strongly on both sides of this issue. I have never witnessed anything quite like this. It is the closest thing I have seen to a holy war. And all I can say to you is we will not satisfy people on both sides. I don't want the perfect to be the enemy of the good. And I think we can work something through where we get the things we need to protect against this—you know, there is real systemic risk, and I think we can get the things—I am hopeful that we can get the things we need, but I will just say to you there may be some people that think we should get more and they may just be disappointed.

Mr. GARRETT. Hopefully I am not disappointed, but thank you very much.

Secretary PAULSON. I hope you won't be, either.

Chairman SPRATT. Mr. Allen of Maine.

Mr. ALLEN. Mr. Secretary, thank you very much for being here. Just to begin, my friend Mr. Ryan, who's left for a moment, and I have a long-running debate in these chambers and I have to respond to something he said, and then to ask you a question. Mr. Ryan said that reality and history have shown us that tax rates do have consequences, and I agree with that, but I would point out that from 1960 to the present, there have been only five years when tax revenues to the federal government went down. In 1971, 1983, 2001, 2002, 2003, those years being really the anomalies in the last 45-plus years.

And I guess the point I would make is that in 40 years of tax increases and tax reductions where revenues almost always go up to the federal government, what some very distinguished economist sitting in your chair here earlier this year said. They said tax cuts could stimulate the economy, at least in the short term. They don't recover all the revenue that you lose. But they also said spending can stimulate the economy. And unfortunately, what we have been doing in the last six years, in my view, is we have been doing both. It is stimulation on steroids; vast increases in spending, and tax cuts larger than the economy could withstand.

My question is about healthcare. You mentioned it in your comments and I wanted to come back to it, particularly because it seems to me that from all of the work I have done in healthcare and all the different people that I have talked to about the cost drivers of the American system, I think they would say the rapid growth of medical technology is a primary cost driver, that the over-use of some drugs and procedures and tests is another cost driver, and that underlying it all is a very complex multiple insurance plan. It is a system that is far more complex than other developed countries in the world.

But in your statement you seem to say, well, it is the tax code again, that we are encouraging overspending and therefore if we simply change the tax code we will get a different result. What I am concerned about is this: It seems to me that if you push people away from employer-based healthcare plans, despite all the problems we have with those plans, into the individual market, you are basically going to push older and sicker people, or people who have some healthcare problem in the past, into a situation where they can't get healthcare, or they can't get it at an affordable rate. And in small States like mine, I don't believe the individual market could possibly provide enough choices with a very small risk pool to make any significant difference in cost.

And my question is, how do you deal with that critique of the administration's proposal?

Secretary PAULSON. Well, let me begin by saying I think you are absolutely right, if you are saying to me that the healthcare issues we face are significant, they are complex. It is hard to imagine any one proposal would be a solution. Social Security, we may disagree on what the right policy choices are, but I think they are pretty well-defined and the analytics are pretty good, and we could come together and forge a permanent solution rather quickly. Healthcare, there are going to be a number of intermediate incremental steps we are going to need to take.

So the way I look at the tax component is, just as the way I stated, it is the biggest preference in the tax system and so you've got to begin by saying this, we certainly can do better than. We can certainly do better than something that provides big benefits to those who get employer coverage, nothing to those who are uninsured, 17 million who are self-insured, and—and something that has got biases and distortions in the system, okay, where the bias is toward the more expensive coverage, which in essence is just prepaid health insurance for whatever, everything from glasses to cosmetic surgery or whatever on the high end.

So that what this is is a step, and it is a step in the right direction. And I just will say this. We have done a lot of work on this, and the idea of saying that this is going to lead to any kind of significant weakening of the employer-provided health insurance, I think is wrong. What the data shows is that most of the bigger companies, 200 or more employees, provide health insurance 97, 98 percent or something and they need to. That is very important to their employees, that is a way for them to differentiate themselves. The research also shows that there is a trend among smaller companies, which is to provide—fewer of them providing insurance over time. In 2000, 69 percent of the employers provided health insurance. In 2006, it was 60 percent.

So, what this proposal does is I think first of all, it removes biases, and it will give you greater access. There will be three to 5 million more people who will have insurance as a result of this. Affordability, portability—but we need to look at it as part of an overall plan. Secretary Leavitt will talk with you about his affordable choices and some of the things he wants to do to help build pools and make insurance more available at the State level.

And when you talk to people at the State level, the one thing they can't deal with, you know, they can do a lot of things but they can't deal with our tax code. So again, think about the tax code. You know, I welcome your ideas, welcome—there may be improvements, suggestions, but when you look at this proposal, and your people can find questions, imperfections—again, I said, you know, when talking about GSEs, let us not let the perfect be the enemy of the good. What we currently have in terms of the way the preference, corporate tax preference works, let me tell you that is not close to perfect. So we sure should be able to do better than that.

Mr. ALLEN. My time has expired, but I would appreciate it if you would provide me with information on what kind of backstop there would be for those people who are forced into—who can't get insurance in the individual market, at a later time. My time has expired. I thank you very much.

Secretary PAULSON. Thank you.

Chairman SPRATT. Mr. Hensarling of Texas.

Mr. HENSARLING. Thank you, Mr. Chairman. First, I am sorry that my friend from Texas who lectured us on courage has exited the room. I think every witness who has appeared before this panel has told us that the number one fiscal challenge we face as a nation is runaway entitlement spending. That at least several have said, I believe, that we may be the first generation in American history on the verge of leaving the next generation with a lower quality of life, less freedom, less opportunity. I do not recall the gentleman from Texas embracing entitlement reform spending in any of his proposals, nor do I recall receiving any support from the other side of the aisle on a Republican budget that did that, so when they gentleman from Texas will embrace the entitlement spending reform, I will be happy to sit for his lectures on courage.

Mr. Secretary, you've heard a lot already about massive tax cuts, which is a current theme in this Committee. If I can have chart number five, please.

When we hear the phrase "massive tax cuts," and I am looking at this chart and I am kind of eyeballing it here, tax revenues have gone from roughly, oh, I don't know, one-nine, when President Bush took office. Apparently there was declining for a couple of years. He put into place the pro-growth tax policies, and they seem to skyrocket from there. as I understand it revenues are up 14.6 percent in 2005, 11.8 percent in 2006, and 8.1 percent for the first quarter of fiscal year 2007. Are those figures correct, Mr. Secretary?

Secretary PAULSON. Yes, they are, sir.

Mr. HENSARLING. And I believe your forecast, which is in line with the Blue Chip forecast, will have revenues over the five-year budget window growing at approximately what was at five-point——

Secretary PAULSON. Four percent.

Mr. HENSARLING. Five point four percent. So I am personally still looking for the massive tax cuts that I have heard about. And still, what I think I see is massive revenue growth. In nominal terms, do we have the greatest amount of tax revenues we have had in the history of the nation?

Secretary PAULSON. Yes, we do.

Mr. HENSARLING. We also hear about massive budget cuts, and I do want to thank our Chairman, because 95 percent of the time I hear somebody used the term "cut," what they really mean is that some budget function doesn't grow as fast as they want it to grow. Now, in the Chairman's case, I think he alluded to an education function being cut, and I think he used the term in its correct sense. I think it might, however, need to be put in a broader context. If I have done my research properly, and I am going to OMB numbers, since President Bush has been in office the education function is up 107 percent from 2001 to 2006. And as I can eyeball all the different function categories, I am having a hard time seeing any other budget function increase as precipitously as the education function.

Mr. Secretary, do you know how much the administration has increased that function? Do you have that number?

Secretary PAULSON. I don't have it in front of me, no.

Mr. HENSARLING. Okay. Mr. Secretary, although I want to reserve judgment until I see the final details, I very much want to compliment the administration on your proposal to take the tax code bias out of the choice of healthcare. I mean, empowering people, empowering taxpayers to choose the healthcare that is right for them and their families, as opposed to having a third-party employer pick it for them, I think is a huge reform.

I mean, we all know in this Committee room that until you find the key to trying to reform healthcare costs, ultimately, you cannot solve the budget crisis that we face in future generations. So a proposal that will help healthcare become more affordable, accessible and give families—not Washington bureaucrats, but families—the choice of their control is a very, very important step forward. And I certainly think you for that.

And contrary to my usual pattern, with eight seconds to go, Mr. Chairman, I will yield back the remainder of my time.

Chairman SPRATT. The gentle lady from Pennsylvania, Ms. Schwartz.

Ms. SCHWARTZ. Thank you, Mr. Chairman. And thank you, Secretary Paulson. I appreciate the opportunity to follow up on some of the questions that were asked about the healthcare proposals, the tax proposals. I wanted to follow up on some of them.

What I am going to try to do since I only have five minutes, and I hope you will as well, is to ask questions somewhat briefly, and if you answer them somewhat briefly, maybe we can get through a few tight questions, if I may.

The healthcare proposals that the President has put out on the tax side, to me, seems to be moving in absolutely the wrong direction, and I think you acknowledge them to some extent. And that is, to really discourage or create fewer incentives for employers to cover insurance. You said yourself that smaller companies are dropping coverage. You almost said "anyway," so we ought to acknowledge this maybe, your implication, and help—just individuals the opportunity to purchase in the private marketplace.

This seems to me to do two things: is to ignore the way insurance works, which is that it is most affordable and most accessible when you pool the risk with the largest group of people. What you are doing instead is actually saying "We are going to make Americans be more on their own when it comes to purchasing healthcare." Not the way the insurance market works. So I want you to speak to what have you heard from the insurance industry or do you know about the insurance market that suggests that putting more people in the individual marketplace will in fact make it more affordable more accessible. there is nothing that indicates in any of our history that is going to happen.

Secretary PAULSON. Well, let me, even before addressing that, let me just tell you that I could not disagree with you more strongly about your first statement, because there is nothing in this that discourages corporations from providing healthcare. It is still deductible to corporations.

What this proposal does was, it tries to put some fairness into the situation, and that there is 20 percent of those that get insurance from corporations are getting a huge tax benefit that is—and what this does is give everyone became same tax benefit regardless of whether they are getting insurance from their employer or what they are getting the gold-plated from the employer or——

Ms. SCHWARTZ. I don't think anyone would disagree if we were just simply including individuals in that fairness in the individual marketplace. The concern we have, that in fact it actually—the President is saying, what you are saying, is that "the employers are being too generous, we want them to stop providing comprehensive coverage, we want them to reduce the coverage," and I think for many of my constituents, they are already saying that they are seeing their co-pays go up, they are seeing deductibles go up. We are already seeing a shift, dramatically, to the individual employee, but this would encourage employers to reduce the benefits package they provide, and potentially—160 million people get coverage through their employer right now.

Secretary PAULSON. And it is very interesting, and a huge percentage of those 80 percent get coverage below the level at which they will get the deduction. So all this does, it doesn't encourage employers to not provide coverage. What this does is, it treats people fairly.

Now, but your question, which has to do with the individual market, and access. And there is no doubt that there needs to be more to be done to help develop that market, and a lot will be done at the State level. But I would say the conversations that some people have had, and I have not had these conversations directly, but there have been conversations and there is going to be work that needs to be done on this, with a number of the insurers who are providing this insurance saying something like this would provide a big impetus and it would help jumpstart the market.

Ms. SCHWARTZ. I guess what I would say that just in terms of careful about time, I think the notion of jumpstarting the market is interesting, but it doesn't tell us what you mean by that. Given what we know certainly about the marketplace again, and in Philadelphia—I don't think it is that different than the rest of the country—is that it is very hard and very expensive to buy insurance individually in the private marketplace. there is not, there is not now an easy way to find affordable and accessible healthcare for individuals, and particularly if you are sick or if you dropped your insurance before and have pre-existing conditions. And so while we have tried to do some good work here to help make sure that the coverage that people can buy is meaningful, but given the expense I think what you are suggesting is that it will somehow magically be more—will work out, and I want to make sure people can afford it, that there is some ability in the private marketplace. Otherwise we should be moving in exactly the opposite direction, which is helping to create broader pools and helping people be able to purchase healthcare and share the risk in broader ways, rather than going one-on-one.

Secretary PAULSON. Well, I would say this is all about broader pools, and that a big part of this—again, this to me, what we are doing at the employer level with this tax benefit is about fairness, affordability, access. Work has to be done. And when Secretary Leavitt is up here, he will tell you about the work that he is doing at the State level to create these pools. And again—as you work to do that, when you are talking about certain people that are sick or that are in certain categories, that is an issue that we are going to all have to keep working on.

But there is 47 million people right now who are uninsured; there is a waitress, there is a construction worker. They get no chance, they get no benefit at all from the tax system. This would give them——

Ms. SCHWARTZ. I believe my time is up but let me just one other question. Of the 47 million, I understand that the estimates that you have is at best, this whole shift to the individual market would actually maybe benefit 3 million people of the 47 million; is that correct?

Secretary PAULSON. No, we certainly did not say—I don't know where you got that. We have an estimate that says that three to five, which I believe is a conservative estimate. We have got people working on others.

Ms. SCHWARTZ. It is somewhere between three to five. It is about 6 percent, 7 percent of the people——

Secretary PAULSON. This is an important step in the right. But again, as you look at it, I don't know how I or anyone defends a tax code which gives—of the people that get insurance from the employers, 20 percent who happen to be with the employers that provide the most gold-plated service, the other 80 percent with employers are not getting the same benefit. You have got 47 million people uninsured, 17 million self-insured, no benefit.

Ms. SCHWARTZ. Mr. Secretary, let me say I agree there is a lot that we have—more we have to do about this, and a much longer discussion to have, but I think our time is up.

Secretary PAULSON. It is, and it will take a while to work this—and a way to think about this is one part of a broader effort.

Chairman SPRATT. Mr. Alexander—first of all, Mr. Campbell of California is not here. Mr. Alexander of Louisiana.

Mr. ALEXANDER. Thank you, Mr. Chairman.

Mr. Paulson, the OMB Director and CBO Director both have been here and talked about our debt, our nation's debt. I mentioned the other day that we see all up and down the halls the plaques that the Blue Dog members have up that show somewhere, I think a little less than $30,000 per man, woman and child, that is owed.

CBO and OMB, their numbers are hugely different. OMB director says it is somewhere closer to $400,000 instead of 30,000. What is the debt of our nation?

Secretary PAULSON. What is the debt of the nation? There are a number of ways you can look at it, and I think the reason you get some confusion is, when you look at—you can look at the public debt that is outstanding, the treasuries which are outstanding, which are roughly $4.4 trillion that is outstanding held by the public. Then there is another big percentage, about 44 percent, of the total debt is in the Social Security and the Medicare trust funds. And that is where a big portion of it is.

Mr. ALEXANDER. So I guess it would be accurate to say we don't know?

Secretary PAULSON. No, it would be over $8 trillion.

Mr. ALEXANDER. Okay. When we see on the chart a growth of revenue to the Treasury Department, and we also see that we have a debt increase of $3 trillion during the Bush administration, as has been said here, how does an increase of, say, $1 billion in debt affect the growth of money coming into the Treasury? If we know that tax cuts fuel the economy, increase that Treasury income, then we have to assume that if we borrow $1 billion and put it into the system, that is to increase in a positive way the Treasury income, don't we? How do we know how much it affects it?

Secretary PAULSON. I think I see where you are going. But there are different ways of looking at it. Chairman Spratt has mentioned that obviously the debt, one way it affects negatively, having the debt, is the interest we pay, which I think the Chairman's numbers were $280 billion a year. And so that is part of the cost. And so there is no doubt that that the reason we would like to be operating with a balanced budget is because we are concerned if debt levels get to be too high. And I guess the way I would put it, if you are looking at a family, if you are looking at a business, or if you are looking at a government, there is an appropriate debt level, where it is a healthy, appropriate debt level. And our outstanding public debt, which is one thing I look at, which had averaged 46 percent of GDP in the 1990s, right now is 37 percent, and it is headed down. If we were just looking at that, that would be something that with an economy this size would seem to be prudent.

But the reason I think there is so much angst around the fiscal situation doesn't have to do with, you know, the current fiscal situation. It has to do with the growth of entitlement spending and the rate at which this—the rate at which these benefits are growing, and the debt will be piling up, we will be in a situation in a number of years, where there are some very tough choices we will have to make if we don't solve the problem. And there it will be either taxes that are a lot higher higher, discretionary spending that is a lot lower, or benefits that are much, much lower. And so that is what I think all the discussion is about.

Mr. ALEXANDER. Thank you. Thank you Mr. Chairman.

Chairman SPRATT. Mr. Doggett of Texas.

Mr. DOGGETT. Thank you, Mr. Chairman. I see that Mr. Edwards has returned from the briefing that he organized for our Texas delegation with the Adjutant General to talk about our National Guard meetings. But I do think Mr. Hensarling, in referring to him, raises an important matter. And that is the tendency to look at the mess that has been created over the last six years, the $3 trillion of debt. And then the first issue that is always up is how can we cut Medicare or Social Security to deal with it?

I don't think it took courage and frankly, I think it would have been foolhardy for Mr. Edwards or any other member on the side of the aisle to have embraced the Republican plan to privatize Medicare and Social Security. The Social Security privatization plan is unfortunately still in this budget. This President will not give up on privatizing Social Security, and there are millions of seniors who I think are mighty pleased that neither Mr. Edwards nor anyone else has embraced that. And as long as that is on the table, it is very difficult to sit down and discuss, as we have said repeatedly to Secretary Paulson and others, the notion of entitlement reform, because this President is determined to make Social Security ever weaker with private accounts.

I wanted to address the second aspect of the mythology that Mr. Hensarling and other members have raised today, and that is that we can solve all of our country's problems with no tax revenue increases, because I know, Mr. Paulson, from the proposals you are defending this morning you certainly don't agree with that position. You have embraced a proposal under which President Bush would raise taxes on 30 to 38 million Americans who have comprehensive health insurance; have you not?

Secretary PAULSON. Sir, you must have come in late to the hearing.

Mr. DOGGETT. I just looked at your proposal calling for affordable choice. It raises taxes on 30 to 38 million people.

Secretary PAULSON. Either you came in late, or I have put you to sleep. Because the point we made was we proposed a one-year patch, relief for one year——

Mr. DOGGETT. No, sir. I am not talking about the AMT. I am talking about the affordable choice program that you endorsed this morning, that the President talked about what it was going to do to provide relief to folks, but didn't bother telling them he was going to raise taxes on 30 to 38 million people. And you had endorsed a proposal.

Secretary PAULSON. I don't believe—I don't see where we are going to be raising taxes——

Mr. DOGGETT. Well, you are going to be raising taxes on anyone who has comprehensive health insurance. That is part of your proposal. You provide in your budget documents for significant increase in revenues in order to pay for your affordable choice program. In fact, one estimate I have seen is that the year after next you are going to raise taxes by a total of $236 billion on those people, on their comprehensive health insurance program with the new Bush health insurance tax.

Mr. RYAN. Will the gentleman yield for clarification?

Mr. DOGGETT. I would like for the Secretary to answer, first. This is a program you said is so important.

Secretary PAULSON. Well, I don't know anything about the new Bush health insurance tax.

Mr. DOGGETT. Well, it is in your budget documents, Mr. Secretary.

Secretary PAULSON. You are going to have a very interesting discussion with Secretary Leavitt, I guess, when he is here, because——

Mr. DOGGETT. Well, I do plan to ask about it this afternoon, but you are the Secretary of the Treasury, and you had endorsed, you would have a much bigger hole in your budget than you do if you didn't raise revenue. And you are raising revenue. I understand if you just listen to the President's State of the Union address, you would never know that was part of the proposal, but he has got a proposal to raise taxes on 30 to 38 million Americans who have comprehensive health insurance. He says that is going to encourage—it is going to redesign the marketplace. But nevertheless, if you are out there and if you got a good insurance program, you are going to be paying higher taxes on it——

Secretary PAULSON. Okay, so you are talking about the tax preference on health insurance——

Mr. DOGGETT. I have been talking about a $238 million increase in taxes that the Bush administration is proposing the year after next on people who have comprehensive health insurance, that tax.

Secretary PAULSON. I got to tell you I don't know what you are talking about. But if——

Mr. DOGGETT. Look at your budget documents, and I welcome a follow-up, and I will ask Secretary Leavitt, and I will move on to something else.

Secretary PAULSON. Now let me ask you—are you talking about the standard deduction for health insurance?

Mr. DOGGETT. I am talking about the fact that people who have comprehensive health insurance are going to be taxed on it under the Bush plan, and they are not today. And for every one of those 30 to 38 million Americans, that is a tax increase. It is a Bush tax increase.

Secretary PAULSON. Let me say to you, what this does, this health insurance is a standard deduction. It gives the same standard deduction to everyone, no matter what their health insurance plan is, and it treats——

Mr. DOGGETT. Well, thank you, Mr. Secretary. I don't think that is a really responsive to my question. But let me ask you about the other tax increase that the Chairman asked you about.

Secretary PAULSON. What is the tax increase that you are talking about? What——

Mr. DOGGETT. I am talking about the tax increase that the Bush administration has proposed on people with comprehensive health insurance, that you have included in your budget documents as an attempt to offset a portion of what you call your affordable choice program. And it is a tax increase as real as any that anyone has ever talked about here.

But me ask you about the AMT since you talked about that with the Chairman——

Chairman SPRATT. Is there something you want to say to that?

Secretary PAULSON. Yes. I guess I am confused as to what the Congressman is talking about.

Chairman SPRATT. I think what he is talking about the exclusion from ordinary income, from employee-provided premiums, which will be repealed and replaced with a standard deduction.

Secretary PAULSON. Yes, absolutely.

Mr. DOGGETT. The Bush health tax.

Secretary PAULSON. Okay, now, the health tax——

Chairman SPRATT. The 20 percent of the population, the health coverage population, by your estimates, who will be disadvantaged by that.

Secretary PAULSON. Okay, now, in terms of the——

Chairman SPRATT. I don't accept that characterization, but I understand——

Secretary PAULSON. I don't either, so let me just again look at it, and say what this does, and address his question about the tax. What this is is a standard deduction that everyone who has health insurance gets, whether they get it through the employer, whether they get it themselves in the individual market. What this does is, there will be—it is a $15,000. So those, 20 percent of those in the employer-provided health market, 20 percent of those people, who get a plan that is a gold-plated plan, where the premiums are greater than 15,000, will pay more taxes unless they restructure their health insurance. Eighty percent will end up better from a tax standpoint.

Mr. DOGGETT. Let me just say, your own revenue estimates show this Bush tax increase, and if you are out there and you call it "gold-plated" but it is a comprehensive plan to cover your child with disabilities, you are going to be paying more taxes. And you said you can't institute this plan to cover what I think Ms. Schwartz appropriately identified as a 7 percent solution, to cover 7 percent of the uninsured, unless you add this kind of additional revenue.

Secretary PAULSON. Congressman, we need to spend some time off-line, because what this will do is, from a—the vast majority of people will be better off. And this is revenue-neutral.

Mr. DOGGETT. I understand full well your claims, and the very fact that you just told me it is revenue neutral makes the point. It costs something to provide this additional coverage, and 30 to 38 million people are going to pay higher Bush insurance taxes as a result, to make it revenue-neutral.

Secretary PAULSON. Well, there will be 20 people at the high end that get gold-plated insurance plans will have—they will either have the opportunity to restructure their insurance, or they will pay more taxes, but there will be 80 percent that will be much better off.

Mr. DOGGETT. Thank you. Thank you for acknowledging that. Thank you, Mr. Chairman.

Chairman SPRATT. Okay. Mr. Porter of Nevada.

Mr. PORTER. Thank you, Mr. Chairman.

Chairman SPRATT. Excuse me. Mr. Barrett is not here, Mr. Smith is not here, Mr. Bonner is not here, so you come next.

Mr. PORTER. Thank you.

Mr. RYAN. Mr. Porter, would you just yield for a minute?

Mr. PORTER. Happy to.

Mr. RYAN. Thank you.

There is a lot of confusion on our side and on the other side as to what this is, this healthcare thing. Employers can deduct the cost of providing healthcare benefits to their employees now, and they always will be able to under this plan. That is not the issue. And I know that is not what the gentleman from Texas said, so I don't want to be putting words in your mouth.

The question then is, to the individual on their taxes, right now they get healthcare benefits from the employer and it is not taxed. It is given to them in a tax-free way. This proposal changes this to make that taxable, and it transfers that tax benefit from the employer benefit to the individual so that the individual, whether it is an individual with their own, a single person or a family, they get a tax benefit on their income tax, $15,000 for family plan, $7,500 for the individual plan. And the numbers that I have to call into question is, 100 million people get health insurance from their jobs and that is the plans. It is mathematically impossible that 38 million people are going to have their taxes increased. It is their estimate that 20 percent——

Secretary PAULSON. 20 percent at most.

Mr. RYAN. 20 percent of those plans cost more than 15 grand. that means 80 percent of those plans cost less than 15 grand and these individuals will see their taxes go down. What happens to the 20 percent above 15 grand? Well, they will probably restructure, maybe they will get a tax cut, I don't know, but we know that that is not 38 million people. So I just want it clarified. For our guys too, this is not talking about taking away the tax expenditure on the business side; it is transferring the tax expenditure on the individual's side to the actual individual, rather than attaching it to the benefit. That is——

Mr. DOGGETT. Will the gentleman yield?

Mr. RYAN. Sure.

Mr. DOGGETT. Well, there is a study that the Lewin group has done, since the Treasury has not provided these numbers themselves, that shows it is 30 to 38 million people. And whether it was 30 to 38 million or three to 5 million people, they are going to have a tax increase and it is a very clear tax increase and the estimate of the Lewin group is that it is hundreds of millions of dollars the year after next.

Mr. RYAN. Reclaiming—and I haven't seen the study that—and I have a hard time buying that, but—Mr. Porter, thank you very much for your time.

Chairman SPRATT. Mr. Porter.

Mr. PORTER. Thank you, Mr. Chairman.

Mr. Secretary, it is good to see you again, yesterday at ways and means, and now here again this morning.

Two points. One, to follow up on a conversation that we had yesterday. We were talking about how we got to where we are today, and there is no question that we have substantial deficit and a debt. But if we look back through the early part of 2000, as the recession was starting to have a major impact on our country, we had 2001, we had 9/11 and billions of dollars in our economy that were impacted by the attack on our homeland, to New York and here in D.C. We also had to rebuild the military that was drastically cut for a decade, or eight to 10 years. Our military was underfunded, under-built to protect our homeland. So as we talk about where we are today, I think it is important to keep in history, that a lot of this has to do with some things, from a natural disaster to an attack on our homeland. And we are doing everything we can to address it.

But I would like to visit one more time some of the successes of this proposal of reducing impact on families and taxes. Now we look at Nevada as an example. Currently we are building 40,000 new rooms for visitors. Our unemployment rate is as low as it has been in four decades. We are drawing 70,000 people a month. Our room occupancy is around 97, 98 percent.

All of those are a bellwether for the economy. And we talked, in Ways and Means and in this Committee, about the attitudes of Americans. I would like to cite, and if we could add it to the record, New York Times, they did some research in March. They asked people how they felt about the economy, how they felt about the direction of the country.

"And more than ever, Americans cherish the belief that it is possible to become rich. Three quarters think their chances of moving up to a higher class are the same or greater than the last 30 years. Compared with their social class when growing up, people said their current class was 48 percent higher, compared to 30 years ago when the likelihood of moving up from one's social class to another is about 40 percent greater."

And I enter this into the record because I think we are all in all we are hearing is how miserable people feel. I think that the policies of returning hard-earned dollars to Americans is making a difference. I think that needs to be taken into consideration, that people appreciate the fact that we are reducing our expenses.

On another issue, very specific, something that has not been brought up, and that is Yucca Mountain. And I know there are those that think it is out of sight and out of mind, but if you look at the history of Yucca Mountain in Nevada, It is been a $9 billion hole, and even those proponents should look closely at the waste, the gross waste of dollars. It is close to five or $600 million a year. Hoping to reduce debt in this budget to something substantially less than that. But I think as a Committee, as we are looking at ways to save money, and the budget hawks that may support burial of nuclear waste in Nevada need to look at the fact that it is a colossal waste of taxpayers' dollars, close to $9 billion, and we need to find alternatives.

So I guess it is not really a question regarding the economy, regarding Yucca Mountain, but could you address the impacts that these things have had on the growth of our economy, from 9/11 to our catastrophic national disasters?

Secretary PAULSON. I just want to say one thing real briefly on mobility. When people talk—and I have spent a lot of time looking at the growing divergence of income. But the one bit of good news is the mobility you've talked about, that dynamism. Because what the numbers show is that of those in the bottom quintile, half of them will have moved out of that, in a 10 year period. And those in the top quintile, half of them were not there 10 years earlier. And so there is great mobility.

And in terms of the tax cuts, I saw it firsthand, in terms of what they did, and in terms of inspiring investor confidence, and corporate confidence to invest in the economy, changing behavior. I think one way we probably all can see it is when you look at small businesses. And you know, the top individual rate is often the small-business rate with the schedule C filers. You know, you probably know a lot of small businessmen who every extra penny they have they plow back into their business, and they are a big driver of growth. And so I would say you are right, that has changed behavior, and it is an important part of this economic growth.

Mr. PORTER. Now, Mr. Secretary, it may seem parochial to mention the Nevada experience, but people who do not travel do not enjoy tourism and travel, and we would not be at a 97 percent occupancy if the American people didn't feel comfortable, and believe in the future of our country. Thank you.

Secretary PAULSON. Thank you.

Chairman SPRATT. Mr. Blumenauer.

Mr. BLUMENAUER. Thank you, Mr. Chairman. Just a general comment. I find it somewhat optimistic on the part of the administration bringing us this budget predicated on a one percent limitation to non-security and domestic spending, something that my Republican friends have been unable to achieve even once in the 12 years that they have been in power. And somehow the administration thinks that with Democrats in charge we will do that in the next four years. Somewhat ironic.

The second irony is that the Treasury Department and the President do not place a higher long-term priority on extending the tax codes than dealing with the alternative minimum tax, which is rapidly morphing from a tax on lawyers, doctors, and lobbyists. It doesn't get the hedge fund managers, and the typical CEO, but it does get the lobbyists, the lawyers, the doctors, the accountants. But this is rapidly morphing into a tax on two-income teacher, firefighter, plumber—the plumber that you referenced, that 89 percent of married families with children will pay the ATM by 2010, under the priorities that have been advanced by the Bush administration's budget. I find that ironic, that concern about tax reduction and prioritization, and I think it is a sadly mismanaged set of priorities, which I hope our Budget Committee will address.

Mr. Secretary, I was pleased to see that the Global Environmental Facility, GEF, received not only the 8 million that was pledged, but it appears in this budget as I read it that there will be a commitment towards paying off our past shortfall. I know you are a noted person who is concerned about the environment as part of your resume, which is something I was pleased to see, and I really commend you and the administration for meeting this commitment, and I hope we can continue to do so in the future.

My question to you deals with issues surrounding debt cancellation. Impoverished countries have benefitted from the 2005 debt agreement reached recently in the UK. Your sort-of counterpart, Gordon Brown, has named 67 countries as requiring full debt cancellation. I am wondering what your thoughts might be about our being able to go forward under the confines of this budget, or work that we can do within the budget Committee or the Ways and Means Committee, where we need to revisit it to be able to move in this direction, as a way to help put the underpinnings under these poor countries.

We appreciate what the President has done in this budget with HIV-AIDS. I personally hope we are able to do a better job keeping our commitments for water and sanitation, but I wonder if you have some observations also——

Secretary PAULSON. First of all, I thank you for the question and I talk with Gordon Brown fairly often, and this is a topic that he is very passionate about. And it is one that the administration worked very closely with him a year or two ago, fashioning that very important agreement.

The poor developing countries is a very important issue, and it is important when we do it, we do it in a way in which we think has got a reasonable chance of being sustainable, and so we come together as a group. And one of the things we have been spending a lot of time talking about is the importance of keeping nations from coming in afterwards, and then individually loaning, or unilaterally loaning money to increase their problem again.

So this is something that we will continue to focus on. And I think right there, it has got to be part and parcel of some credible economic program. And I would also just put in a plug for trade and for Doha, because if we don't get a Doha agreement, the poorest countries are going to be the ones that are going to be paying the biggest price for that.

Mr. BLUMENAUER. I appreciate your comments, and I appreciate your courtesy, Mr. Chairman. I would hope that as you move forward, that there is—I appreciate that we need some standards and for these countries themselves, I hope there is some sensitivity, particularly as we deal with their water and sanitation.

Secretary PAULSON. Very very much so.

Mr. BLUMENAUER. Thank you.

Chairman SPRATT. Mr. Simpson of Nevada.

Mr. SIMPSON. Thank you, Mr. Chairman. Thank you for being here, Secretary Paulson, we appreciate it, in this fun give-and-take that we have.

I want to take you back if I could to something you said when you were talking, when you answered Mr. Edwards' questions, relative to the deficit and the debt. You said, speaking of Congress, the need to maintain the economic policies to stimulate growth and so forth, and the spending restraint. And you said, referring to Congress, "there has been some restraint down here. Not as much restraint as we would like to see."

Given that in the six years that I think the President has been President, this Committee and Congress has adopted the discretionary budget cap put fourth in the President's budget proposals, our 302 cap is always reflective of the President's cap on discretionary spending. What additional spending restraint are you talking?

Secretary PAULSON. Well, it was a general statement in the sense that I think we all recognize a need for greater discipline. The President has talked a fair amount about earmarks, and so I think there is a number of things that we could do better. But I take the comment that the previous speaker made, which is we, holding nonsecurity discretionary spending to one percent a year would be better than we have done in the past. And it is not easy, and I don't mean to imply that it is easy.

Mr. SIMPSON. Well, what bothers me, I guess is that I continue to hear the administration and the officials talking about spending restraint, we need to make sure that Congress exercises exercises spending restraint. As a member of the Appropriations Committee, we have had some tough times trying to live under the budget caps, but we have done so. And I get this feeling that the administration is trying to shift the blame to Congress for not being fiscally constrained enough to hold it down, and we have done a good job.

And as far as mentioning earmarks, hey, you know I was at an event yesterday with the President when he held up this big stack of earmarks and all this kind of stuff. Then the CR that we just passed the House, you will notice that we eliminated almost all the earmarks out of that. There were some that were left in, particular from the Senate side, but most of the CRs were left out, or most of the earmarks were left out. Guess how many dollars we saved.

Secretary PAULSON. Not a lot.

Mr. SIMPSON. Zero. Because that money went into the agencies and now guess what. Now, we go to the agencies and ask them to fund the projects. The only thing that changed with that was the discretion of which projects are going to be funded, whether it is going to be that by the administrative branch of government, or whether members of Congress are going to have some control over a very small portion of that budget. Earmark reform is not going to save a dollar. Should it be more transparent? Yes. Should we look over it better and make sure they earmarks are justified? Yes. But in terms of saving dollars in fiscal constraint, all I want is the administration to acknowledge that it is a joint problem between the administration and Congress. And certainly he is going to propose spending programs to be eliminated. Some of them we have done. Some of them we disagree with the administration. And that is the way it is. He is going to propose, as an example, on the public schools, the county payments for those counties that have lost forest timber revenue, he is going to propose, as he did in his budget, the way to pay for that for the next five years is to sell public lands. He proposed it last year.

So we are going to have to find another way to do it. And we will work within that budget. But the acknowledgment that we have actually had fiscal constraint and fiscal spending discipline on the discretionary part of this budget, I think, by the administration, would be a good thing. And what we really have two do, in a bipartisan fashion is work on the mandatory spending of Social Security, and Medicare, and Medicaid, and no matter what anybody says, everybody that looks at it knows that we have got to address it because you can't continue the growth that it is on.

Secretary PAULSON. I would say amen. And so I clearly see that both Congress and the administration deserve a lot of credit for the fiscal situation we have right now in the short term, which is a stronger fiscal situation. And so we have a strong economy, revenues coming in, and there has been restraint when you look at, you know all of this after the natural disasters and hurricanes, and 9/11, the war, and funding all of that. And so you are very right to focus on the big problem.

Mr. SIMPSON. I appreciate that. And I would say to my friend from Texas, Mr. Doggett, that it is difficult to meet and talk about saving Social Security, the Treasury Department Social Security, because the President would have to propose private accounts.

Put everything on the table. I don't care what the proposals are. Let us sit and talk about it, and have a bipartisan solution to this. It may include private accounts, it may not, I don't know. But let us work it out, and quit the politics of blaming each other for it and try to find a solution.

Thank you Mr. Chairman.

Chairman SPRATT. Mr. Berry.

Mr. BERRY. Thank you Mr. Chairman.

Mr. Paulson, thank you for being here. We don't run across—I am looking at your resume here. Dartmouth, MBA from Harvard, we don't have too many of those at the Rice Paddy Motel coffee shop in Gillett, Arkansas. And we don't have access to this kind of expertise very often.

So I would like to—I have been around here since 1993. Most of the discussions I have ever heard about the economy or public policy or whoever, certainly from your side of the aisle, would indicate that the only thing that matters is the tax rate, that if you just cut taxes the economy just bubbles up out of the ground. And if you raise them, that horrible things happen. Now, to the best of my memory in that short period of time, we have raised taxes and had a successful economy, and we have cut taxes and incurred huge debt. So my first question is, is there anything that impacts the economy besides taxes?

Secretary PAULSON. Obviously, many things. We have a very diverse, very, very strong economy, great entrepreneurial spirit. There are many things that impact the economy. Taxes happen to be an important one.

Mr. BERRY. I asked this question of Director Portman yesterday. Do you all ever recognize the value to the economy that the American people get because they spend less than half as much of their money for food as any other nation in the world? Does that ever occur to anybody at the Department of Treasury? Can you get a report on that and the value of it, and what would happen if we doubled the price of food? Not now, but at some future date?

Secretary PAULSON. Sure.

Mr. BERRY. I would love to see that information. I would associate myself with the remarks of the gentleman from Idaho about earmarks. I think we know more how to spend money than the administration, whether it is this administration or another. And I think it ought to be transparent, and I think it is a good thing.

I think you have been given the most difficult task of making chicken salad out of chicken litter, and I don't think it is going to be an easy thing for you to do. I appreciate your willingness to come up here and tell us how good things are going to be, and how wonderful the world is going to turn out to be in spite of the fact that we have completely ignored—if we came forward today and proposed just borrowing over the next two years $1 trillion, let us just float a $1 trillion bond issue. And let us take it and divide it up among the people according to how much money they make, whoever makes the most money gets the most. Would your former—the company that you headed before you came here, would you all be interested in buying those bonds, and doing that?

Because essentially that is what we have done. We have sold $3 trillion worth of bonds and given the money to the people according to how much money they make. Doesn't borrowing money and giving it away, doesn't that stimulate the economy too? You know, like I said, I am just a poor dirt farmer from eastern Arkansas, but I can add and subtract. And I am curious, am I right about that? If you borrow money and give it away to the people, doesn't that stimulate the economy?

Secretary PAULSON. There will be a short-term stimulus, sure. I would just say, Congressman Berry, a couple things. First of all, if you think I am sitting here saying everything is going to be bright and rosy in the future, you've misunderstood me. The one thing I will say is we all can be pleased that we have a strong economy today. We have a strong economy today, and that puts us in a stronger position to solve some of the problems we need to solve.

But frankly, since coming to Washington, although I have had a pleasant surprise on the short term, that frankly, in January, if you had asked me last January whether the economy would be as strong as it is this January, I wouldn't have guessed it. And it looks like we have made a transition to a sustainable rate of growth, and that this expansion—I would say the problem—I see a huge problem, which is the longer-term problem of entitlements.

Mr. BERRY. I understand all that.

Secretary PAULSON. And that is bigger than I thought it was before coming here.

Mr. BERRY. Let me ask you this. What would our economy look like today if we hadn't borrowed $3 trillion?

Secretary PAULSON. I have got to tell you that is an unknown, what the economy would look like. I would do you this: I know that the tax relief played a very big part in getting this economy back up and going, where we needed to get it.

Chairman SPRATT. On the Republican side, Mr. Conaway.

Mr. CONAWAY. Thank you, Chairman. Last week we had Mr. Orszag here, and I challenged him to begin parsing his adjectives better. You used the word "huge" earlier in connection with something. We always use the word "massive."you all use the word "massive." We do that I think in order to try to augment the strength of our arguments, as opposed to just letting the argument lie where it is. Numbers go up, numbers go down, and we ought to be able to understand it.

But in that vein, my brother colleague from Texas augmented one of his positions by saying that he was offended—is challenging the change in VA benefits, the co-pays or whatever it is we may be asking this budget to do, and I certainly agree we ought to talk about those. But he seemed to want that, then, by saying that members of Congress aren't sharing proportionally some sort of a burden.

So, I am not in the least embarrassed by how much I make or we make, the benefits. I defend it all the time in my district, I voted for the pay raises. But if my good colleague from Texas is in fact wanting to augment his argument that Congress, and the staff, and the Secretary of the Treasury, others, ought to share in this by taking pay cuts or a reduction to benefits, then let the bidding begin.

But it ought to begin on his side. If he is not serious about that line of logic, which is very emotional one, and one I don't agree with, but it is very emotional, and it appeals to an awful lot of folks. If in fact he wants to continue using that line of logic, which he has used in the past, used again today, then I would encourage him, I guess, as part of next week's unveiling of the new agenda, to include I guess the opening bid, which would allow us on this side to begin, you know, raising that bid.

A comment was made about earmarks. I would argue that there were—there was, or is, member-directed spending in the Continuing Resolution. I would argue that our good colleague, the chairman of the Appropriations Committee singlehandedly directed an awful lot of spending, moving monies around within that CR. It took 137 pages to do what normally takes two to four pages to do, and so there was member-directed spending in the Continued Resolution.

Looking forward to more conversations like this. I don't have anything to add other than just to say we have got some tough decisions to make, and whether you raise taxes and this economy goes to the tank, or you spend more money or whatever we do, I am continually impressed by the resiliency of this American people, this American economy. It thrives in the face of things we do here in an attempt to make it better. And most the time it just continues to trudge along, and overcomes them amidst the challenges that we put in the face of it, whether it is a complicated tax code scheme that is criminal on its face, or other over-regulations, or other losses, all the kinds of things that we have got out there, that this economy can continue to thrive, and goodhearted Americans get out there and work every single day, in spite of what we do here in these chambers.

So Mr. Paulson, thank you very much for your service. You do have a tough job. Chicken litter, I guess that is a phrase I am not real—I know what it is, but I just haven't heard the more genteel phrase. But I look forward to working with you.

And with that Mr. Chairman, I yield back.

Secretary PAULSON. Thank you.

Chairman SPRATT. Mr. McGovern of Massachusetts.

Mr. MCGOVERN. Thank you, Mr. Chairman, and thank you, Mr. Secretary, for being here. I appreciate your testimony. I am a new member of this Committee and one of the things I have come to appreciate from your testimony and listening to others is that there is no simple quick-fix solution to the mess that we are kind of confronted with. We are going to have to talk about entitlement reform, we are going to have to deal with issues of not only tax cuts, but tax increases. I think there is a lot of controversial issues down the road that if we are honest we are going to have to deal with them.

I am also a bit concerned however, that we all talk about numbers. Sometimes we forget that there are people behind these numbers. So when we talk about cuts in programs or we talk about "we are not going to raise the amounts in some of these programs to deal with inflation," to deal with increased participation, that there are people that fall through the cracks, and I think we need to keep that in mind.

I have limited time so I just wanted to ask, I have a couple of sets of questions. The first is, Mr. Secretary, when are we going to have to raise the debt ceiling? That is, when is the administration going to make a formal request to us to raise the debt ceiling?

Secretary PAULSON. The best estimate of that would be sometime this fall.

Mr. MCGOVERN. Will the administration make a formal request to Congress asking it to be increased?

Secretary PAULSON. Yes.

Mr. MCGOVERN. The other area I just wanted to focus on a little bit is the issue of the war cost. We have spent over $300 billion already on Iraq. If I add all the numbers up, if we do everything in your budget, which is I think kind of lowballing it, looking at some of these out years, that will be over $600 billion, and almost all that is not paid for. And I guess my question is, is the administered ever going to actually consider paying for the war? In the form of a war tax, or maybe a user fee, to make it more comfortable for some of my friends on the other side of the aisle?

I ask the question for a couple of reasons, not just because of the budgetary impact, and when you are talking about several hundred billion dollars, that is a lot of money. And we have no idea how much it is ultimately going to cost. Surely it is costing much more than was advertised when the war began. But I also ask it because right now the only people that are really paying the price of this war are the troops and their families. They are the only ones being forced to sacrifice here. And I am not sure the American people would object to stepping up to the plate and doing their part, which is to make sure that this war is paid for, and not put on the backs of our kids and our grandkids, and our great grandkids.

And I ask that question because I think it is the right thing to do, I think we should be paying for this thing. All of us need to be sacrificing. And it is a little bit disconcerting that in a time of war, we are giving people tax cuts. And we can argue about whether the war stimulates the economy, we can go back and forth on that. But I think at a minimum I think that it wouldn't be too much to ask that all of us sacrifice, and that we actually pay for this war also.

Secretary PAULSON. Okay, all of us owe a great debt to the men and women who are in the war in Iraq, and it is—I would say one thing I know will be very important to them is when they come home, they come home to a strong economy, which is growing and providing opportunity.

Mr. MCGOVERN. Well, how does paying for the war undercut a strong economy?

Secretary PAULSON. I didn't say it did. I would also just remark that when Congressman Conaway talked about just what a remarkable thing our economy is, which is pretty amazing when we look at, as you said, the cost of the war and all the other things we have funded, and again look at how strong our fiscal situation is right now. No, I appreciate your—I hear the spirit in which you made it.

Mr. MCGOVERN. Again I appreciate your response. And again, I think it is the right thing to do, and I don't think it would be terribly controversial for the President to say, look, you know, as part of our national sacrifice we are all going to pay for this war. And you know, you can repeal the user fee or the war tax when the war is over with, or you know, have it sunset. But it just seems to me—I mean, to a lot of people, and I have talked to a lot of soldiers who are fighting this war. It is a little bit disconcerting, when I think a lot of people in the military think they are fighting this war and it is all on their backs and we are not doing our part.

Secretary PAULSON. I understand the feeling.

Mr. MCGOVERN. Thank you.

Chairman SPRATT. Mr. Conway—no, you have already gone, I beg your pardon. Mr. Lungren.

Mr. LUNGREN. Thank you, Mr. Chairman, and thank you very much for being here, Mr. Secretary. I apologize for missing most of your testimony, as I was at another Committee.

Let me just be one to say that I share the concern that you've expressed, the administration has expressed about earmarks. I was absent from this place for a number of years and surprised—alarmed, frankly, I came back to see the proliferation of earmarks here. And just so that the record at least reflects this member's views: while the earmarks themselves may not be that large in terms of the dollars in the budget you deal with, frankly there is a psychological impact of earmarks here, which is if members get their earmarks in they are far less likely to vote against a bill that spends more money than they believe ought to be spent. And that I believe is one of the dynamics that we refuse to admit around here. We need our own discipline, and that is why I hope that you and the administration will continue to fight for the legislative line-item veto, or enhanced rescission, whatever you want to call it, because we use the word "transparency," but transparency only is a means to help us do what we need to do, which is to get this budget under control. So I hope you don't believe that all of us here disregard the importance of earmarks.

As I understand your testimony and the testimony that we had from Rob Portman yesterday, with the administration's budget and the projected budget for the next five years we will be at about 18.5 percent of GDP for the tax revenues; is that correct?

Secretary PAULSON. Yes.

Mr. LUNGREN. And that is slightly above the average for the last 40 years, including those years going back to the Vietnam War through the present time; correct?

Secretary PAULSON. Yes, correct.

Mr. LUNGREN. So essentially, we are asking the same sacrifice of the American people that we have asked for the last 40 years in wartime and in peace; is that not correct?

Secretary PAULSON. Yes, it is.

Mr. LUNGREN. The other thing I would wonder is, what are our overall tax rates on the American people in comparison to the tax rates that we see in Germany, France and Japan?

Secretary PAULSON. They would be—Germany, France and Japan have much higher tax rates.

Mr. LUNGREN. And as I understand it, even with the deficits that we have been running, the U.S. Federal debt as a shared GNP is falling, and is at 37 percent. And that compares to Germany at 52 percent——

Secretary PAULSON. The public debt outstanding, yeah, 37 percent.

Mr. LUNGREN. Right. With Germany, in comparison, at 52 percent, France at 43 percent, and Japan at 79 percent, is that pretty accurate?

Secretary PAULSON. I don't know those numbers off the top of my head, but that is directionally right.

Mr. LUNGREN. So systems that have significantly higher tax rates than we have are suffering under far greater public debt burden?

Secretary PAULSON. In the case of those countries that is absolutely true.

Mr. LUNGREN. Do you have an idea what the unemployment rates of those countries are at the present time?

Secretary PAULSON. They are clearly, in Germany and in France, much higher than in the U.S. and in Japan, higher.

Mr. LUNGREN. I don't have the folk wisdom that some other members have expressed here, but I do remember a statement years ago. I think it was Pete Wilson, when he was first running for statewide office in California, said that the greatest social welfare program is a job, and to the extent we can establish an economy that generated jobs, primarily in the private sector, we would be doing the best thing that we could for the average American.

Do you have a recollection of what the sustained unemployment rate was in the 1970s?

Secretary PAULSON. I don't, but it was well above where it is here. This is—maybe the Chairman does. We were both—the 1970s were not a great time for our economy. We had "stagflation" and so it was——

Mr. LUNGREN. The reason I bring that up is we like in this Committee to compare what is happening now with what has happened in the Clinton years, which I happen to think the Clinton years in some ways benefitted from the legacy of the Reagan tax cuts, which when they came into effect came into the context of an economy that had a much higher sustained rate of unemployment, economists saying that you couldn't have—well, full employment they were defining as no more than 94 percent. That is, we would run this economy into a tailspin if we had less than 6 percent sustained unemployment rates. We had higher inflation rates. We had higher tax rates.

And as we look at the difficulties—and there are difficulties. I am one of those who believes we ought to be concerned about the debt. But as we look at that, we should also ought to look at the alternatives of what we had before, when we had higher tax rates, which higher rate of inflation, which higher rates of an appointment, with economists agreeing that we could never have the kind of vigorous economy that we have had, that is the sustained literally with few recessions, compared to what we were seeing through the 1960s and 1970s.

Chairman SPRATT. Mr. Lundgren, we got to move on.

Mr. LUNGREN. I appreciate that.

Chairman SPRATT. To answer your question there were 22.7 million jobs created during the years of the Clinton administration, which vastly outdistances what has happened in this——

Mr. LUNGREN. All after the Reagan sustained tax cuts that we basically have followed, then, along with the Bush——

Chairman SPRATT. That is the subject of another hearing. Mr. Andrews of New Jersey.

Mr. ANDREWS. Thank you, Mr. Chairman.

Mr. Secretary, in answer to Mr. McGovern's question a moment ago, you indicated the administration will be submitting a request for increase to the debt ceiling. When do we expect that request, and how much of an increase to the debt ceiling will you be asking for?

Secretary PAULSON. I don't know the answer to either of those, because it is going to be very dependent on the way which revenues come in. But it would be sometime in the fall.

Mr. ANDREWS. Thank you. In your testimony you indicate that the projected surplus under the administration's budget proposal will lay the foundation for dealing with entitlement reform. I am a little skeptical that it is really a surplus by 2012, and here is why. I am correct, aren't I, in that every dollar of the projected Social Security surplus during this five-year window is applied to the deficit; is that correct?

Secretary PAULSON. That is the way it works under the law.

Mr. ANDREWS. And if we were to express the operating budget of the federal government, net of Social Security, my reading of the budget tells us that we would be $187 billion in deficit by 2012; is that correct?

Secretary PAULSON. I can't confirm that number.

Mr. ANDREWS. In addition to that, there are some other costs which are not built into the five-year plan. One is the alternative minimum tax. There is a plug, but it doesn't extend to 2012. If Congress takes action that would shelter 39 million people from paying the alternative minimum tax, which I think is likely, that increases the deficit in 2012, doesn't it?

Secretary PAULSON. You know, I have to answer this question a number of times, but clearly, what I have said is we are going to need to work together on solving the alternative minimum tax.

Mr. ANDREWS. I mean, as a logical proposition, unless we raise taxes on someone else, or cut spending to offset the tax relief for people under AMT, it is would increase the deficit, right? Okay. If I read the budget document correctly there are no war costs built into fiscal year 2012 at all. Now, I hope there are none. I hope that we are successful in resolving the conflict, and we are not spending any money in Iraq or Afghanistan. I strongly doubt that. But am I correct in my assumption that there is zero war costs built into 2012?

Secretary PAULSON. Yes, because what we have done is we have a placeholder for 2009. It is difficult to estimate.

Mr. ANDREWS. It certainly is, I understand that. And here is the calculation I have done. If you take the net budget deficit, net of Social Security, is 187 billion. If you add in the AMT, the CBO tells us that would cost us $93 billion. If the war is costing us about what it is costing us today—I hope it isn't but if it is that is $87 billion, and then if you add interest on further debt we would have accumulated in the first four years, that takes us to $393 billion deficit.

Now, we further compound the problem. Those numbers are built on the administration's revenue assumptions, which I hope are correct, that revenue will grow at the rate that you project. If you use the CBO's revenue numbers, though, you would have a falloff of $155 billion in revenue, which means that the deficit would be $548 million before you get into the Social Security surplus. Even applying the Social Security surplus you would have a deficit after that.

Now, here is my concern. David Walker was here 10 days ago, and testified that if no policy changes by the middle of the next decade, we will have a deficit that is 5 percent of GDP, because of the onrush of the baby boom retirees. This budget really doesn't change policy. It continues the existing policy.

Are you confident that this existing policy is going to avoid the problem I just talked about, given the fact that there is no war cost, there is no AMT built in here, that we are spending every dollar of Social Security surplus? Can you approach 2017 with a high degree of confidence that are going to be ready to deal with entitlement reform?

Secretary PAULSON. I can't unless we start dealing with entitlements now. In other words, I would have different numbers. Your chairman had different numbers. Under his assumption that there was a deficit of eight tenths of a percent GDP. We think we can balance the budget. But the forest through the trees is the problem you have pointed at, and I would say of all the things most frustrating to me coming down here is to be able to look at this big structural issue we see ahead of us, and it is like we are flying into the side of a mountain, and we have got time. We can avoid it but we can't—we need to come together.

Mr. ANDREWS. I see my time is up. I would agree. I am just concerned that we are not really changing the direction of the plane. I think that proposed in the next five years takes us right to the mountain again.

Secretary PAULSON. Let us deal with the big issues then, because I would say the fiscal deficit today of 1.8 percent of GDP is not our problem. The problem is the structural issue coming up with the entitlements.

Mr. ANDREWS. Thank you very much, Mr. Secretary.

Chairman SPRATT. Mr. Secretary, we have three members who have waited patiently. Do you have the time to entertain us?

Secretary PAULSON. I am certainly not going to tell them if they waited they cannot go. I will try to—I realize part of the reason we have gone over is I have been too loquacious myself. So let us go on and I will try to be very, very brief.

Chairman SPRATT. Mr. Etheridge.

Mr. ETHERIDGE. Thank you, Mr. Chairman.

And Mr. Secretary, thank you, and thank you for being here today, I will be try to have my stuff as tight as I can, too, so you can get in. I appreciate you taking the time. Let me just ask you a couple of quick questions.

Yesterday, the Federal Reserve Board chairman, Mr. Bernanke said spreading economic opportunity as widely as possible is important, and here is what he said about it, he said, "policies that focus on education, job training and skills, and that facilitate job search and job mobility, seem to me to be promising means of moving toward that goal." In effect, if we are going to be involved in our economy, close the gaps on the debt, and provide opportunity to education, is that piece, and those things around it. Would you agree with that statement?

Secretary PAULSON. Yes.

Mr. ETHERIDGE. And I think we do. Now, that being said, let me just share—because I believe budgets really are moral documents as well as numbers, and I think too many times we get engaged in budgets and we forget it is about people who are on the ground. And if we cut at the federal level and do our job, it rolls to the State, to the local, and business gets caught in the gap. And ultimately it is a combination of those who make it happen. In this budget, when we talk about defense of this country, we are cutting COPS programs by 95 percent. Those are people that are on the ground helping people. First responders are being cut roughly 65 percent and a variety of education programs, about 44, are being eliminated. We may agree with some or may disagree, but I happen to know a lot of them, having been a State superintendent for eight years, that are absolutely important to the local units, because they catch students who fall through the gaps.

And as we look at those issues—let me give you one more and then I will let you respond. It gets back to our issue of where we have built up huge debts and we are borrowing money from overseas. And it piggybacks on something some other colleagues have said. Historically, when we ran a national debt, a deficit, we sold the money by and large to ourselves. We sold bonds, we bought them through Treasury notes, et cetera. Currently we are seeing that debt explode, is probably the best way to put it. It is being bought by countries like Iran, Venezuela, Libya, Saudi Arabia, a host of other people. They are being bought through European or Caribbean banks.

Does it bother you that a lot more of our debt is being held by foreign countries? In some cases those countries that we have—China is a large purchaser. And the list is long. Does it bother you that we are selling it on the market, they are picking it up, they are people who we are trying to deal with diplomatically, and they have leverage on our debt?

Secretary PAULSON. there is a good number of things that bother me. That is not high on the list.

Mr. ETHERIDGE. Why?

Secretary PAULSON. Trying to be very brief. We have, as I said, about $4.4 trillion of treasuries that are held in the public markets. And if we are going to be growing ourselves at the rate we are growing, and not saving, and there are these big global imbalances, we need people to buy our treasuries and there is a great—these are very liquid markets, and there is great diversity. Let me just take China as an example.

The two biggest holders of our debt are—the Japanese own roughly $650 billion. The Chinese about, I think the last I saw was $346 billion. And of that, part will be held by the government, central banks, and part will be held by individuals. Our treasuries trade about $1 billion a day, so the Chinese hold less than one day's trading volume. And people own our debt because they believe—they've got confidence in this economy, and it gives them the best risk-adjusted rate of return.

So again, as I look at those numbers very carefully and there is a great diversity, we are part of the global economy. And so there are some other things I worry about but that is not—I am not discounting it. I am just saying it is not high up the list for me.

Mr. ETHERIDGE. Well, I had another question, but I will not go there because I am running out of time, Mr. Chairman. But the point is that you talk about the growth we are having over the last several years, and you can just give a yes or no hopefully on this one. With the large deficit we are running with borrowed money, isn't that having an impact on our GDP, because we are infusing an awful lot of money that we aren't generating?

Secretary PAULSON. I would say this. The current account deficit, which is part of the reason we have got the holders overseas, we have really reached a fortunate point in time, that gets right—for four quarters in a row, our exports have been growing faster than our imports. And so you look at the latest GDP number. We had one percentage point of growth in there for exports. So it is getting better.

Chairman SPRATT. Mr. Becerra.

Mr. BECERRA. Mr. Chairman, thank you.

Mr. Secretary, thanks for staying over. I appreciate it very, very much. I will try to make my questions somewhat pointed so that hopefully you can give me some directed answers as well.

As I mentioned yesterday when you were testifying before the Ways and Means Committee, the disconnect that I think occurs between an economy that you and others have said is moving and booming, and the fact that Americans are feeling very insecure about their future I think has to do with the fact that today more and more we are seeing the disparity between what we produce and who gets it. More and more we see folks who are wealthy getting far more than those who are middle class. And today, nothing more than the CEO salaries of some of our large corporations is testament to that, when you see people making tens of millions of dollars in one year, and you've got workers who are finding they have to fight to just struggle to maintain their wages at the previous year's level, and maybe get a small increase.

As we talk about our choices and our priorities, I look at the fact that we are spending all—the President's budget spends all the Social Security surplus monies in the trust fund over the next five or six years for nothing related to Social Security, that we still have seen the highest deficits we have ever seen, record deficits, and while they are coming down, they are still massive.

And today we pay more simply on interest on what we owe in our national debt than we have ever paid before. Some $250 billion is spent by this government simply to pay the interest. It doesn't reduce the principal of what we owe. It is not money available in the future for us to reduce taxes or to provide more services. It just goes to pay interest, like somebody who is paying interest on their mortgage, you are never doing anything to the mortgage in this case. All we are doing is paying interest on the national debt.

And so when we think about that in our choices and priorities, and realize that today we have men and women who are sacrificing for this country, especially in places like Iraq and Afghanistan, I have to ask you as Secretary of Treasury, do you think it is appropriate for us, for this government, for the President to be proposing that we further cut taxes that will principally benefit the wealthiest in this country? And some estimate that if you play these tax cuts out, that the individuals who are making about $1 million or so a year will get about $162,000 in tax cuts in 2012 dollars. So as you play these out in perpetuity, you are giving folks who are millionaires this massive tax cut, and then have folks who are right now in Iraq making small money, for the purpose of defending our country and its freedoms. So the question is first, is it appropriate for us to be cutting taxes at a time of war, when this country has never before this war and this President cut taxes when we are in a state of war?

Secretary PAULSON. I have said I do believe that the tax policy makes sense. And again I think what you are doing is you have mixed two facts; one of which is a greater divergence in income, which is a trend that is been going on for some time. It is related to a number of things. Technology has got to be a big part of it; and the President's tax relief which, you know, a lot of that was at the low end.

Mr. BECERRA. but if we are not doing anything to reduce the debt burden, today a child born—while we are speaking a child will be born in this country. That American child today has what I would consider a birth tax stamped right on his or her forehead, that is about $29,000 today that that individual is born owing as part of the American family, for that massive debt of over $9 trillion.

And so maybe we have room for tax cuts, maybe we have room for wise spending programs, wise services that we provide, but at a time when we have servicemen and women who are sacrificing their lives, should we be skewing tax cuts towards mostly folks who are making a massive amount of money?

Secretary PAULSON. Well, I would focus on that child is being born today, and what is coming down the road, and I just see a huge need, very important need to deal with this growth in the entitlement programs.

Mr. BECERRA. There, I agree with you, but can I ask you—I am going to run out of time real quickly. I wanted to get into these fee increases for veterans' healthcare, the short-changing of the No Child Left Behind education program that the President passed by about $15 billion for 2007 authorization levels, but let me just ask one last question.

The enforcement of the tax laws, where we have so many people who are not paying taxes when they owe it, where you have many good hard-working Americans who do, how do you deal with that tax gap of some $345 billion the IRS estimates that we don't collect, when your proposals that you provide in essence talk about collecting $3 billion a year over the next five years, of that $345 billion that people are stealing from the American taxpayers, under their noses, when—when you don't collect the taxes that someone owes, another American has to increase taxes——

Chairman SPRATT. Mr. Becerra, he answered that in some length earlier. We will get that in the record for you.

Mr. BECERRA. That is fine.

Chairman SPRATT. Just so he can give a brief answer to it.

Secretary PAULSON. Thank you, Mr. Chairman, but I will be very brief, and I appreciate because I did go into some depth. I would say that the number I think to focus on, which was last developed in an estimate in 2001 was 290 billion. And we have proposals to deal with this——

Mr. BECERRA. At 3 billion a year?

Secretary PAULSON. Well, I would say to you they are very serious proposals, and I would like to get those enacted and I would like to talk—you know, we also have a very robust audit function. I would just say to you, because you care a lot about the individual taxpayer and the honest taxpayer, many of the things we would have to do to go beyond that would place a very big burden on the taxpayer who is paying his full share because it will be greater reporting requirements. And you will get my answer——

Mr. BECERRA. I look forward to working with you on that issue. Thank you Mr. Chairman.

Chairman SPRATT. Thank you, Mr. Becerra. Ms. Kaptur of Ohio.

Ms. KAPTUR. Thank you, Mr. Secretary, for remaining for the rest of us. You have a very important job. And in your testimony you paint a very rosy picture about the economy, even indicating real wages have risen 1.7 percent, which isn't a whole lot, but what you don't say is it is disproportionately shared. Those in the top one percent have had a relative income increase of $146,000 a year, while the average middle-class family in our country actually has fallen behind $1300 a year since the beginning of the Bush administration. They are paying more for gas, they are paying more for medicine, they are paying more for healthcare. Job growth is sluggish. During the Clinton administration, we had about 227,000 jobs being created annually, and by this administration 66,000. It is a quarter of what had happened before. We have a negative savings rate in this country. Our trade deficit knocks off almost a full point or more off our GDP, with nearly $1 trillion of trade deficit, and we have the highest vacancy rate in housing in over 40 years. I am very worried about that. All across the country, and what is happening in the mortgage market.

So my question to you is very—I have a couple simple ones. Has the Bush administration in its seven years of submissions to the Congress ever submitted a balanced budget to the Congress? The Bush administration. I know you haven't been there for the full seven years, but in any of the years, have you ever submitted a balanced budget, yes or no?

Secretary PAULSON. Have we achieved a balanced budget?

Ms. KAPTUR. Have you submitted a balanced budget, in any of the seven years that you have——

Secretary PAULSON. I haven't been here. You will have to ask someone else that question.

Ms. KAPTUR. Sir, you are the Secretary of Treasury.

Secretary PAULSON. I can tell you we have submitted a budget——

Ms. KAPTUR. You have never submitted a balanced budget. Please be realistic about what you have done. What is the amount of debt, the accumulated debt that the Bush administration has added to this economy? How much? over the seven years? Three point nine trillion, do you know that number?

Secretary PAULSON. I know the number.

Ms. KAPTUR. All right, thank you very much. Three point nine additional trillion dollars onto the nation's debt. Are you aware that interest payments on that debt has now grown to nine percent of our total budget, totaling nearly $300 billion a year, which is enough to fund half the federal agencies we have to fund in terms of discretionary funding? Are you aware of that? Nearly $300 billion a year in interest that we are paying?

Secretary PAULSON. I am aware of what the interest is.

Ms. KAPTUR. Are you aware of that 95 percent of the new issues, the new securities issues for that debt are purchased by foreign interests, 95 percent?

Secretary PAULSON. We just addressed the foreign holding.

Ms. KAPTUR. Alan Greenspan told me a few years ago that when I tried to encourage him to sell the debt in small denominations like Roosevelt did to the American people, through postal savings stamps, he told that we didn't need to do that because 20 bond houses on Wall Street handle all of our issues. Is that still true?

Secretary PAULSON. We have 20 primary dealers.

Ms. KAPTUR. Okay, 20 primary dealers. Can your office sends me those dealers, please? The names of those dealers?

Secretary PAULSON. Sure.

Ms. KAPTUR. All right, and do they receive a fee for this service they provide? Can you also give me how much they make in those annual fees, please? Do you have that information.

Secretary PAULSON. We will send you the information we have.

Ms. KAPTUR. All right, is Goldman Sachs one of those dealers?

Secretary PAULSON. I believe they are.

Ms. KAPTUR. All right. Are you the former CEO of Goldman Sachs?

Secretary PAULSON. Yes.

Ms. KAPTUR. Are they still a dealer in our public securities?

Secretary PAULSON. They are still——

Ms. KAPTUR. Thank you very much. Could you also provide this to me for the record: for our earned income tax credit, States like Ohio are foregoing over $250 million to our citizens who don't get those refunds. In my congressional district probably $20 million is foregone by the public that should be receiving, working people should be receiving those dollars back. Could your staff make a recommendation to us on how every single American who qualifies for the EITC can get it, and how much you can simplify the procedures for that? Or does Congress have to do that for you?

Secretary PAULSON. Well, this is a very high priority of mine, and we are doing a good deal of work on this right now.

Ms. KAPTUR. All right. Finally, thank you very much, I would appreciate the recommendations of your staff on how to simplify the filings for that.

Secretary PAULSON. We are working with Chairman Rangel on that.

Ms. KAPTUR. All right. Finally, are you aware of a deal that was signed during the Reagan Administration with the U.S. Treasury, and I suppose the Federal Reserve, with the Saudis, having to do with how petrodollars would be recirculated in our economy as a backup? Over $1 trillion? Are you familiar with that agreement?

Secretary PAULSON. No, I am not.

Ms. KAPTUR. Could you ascertain for me if it is still in effect, the amount, and who might have signed it, and whether or not it has expired? Thank you very much. I appreciate that. How soon can expect to receive the names of the dealers and the fees that they are paying for handling our public debt securities?

Secretary PAULSON. We will do that as soon as we can get it together for you.

Ms. KAPTUR. Within a month?

Secretary PAULSON. We will get it to you as soon as we can pull it together

Ms. KAPTUR. Thank you, Mr. Secretary, very much.

Secretary PAULSON. I am delighted I stayed for your questions. Let me just make a couple of comments.

I begin by saying that I was on Wall Street in 2000, 2001. I saw the impact of the bursting stock market bubble. So I think part of the economy you were talking about in such glowing terms was an Alice in Wonderland economy, the stock market bubble burst. We went into a recession. There was a 9/11 attack. I would respectfully suggest you are being a bit too pessimistic about this economy, which is growing nicely. The numbers I cited were for the average, you know, for the average worker, you know, compensation being up in real terms, 1.7 percent.

Ms. KAPTUR. Mr. Secretary, please. You have to look at the distribution of that. I hear what you are saying.

Secretary PAULSON. I am talking about the average. You know, I am very aware of the distributional effects. The average worker has over the last year seen real gains.

But I will get back to you with as much of the information as I can get together.

Ms. KAPTUR. In a most incredible statement that was ever made, and I will end with this, Mr. Chairman, when Alan Greenspan was head of the Federal Reserve in 2000, when we were finally beginning to balance our annual budgets and pay down our long-term debt, and it was coming down after severe effort by this Congress, by Leon Panetta, by President Clinton, by many members of Congress who lost their seats because they voted to try to balance that budget over a series of years, and I can remember Alan Greenspan saying publicly, “You know, now that we are getting to the point were we might actually sell off all these debt securities and balance our budget, well, you know, we are in uncharted waters. We might not want to do this. We don't know what having no debt might mean for the future."

That statement has troubled me ever since he made it because I was so proud as an American that we were finally paying off our bills.

Chairman SPRATT. Ms. Kaptur, we have got to let the Secretary go because he is due out of here at 12:30.

Thank you for your forthright answers, for your forbearance. We are glad you are where you are, and we are looking forward to working with you.

Secretary PAULSON. Thank you, Mr. Chairman.

Chairman SPRATT. Thank you very much.

[Whereupon, at 12:38 p.m., the Committee was adjourned.]

○