HEARING ON THE ECONOMY

HEARING

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HEARING ON THE ECONOMY

TUESDAY, JANUARY 23, 2007

U.S. House of Representatives,
Committee on Ways and Means,
Washington, DC.

The Committee met, pursuant to notice, at 10:00 a.m., in room 1100, Longworth House Office Building, Hon. Charles B. Rangel (Chairman of the Committee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: 202–225–1721
January 16, 2007
FC–1

Ways and Means Committee to Hold Hearing on the Economy

House Ways and Means Committee Chairman, Charles B. Rangel (D–NY) today announced that the Committee will hold a hearing on the state of the U.S. economy. **The hearing will take place on Tuesday, January 23rd, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10 a.m.**

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

FOCUS OF THE HEARING:

The American economy has changed significantly in recent years. After a period of recession in 2001, the economy began a slow recovery, although job creation has lagged behind the pace set in other recent economic recoveries. During these years, income inequality has grown significantly and many Americans have experienced little or no growth in wages.

This hearing is the first in a series on economic conditions in the United States. The hearings will examine such topics as the current state of the economy, potential dangers to continued economic health, the cost of poverty on the American economy, the impact of globalization on workers and the economy, economic pressures on the middle class, and whether all Americans have shared in the benefits of the economic recovery since the last recession.

In announcing the series, Chairman Rangel said, "These hearings will help provide the Committee with a good economic overview as we begin our legislative work in the new Congress. Economic issues are vital to the security and prosperity of our great nation and Congress needs to know, to the fullest extent possible, how the economy is, or isn't working for every American."

WITNESSES:

Witnesses will be announced before the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*110th Congress*" from the menu entitled, "*Committee Hearings*" (*http://waysandmeans.house.gov/Hearings.asp?congress=18*). Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You ***MUST REPLY*** to the email and ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Tuesday, February 6, 2007. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

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

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

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

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

Chairman RANGEL. The Committee hearing will come to order.

One of the reasons why we will have this as a series of hearings is that soon the Committee will have to settle down and start getting our legislative calendar together. What is going to be important as we hear from the witnesses sharing with us the status of the economy and fears that they may have in the future most all of these decisions will have to come one way or the other back, to our Committee.

So, as we listen to the witnesses, it would be very helpful for the Committee members to think in terms of their Committee assignments so that when we go into the full hearings, we will go with the benefit of the discussions that we are having with expert witnesses.

Again, maybe a lot of people in the audience are unaware that the Ranking Member and I, and the full Committee and our staffs, have committed ourselves to try to find a middle ground and legislation that is good for our country, the Congress, and certainly the prestige of this Committee.

So for those of you who would want to over-impress us with how bad Democrats or Republicans are, we have been through that. We are fully aware of the issues there. We are now going to try to move forward as the Committee on Ways and Means to see what contribution we can make to our great country.

At this time, I would like to yield to my friend Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman, for yielding time. I have an opening statement in writing that I would submit for the record.

Chairman RANGEL. Without objection.

Mr. MCCRERY. Urge the Committee to listen to these witnesses today, consider the tasks that we have before us, and recognize that it is not going to be easy to deal with some of the problems this Committee has jurisdiction over, and recognize that it is going to take both political parties working together to solve some of these problems that will be pointed out by these witnesses today.

With that, Mr. Chairman, I yield back.

[The prepared statement of Mr. McCrery follows:]

Opening Statement of The Honorable Jim McCrery, a Representative in Congress from the State of Louisiana

Mr. Chairman, thank you for yielding time, and I thank you for holding this hearing today on the state of our economy.

I have to start by saying that I am encouraged by the state of our economy in the short-term, while recognizing that we need to squarely face the long-term challenges ahead of us.

Over the past several years, we have focused on reducing taxes and creating a tax code that encourages individuals and businesses to invest. The results have been excellent for workers, for the U.S. Treasury's bottom line, and for the American economy as a whole.

The Bureau of Labor Statistics reports that we have had 15 straight months at or below 5% unemployment. In the past 3 months, 407,000 net new jobs have been created, and we have had 40 straight months of job growth. Over the past year, average weekly wage earnings grew 4.8 percent, while the Consumer Price Index increased by only 2.5 percent.

Tax receipts increased 11.8% in fiscal year 2006 (FY06), to over $2.4 trillion. That was on top of fiscal year 2005's 14.6% increase. Tax receipts have grown another 8% so far in the first quarter of fiscal year 2007, compared to the first quarter of fiscal year 2006.

Overall, according to the Bureau of Economic Analysis, our economy saw 3.4% annualized real GDP growth through the first 3 quarters of 2006.

But, as we all know and as the Chairman of the Federal Reserve reminded the Senate Finance Committee last week, our economy faces long-term challenges in reforming our entitlement programs.

The first of the Baby Boomers are poised to retire and begin receiving benefits from Social Security and Medicare. Between now and 2035, our population aged 65 and older is expected to double, while the population aged 20–64 is expected to grow by only about 11 percent. As a result, there will be fewer workers supporting each beneficiary. In 1950, 16 workers supported each retiree; today, three workers support each retiree. In 25 years, two workers will support each retiree. According to the Social Security Board of Trustees, starting in 2017, Social Security's revenues will fall short of the amount needed to pay promised benefits. By 2040, the Treasury bills in the Social Security trust funds will be depleted and payroll taxes will be sufficient to pay only 74 percent of benefits.

As last year's Medicare trustees report noted, "Medicare's financial difficulties come sooner—and are much more severe—than those confronting Social Security." The trustees continued, "while Medicare's annual costs were 2.7 percent of GDP in 2005, or over 60 percent of Social Security's, they are now projected to surpass Social Security expenditures in a little more than 20 years."

Last year, spending on the largest entitlement programs—Social Security, Medicare and Medicaid—represented about 40 percent of all federal outlays and roughly 8.5 percent of American's Gross Domestic Product. According to projections by the non-partisan CBO, spending on those three programs will rise to 10.5 percent of GDP by 2015 and to about 15 percent of GDP by 2030.

In his testimony last week, the Federal Reserve Chairman was blunt about the dangers of inaction. "[I]f early and meaningful action is not taken," he told the Senators, "the U.S. economy could be seriously weakened, with future generations bearing much of the cost."

The challenges we face are not the creation or invention of only one political party, and one political party cannot solve them alone. I look forward to working with the Chairman as we try to continue the recent solid economic growth, while preparing to deal with the changes our entitlement programs will require over the coming decades.

Chairman RANGEL. As the witnesses know, since most all of you are professionals before this Committee, we would ask that you summarize your statement to 5 minutes to give time to answer questions.

The first witness will be Mark Zandi; Dr. Mark Zandi, chief economist, Moody's Economy.com, West Chester, Pennsylvania. Thank you.

STATEMENT OF MARK ZANDI, PH.D., CHIEF ECONOMIST, MOODY'S ECONOMY.COM, WEST CHESTER, PENNSYLVANIA

Mr. ZANDI. Thank you, Mr. Chairman, Members of the Committee. I am Mark Zandi. I am the chief economist of Moody's Economy.com.

I will make four points in my remarks. First, the economy in the aggregate is performing well and is expected to continue doing so during the coming year.

Second, the benefits of the strong economy are not accruing evenly, as the industrial Midwest and Gulf Coast economies continue to struggle, and lower income and less-wealthy households fall further behind wealthier households.

Third, the economy's long-term growth prospects are worrisome, given the nation's daunting fiscal challenges, unless substantial changes are made to both tax and spending policies.

Finally, any policy changes must be considered from many perspectives, including examining them from the prism of the distribution of income and wealth.

The economy is currently experiencing growth near its potential, is operating close to full employment, and inflation and interest rates are low by historical standards. While growth will be slower in the coming year due to the ongoing housing correction and some spillover effects into other parts of the economy, the economy will enjoy its sixth year of expansion.

This optimism is based on record corporate profits. Profits have more than doubled since the 2001 recession, and margins have never been wider. Businesses have significantly pared their debt loads and are flush with cash, which they are using to repurchase stock, pay dividends, acquire and merge with other companies, and invest overseas, and also to invest and hire here in the United States. Businesses are unlikely to significantly pull back on their expansion plans, given their currently stellar financial situation.

The housing correction is weighing on growth. Previously soaring house prices combined with the Federal Reserve's tightening efforts have undermined housing affordability. Builders are working off a large amount of unsold inventory, and short-term speculators are being wrung out of the marketplace. Sales, construction house prices, will remain weak throughout the year.

There will also likely be some spillover of housing's problems into the rest of the economy as lower housing wealth and surging delinquencies and foreclosures crimp consumer spending growth. The housing correction is unlikely to devolve into a crash, however, given the sturdy job market, and thus while recession risks are elevated, they are low.

The benefits of the expansion are not accruing evenly, however. The auto producing areas of the industrial Midwest are in recession as domestic vehicle producers are cutting production and jobs. The Gulf Coast recovery from Hurricanes Katrina and Rita is disappointingly slow, and New Orleans employment is still 20 percent below its pre-storm level.

Parts of the rural economy, particularly in the South, are still suffering the ill effects of job losses in manufacturing, and the economies of many of the nation's urban cores are moribund.

Lower and lower middle income households have not kept up financially in this expansion. Rural incomes, median household incomes, are no higher today than they were in the late 1990s. This reflects very strong income gains for households in the top half of the distribution of income, but little or no gain in real incomes for those in the bottom half.

The distribution of wealth is even more skewed. Those in the top 10 percent of the wealth distribution have median real household net worth of about a million dollars. This is double what it was a decade ago. The median household net worth of those in the bottom half is less than $50,000, and that has barely grown at all in the past decade.

Globalization and the rapid pace of technological change have enormous economic benefits. While both are vital to a strong economy, they have also been the principal driving forces behind this uneven distribution of those benefits. Those with education, skills, and talent are now able to sell their wares into a large and fast-growing global marketplace, while those without are now competing in a much larger global labor market.

The economy's long-term prospects are also worrisome, given the prospects for large budget deficits in the decades ahead. As articulated in recent congressional testimony by Federal Reserve Chairman Bernanke, without substantive changes to tax and spending policies in the near future and making some very reasonable assumptions, the deficits will amount to nearly 10 percent of the nation's Gross Domestic Product (GDP) a quarter century from now. Driving this worrisome outlook are the inexorable aging of the population and the rapid growth in health care costs.

Mounting deficits will ultimately weigh heavily on investment, productivity growth, and ultimately the level standards of all Americans. Lower and middle income households will be particularly hard hit, however, as they rely heavily on Social Security, Medicare, and Medicaid, programs that will become insolvent during this period. The debt burdens on these households will also become overwhelming due to higher interest rates engendered by the mounting deficits.

These long-term fiscal and economic concerns should be addressed in the very near term through a combination of what will be painful tax and spending policy changes. Many factors must be weighed in determining the appropriate mix of these changes, including its implications for households, industries, regions, and the broader economy.

How these changes influence the distribution of income and wealth should also be considered. It has long been an anthem for economists and difficult for policymakers to consider policy through this prism. The ongoing skewing of the distribution of income and wealth has become so pronounced, and will become even more so in the years ahead, that those who are being disenfranchised are sure to short-circuit the process of globalization and technological change so vital to the long-term strength of our economy.

Policymakers must be resolved not to allow protectionist sentiment to boil over, or to allow efforts to intervene in the job, product, and financial markets. However, they must be equally resolved to consider all future economic policy in the context of what it means for lower and middle income households.

Thank you.

[The prepared statement of Dr. Zandi follows:]

Statement of Mark Zandi, Ph.D., Chief Economist, Moody's Economy.com, West Chester, Pennsylvania

Mr. Chairman and members of the Committee, my name is Mark Zandi, I am the Chief Economist and Co-founder of Moody's Economy.com. Moody's Economy.com is an independent subsidiary of the Moody's Corporation. We are a provider of economic, financial, country, and industry research designed to meet the diverse planning and information needs of businesses, governments, and professional investors worldwide. We have over 600 clients in 50 countries, including the largest commercial and investment banks; insurance companies; financial services firms; mutual funds; manufacturers; utilities; industrial and technology clients; and governments at all levels. Moody's Economy.com was founded in 1990, is headquartered in West Chester, Pennsylvania, a suburb of Philadelphia, and maintains offices in London and Sydney.

I will make four points in my remarks. First, the economy, in aggregate, is performing well and is expected to continue doing so during the coming year. Second, the benefits of the strong economy are not accruing evenly, as the industrial Midwest and Gulf Coast economies continue to struggle and lower income and less wealthy households fall further behind higher income, wealthier households. Third, the economy's long-term growth prospects are worrisome given the nation's daunting fiscal challenges unless substantial changes are made to both tax and spending policies. Finally, any policy changes must be considered from many perspectives, including examining them through the prism of the distribution of income and wealth.

Near-Term Growth

The economy is currently experiencing growth near its potential, it is operating close to full-employment, and inflation and interest rates are low by broad historical standards. While growth will be slower in the coming year due to the ongoing housing correction and some spill-over effects into other parts of the economy, the economy will enjoy its sixth year of expansion.

Behind this optimism is record corporate profitability. Profits have more than doubled since the 2001 recession, and profit margins have never been as wide. Businesses have significantly pared their debt loads and are flush with cash, which they are using to repurchase stock, pay dividends, acquire and merge with other companies, invest overseas, and also to invest and hire here in the United States. Businesses are unlikely to significantly pull-back on their expansion plans given their currently stellar financial situation.

The economy is also receiving a lift from robust global economic growth. It is not unprecedented for all the globe's major economies to be expanding in unison, but it is unusual. Sturdy global growth combined with a weaker dollar is resulting in a narrowing in the trade deficit for the first time in a decade.

The housing correction is weighing on growth. Previously soaring house prices combined with the Federal Reserve's tightening efforts have undermined housing affordability, builders are working off a large amount of unsold inventory, and short-term speculators are being wrung out of the marketplace. Home sales, construction, and house prices will remain weak throughout much of this year. There will also likely be some spillover of housing's problems into the rest of the economy, as lower housing wealth and surging mortgage delinquencies and foreclosures crimp consumer spending growth. The housing correction is unlikely to devolve into a crash, however, given the sturdy job market, and thus while recession risks are elevated they remain low.

Economic Benefits

The benefits of the economic expansion are not accruing evenly, however. The auto-producing areas of the industrial Midwest are in recession as the domestic vehicle producers cut production and jobs. The Gulf Coast's recovery from Hurricanes Katrina and Rita is disappointingly slow, with New Orleans employment still more than twenty percent below its pre-storm level. Parts of the rural economy, particularly in the South, are still suffering the ill-effects of ongoing job losses in manufacturing, and the economies of many of the nation's urban cores are moribund.

Lower and lower-middle income households have not kept up financially in this expansion. Real median household incomes are no higher today than they were at the end of the 1990s. This reflects very strong income gains for households in the top half of the income distribution, but little or no gains in real incomes among those in the bottom half. The distribution of wealth is becoming even more skewed. Those in the top ten percent of the wealth distribution have median real household net worth of approximately $1 million. Their net worth has doubled during the past decade. The real median household net worth of those in the bottom half of the wealth distribution is less than $50,000 and it has barely grown during this period.

Globalization and the rapid pace of technological change have enormous economic benefits, and while both are vital to a strong economy, they have also been the principal driving forces behind the uneven distribution of those benefits. Those with education, skills, and talent are now able to sell their wares into a large and fast-growing global marketplace, while those without are now competing in a much large global labor market.

Financially-pressed lower income households have been able to mitigate the impact of their constrained incomes on their living standards by significantly increasing their borrowing. This has been facilitated by the steady decline in interest rates over the past quarter century and financial innovations which have substantially increased the availability of credit. It is becoming increasingly difficult for lower income households to supplement their incomes with increased debt, however, as debt burdens are already at record highs, interest rates are no longer falling, and judging by surging mortgage credit problems, borrowers are increasingly unable to juggle their existing obligations.

Long-Term Concern

The economy's longer-term prospects are also worrisome given the prospects for very large budget deficits in the decades ahead. As articulated in recent Congressional testimony by Federal Reserve Chairman Bernanke, without any substantive changes to tax and spending policies in the near future, and making some very reasonable assumptions, the federal budget deficit will amount to nearly 10% of the nation's GDP a quarter century from now. Driving this worrisome outlook are the inexorable aging of the population and rapid growth in health care costs.

Mounting deficits will ultimately weigh heavily on investment, productivity growth, and the living standards of all Americans. Lower and middle income households will be particularly hard hit, however, as they heavily rely on the Social Security, Medicare, and Medicaid programs; programs that will become insolvent during this period. The debt burdens on these households will also become overwhelming, due to the higher interest rates engendered by the mounting deficits.

Policy Changes

These long-term fiscal and economic concerns should be addressed in the very near-term through a combination of what will be painful tax and spending policy changes. Many factors must be weighed in determining the most appropriate mix of changes, including implications for households, industries, regions, and the broader economy. How these changes influence the distribution of income and wealth should also be considered. It has long been anathema for economists and difficult for policymakers to consider policy through this prism. But the ongoing skewing of the distribution of income and wealth has become so pronounced and will become even more so in the years ahead, that those who are being disenfranchised are sure work to short-circuit the process of globalization and technological change so vital to the long-term strength of our economy. Policymakers must be resolved not to allow protectionist sentiment to boil over or to allow efforts to intervene in the job, product, and financial markets, but they must be equally resolved to consider all future economic policy in the context of what it means for lower and middle income households.

Chairman RANGEL. Our next witness is Martin Regalia, Dr. Martin Regalia, Vice President of Economic and Tax Policy and Chief Economist for the U.S. Chamber of Commerce. Thank you.

STATEMENT OF MARTIN REGALIA, PH.D., VICE PRESIDENT OF ECONOMIC AND TAX POLICY AND CHIEF ECONOMIST, UNITED STATES CHAMBER OF COMMERCE

Mr. REGALIA. Thank you, Mr. Chairman, Ranking Member McCrery, and Members of the Committee. My name is Martin Regalia, and I am the chief economist at the U.S. Chamber of Commerce. I thank you for the opportunity to speak on the outlook for the U.S. economy today.

The near-term outlook for the economy remains fundamentally sound, with prospects for solid, albeit not spectacular, performance over the course of the year. The economy has downshifted over the past year from growth well above its potential and increasing inflation to growth somewhat below its potential with slowing inflation. The slowdown was the result of sharply higher energy prices and an engineered increase in interest rates.

Growth appears to have bottomed out in the third quarter at about 2 percent, and we expect it to grow at about 3 percent or so in the fourth quarter, somewhere between 2½ and 3 percent in the first part of the year, and a little over 3 percent, approaching potential, by the end of the year. The composition of growth will remain heavily dependent on consumption, with solid contributions from investment and modest improvement in net exports.

With the economy expected to continue to grow somewhat below its potential through the first half of the year, employment growth is expected to slow a bit and the unemployment rate is expected to rise moderately from its current 4.6 percent to about 5 percent by the end of the year, still relatively low by historical standards. Overall job creation for 2007 should exceed 2 million net new jobs, slightly above the level of 1.8 million reached in 2006.

Inflation began last year on a troublesome note, with both overall prices and core prices rising noticeably. With economic growth slowing and energy prices retreating from historic highs, inflation in overall prices as well as in core prices ended the year in much better fashion. The overall Consumer Price Index (CPI) actually dropped 2.2 percent at an annual rate in the fourth quarter, and the core rate rose only 1.8 percent. For the year as a whole in 2007, we expect the overall CPI to be up about 3 percent or so, between 3 and 3½, and core prices to rise about 2.3 percent, getting closer and closer to what the Fed deems its comfort range.

With economic growth remaining slightly below its potential in the first half of the year and with inflation moderating, we expect the Fed to hold short-term interest rates in their current range. Longer-term interest rates are expected to remain about where they are or drift up only slightly through the course of the year.

The risk to this forecast are balanced. On the down side, the risk of a decline in housing, spreading to a broader weakness in consumption and overall economic growth, appear to be waning. The housing market is showing incipient signs of bottoming out, with both starts and sales improving in the last couple of months of 2006. On the up side, a weaker dollar and stronger growth abroad appear to be improving our trade deficit somewhat more than we expected a few months ago.

While the short run looks pretty good, there are some daunting challenges facing our economy in the medium to longer term. The lack of national saving makes us highly dependent on world capital. An aging population raises concerns over rising deficits and escalating health care costs. The long-term drift in the income and wealth distributions, which appear to be the result of shortfalls in education, will threaten our future competitiveness on a global basis.

I will end my remarks there. Be happy to take questions on the particulars at the right time. Thank you.

[The prepared statement of Dr. Regalia follows:]

Statement of Martin Regalia, Ph.D., Vice President of Economic and Tax Policy and Chief Economist, U. S. Chamber of Commerce

Chairman Rangel and Ranking Member McCrery, members of the Committee, I am Dr. Martin Regalia, Vice President of Economic & Tax Policy and Chief Economist of the U.S. Chamber of Commerce. I am pleased to be able to submit the following testimony for the record on behalf of the U.S. Chamber of Commerce. The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector and region. Over ninety-six percent of the Chamber members are small businesses with fewer than 100 employees. I commend the Committee for its interest in having this hearing on the current state of the U.S. economy.

The economy closed 2006 with solid, if not spectacular, economic growth and employment, and slowing inflation. The economy grew 2.0 percent in the third quarter of last year, down from 2.6 percent in the second quarter and well below the 5.6 percent pace of the first quarter of 2006 as the lagging effects of higher energy prices and Fed-engineered interest rate increases continued to impact economic growth. With energy prices down sharply from their peaks reached earlier this year and the Fed tightening now on hold for the last four FOMC meetings, we are projecting an up-tick in GDP growth to about 3.0 percent for the final quarter of 2006 and continued moderate growth in the first half of 2007.

Looking at the labor market, the economy produced 407,000 net new jobs in the fourth quarter of 2006, down from a total of 556,000 in the third quarter, which was the strongest of the year. Although job creation decelerated in the fourth quarter, it nonetheless remains on solid footing with December's 167,000 net new jobs bringing the year's total to over 1.8 million. The unemployment rate was 4.5% in both November and December, up slightly from the 4.4% level seen in October. Given the expectation for modest GDP growth, we expect the unemployment rate to climb slightly from this point through the middle of the year, peaking at about 5%. Thus far in 2007, the labor market is improving with the initial claims for unemployment falling to 308,000 on a 4-week moving average basis.

Despite the projected rise in the unemployment rate, job and wage growth are expected to be sufficient to ensure continued consumer spending. Last year, consumers increased their spending pace to 2.8 percent in the third quarter, up from 2.6 percent in the second quarter. The increase came as gasoline prices retreated from summer peaks and freed up some discretionary income. Continued moderation in energy prices coupled with modest growth in real disposable income should keep consumer spending reasonably robust. Recent increases in equity markets have largely offset weakness in home equity wealth. Additionally, consumer debt levels, while high by historical standards, are trending down, helping to improve consumer balance sheets.

The government deficit has become a source of anxiety in recent years. However, in fiscal year 2006 the deficit was $248 billion, down from $318 billion in 2005 and well below the $400+ billion estimate made in early 2006. The improvement in the deficit came primarily from a surge in tax revenues, which were propelled by a rise in receipts from taxes on corporations as well as individuals' investment profits. Government outlays jumped 28% between 2000 and 2004, while government receipts fell 7% over the same period. However, with strong economic growth over the last two years, revenues grew 28% while expenditures increased 16%.

Interestingly, political factors may actually help to ameliorate the deficit problem in the short run. With the arrival of the new Congress, potential gridlock may actually produce a positive result in the Federal budget. The last time we had a similar situation was in the latter half of the 1990s, when Democrats controlled the Administration and Republicans held the Congress. Back then, the combination of solid economic growth and political gridlock increased Federal revenue growth while slowing the growth in Federal spending. As a result, the budget deficit plummeted, turning into a surplus between 1998 and 2001. While there's no guarantee that a divided government will produce similar results this time, it is certainly a possibility. Nevertheless, sustainable deficit reductions will likely remain a challenge in the longer-run.

Another challenging area for the country's economy is the trade sector. However, it appears that the situation has improved a bit of late. With the dollar finding a comfort zone at a relatively low level and growth abroad turning in a solid performance, U.S. net exports improved noticeably over the second half of 2006 as exports strengthened and imports slowed, the latter due in part to the recent fall in crude oil prices. Despite this short-term improvement, at current levels our trade deficit will become unsustainable in the long term. Thus, we must continue to push for more access to foreign markets and encourage newly emerging players to remove trade barriers and limit currency manipulation. We must also encourage more domestic saving, which will limit our need to borrow in international capital markets.

Turning to the country's monetary conditions, interest rates seem to have stabilized. At its latest meeting on December 12, the Fed left interest rates unchanged for a fourth straight time. Before its meeting on August 8, the Fed had increased rates 17 consecutive times, each time adding 25 basis points. While the Fed left the possibility open for more interest rate increases in the future depending on "incoming information," we believe that the Fed is done tightening for this cycle as inflation pressures have moderated.

The rise in overall inflation earlier this year was driven by sharp increases in many commodity prices, and more recent commodity price declines have likewise been responsible for the recent drop in inflation. Nominal crude oil prices set records above $77 a barrel in the summer. However, crude has since dropped back to near $50 a barrel as oil inventories in the U.S. have become more plentiful amid a mild beginning to the winter season on the northern East Coast, the largest heating-oil market in the U.S. In addition, gasoline prices have dropped more than 70 cents from their peak at over $3 per gallon earlier this year, while natural gas prices continue to exhibit a lack of price pressures.

Amid the recent decline in energy prices, the CPI decelerated notably in the third quarter, increasing at only a 2.9% pace. Despite an up-tick in December, the CPI fell 2.2% at an annual rate in the fourth quarter of last year. More importantly, core inflation (net of food and energy) also showed signs of slowing. The core CPI rose only 1.8% at an annual rate in the fourth quarter of 2006, down from 3.0 percent in the previous quarter. The personal consumption deflator (PCE)—a measure watched closely by the Fed—increased 0.5 percent in November (the latest data available) and 1.8 percent over the previous three months. Concurrently, market inflation expectations have trended downward since their cyclical peak in early 2005, with the sharpest declines occurring since the summer of this year.

With the Fed expected to remain on hold and inflationary expectations putting downward pressure on longer-term interest rates, we anticipate a flat yield curve for the next few quarters. While the financial markets appear relatively comfortable with both the Fed's monetary policy and the overall growth prospects for the U.S. economy, the risk spread has risen slightly in the last few months as economic growth has slowed. However, the current risk spread remains near the level in the latter part of the 1990s and well below the levels witnessed during, and immediately following, the last recession.

While the overall economy performed reasonably well last year and, after a slow first half, is expected to pick up a bit toward the end of this year, there were certain sectors that were, and continue to be, clear weak spots. For example, the housing market declined sharply in 2006 after years of stellar performance. Both housing starts and sales began slumping in the summer as rising interest rates and home prices significantly reduced housing affordability and tempered demand. As a result, we experienced a sharp increase in the inventory of unsold homes and noticeable weakness in home prices. The drop in housing production was a definite drag on the overall economy, but the feared decline in household wealth and its negative impact on broader consumer spending has failed to materialize in part because of the equity market rally in the latter part of last year.

While the housing sector will likely continue to experience some malaise for another few months as the existing inventory is worked off, we believe that the market is close to a bottom and, while it may be a protracted bottom, a cessation in both interest rate and price increases, as well as continued income growth, should help to rebuild affordability and stop the negative momentum. We have already seen some positive signs with a small pick-up in sales of new and existing homes in November and modest improvement in starts in both November and December of 2006. Housing affordability has increased four straight months since July.

During times such as these, with overall growth slowing and the composition shifting, top line indicators can be inconclusive and we can sometimes get a clearer picture by looking at sector data. One of these underlying sectors is manufacturing. The Institute for Supply Management's computes a Purchasing Managers Index (PMI) that is intended to signal whether this sector is expanding or contracting. A reading above 50 indicates growth while a reading below 50 signals contraction. While a brief stint below 50 can occur even in relatively good economic times, a prolonged stay or sharp decline below that level usually means trouble. In November 2006 the PMI dipped slightly below 50 for the first time since April 2003 but quickly rose back above 50 in December. This brief excursion into negative territory is more consistent with below-trend growth rather than an impending recession.

Another indicator of industrial strength is manufacturing new orders, specifically orders of non-defense capital goods excluding aircraft—a number which is less volatile and more reflective of the overall trend in industrial demand. These orders have trended up since 2004 and rose 9.6% through November of last year compared with the same period in 2005.

The positive performance of manufacturing orders and shipments is reflected by growth in total industrial production. Although it decelerated a bit in the third quarter, industrial production growth remains decent and continues to drive investment and support robust levels of capacity utilization. Moreover, corporate profits continue to surge and provide a healthy source for internal financing of investment, and with credit readily available on world-wide credit markets and interest rates still relatively low, outside financing options are prevalent.

Given the resilience in the industrial sector, growth in equipment and software investment bounced back from an annualized rate of −1.4 percent in the second quarter to 7.7 percent in the third quarter, and helped by a strong 15.6 percent rise in the first quarter will likely rise by about 7.0 percent in 2006. We expect growth in this component at a slightly slower 5.7% pace.

In addition, investment in structures rose 15.7 percent in annualized terms in the third quarter, following a very brisk pace of 20.3 percent in the second quarter—the highest rate in a decade. While we expect some easing in this category over the forecast horizon, the generally strong pace will continue to offset some of the weakness in residential construction.

Like manufacturing, transportation has also proven to be a useful leading indicator of overall economic activity, especially because it includes both domestically produced and imported goods. The American Trucking Associations (ATA) produces an index of truck tonnage, which measures the volume of goods moved by trucks throughout the country. The tonnage index has slumped a bit since early 2006 and through last November was 2.8 percent below the same period in 2005. However, the level of the index remains well above that seen during the last recession.

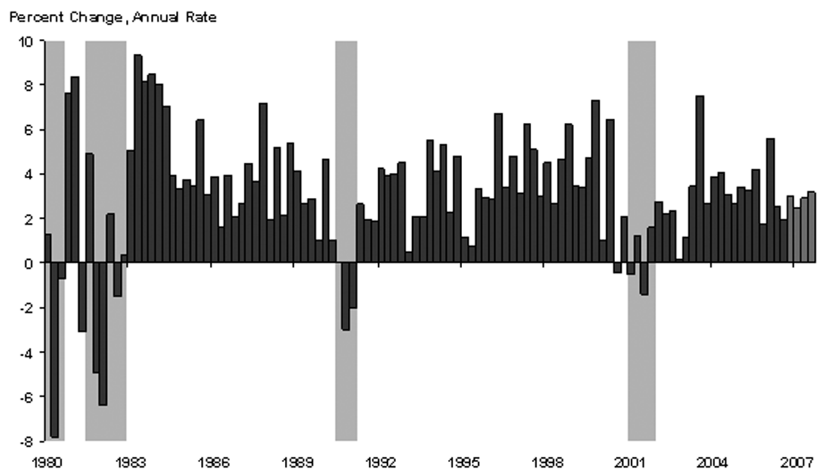
Railroad data also suggests some slowing in the economy. The Association of American Railroads (AAR) publishes statistics on rail activity. In 2006, AAR's total carloadings rose 2.8% over 2005, while intermodal carloadings (which are better correlated with manufacturing activity) gained 5.0%. However, the rate of year-over-year growth in intermodal carloadings has declined noticeably from the nearly 12% pace in late 2004.

Financial indicators are another valuable yardstick to measure economic activity. Growth in the money supply strengthened noticeably after the 2001 recession, running at an annual rate of nearly 6% between 2001 and 2004. Since then growth has slowed to about 1% as the Fed's monetary policy has become more restrictive. The availability of credit, however, has shown no sign of slowing, as total bank credit has risen at an annual rate of 8% in the 2001–2006 period. Moreover, commercial and industrial loan volume, which had dropped off sharply between 2001 and 2004, has since picked up, growing at an annual rate of 11% over the 2004–2006 period.

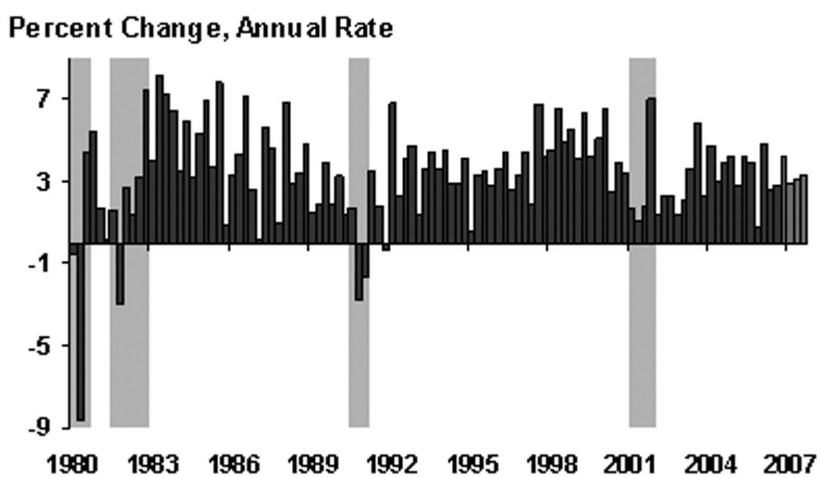
While it appears that both liquidity and credit are readily available, it is a small consolation if businesses and individuals cannot service their debt. However, the data suggest that while delinquencies are up slightly since early 2006, they remain well below the peaks seen during the last recession. The industrial sector has actually outperformed the overall spectrum of borrowers, as commercial and industrial loan delinquency rates have declined significantly from the most recent peak of 3.9% in the second quarter of 2002 to 1.3% in the third quarter of 2006.

On balance, both sector statistics and top line numbers are telling us the same story—despite the current slowing, the economy still has plenty of momentum and should continue to grow and create new jobs in the near future. If we are correct, GDP will grow at about a 3.0% rate in 2006 and slightly less than 3% in 2007. Thus, the economy remains fundamentally sound and it appears that the Fed has achieved the proverbial soft landing.

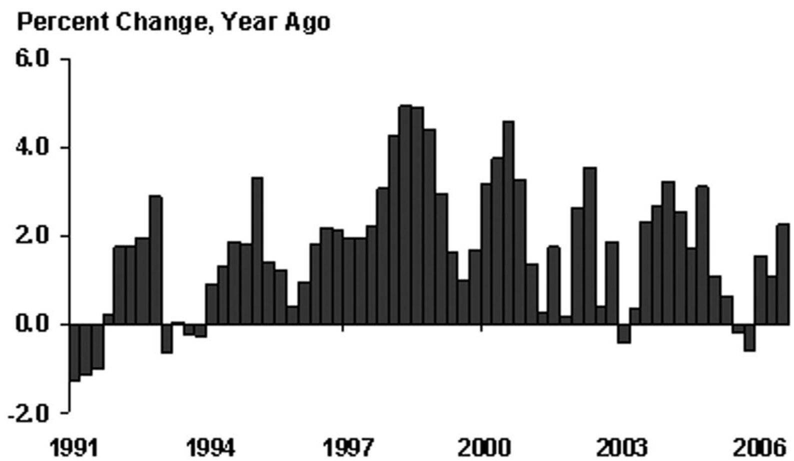
Appendix



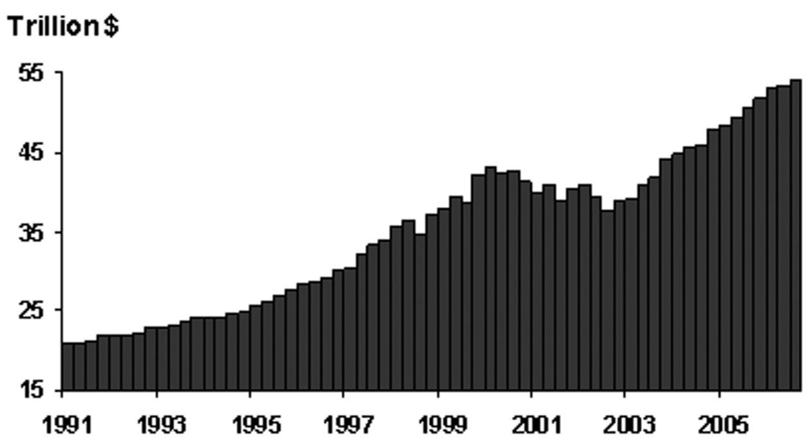
Real GDP Outlook



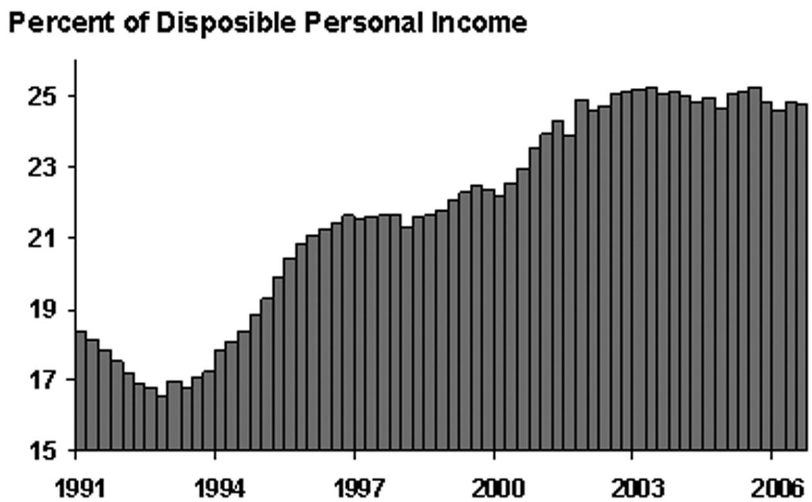
Real Personal Consumption Expenditures



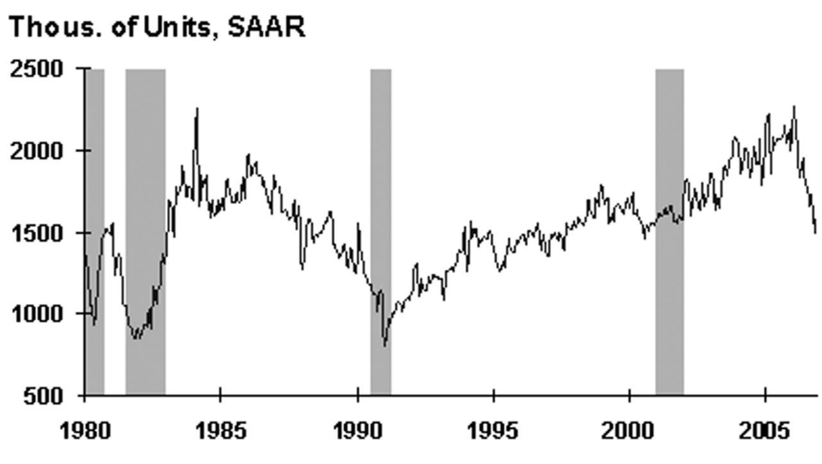
Real Disposable Income Per Capita



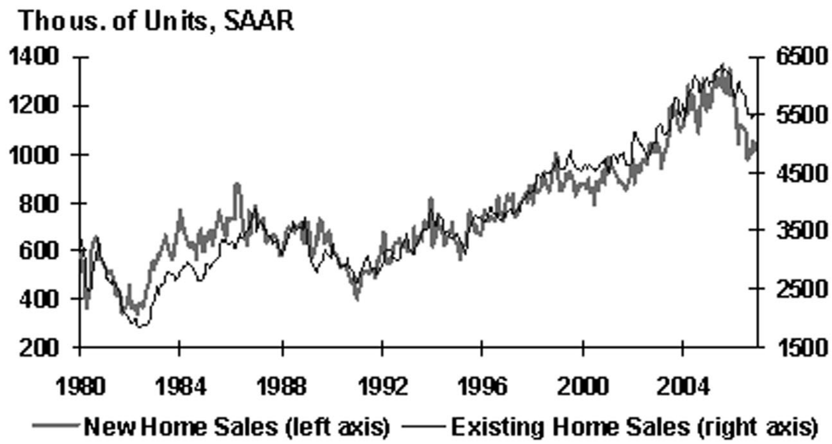
Household Wealth



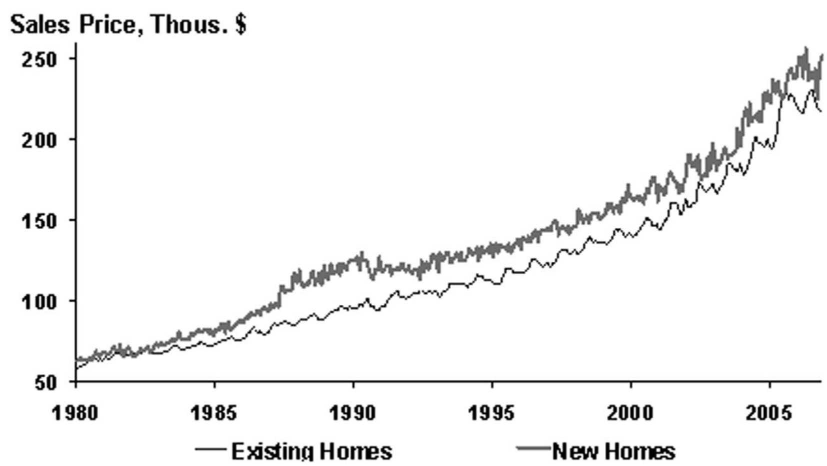
Consumer Debt



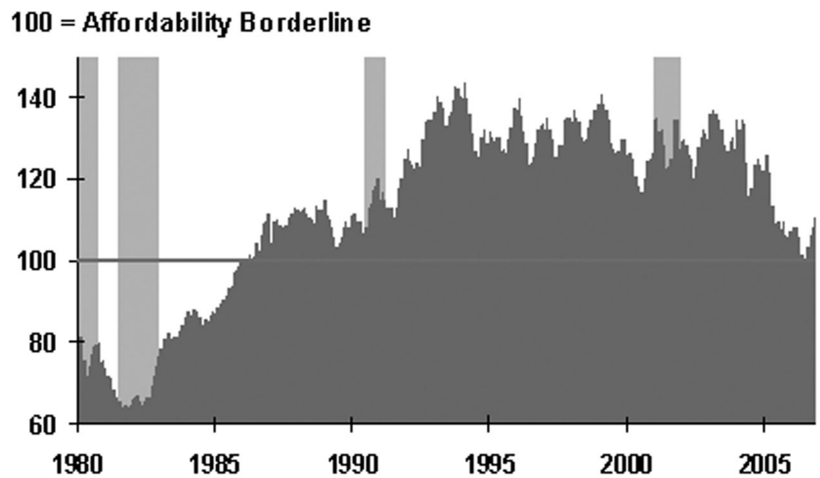
Housing Starts



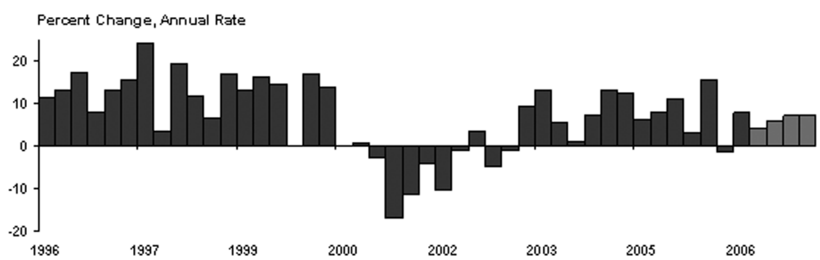
Home Sales



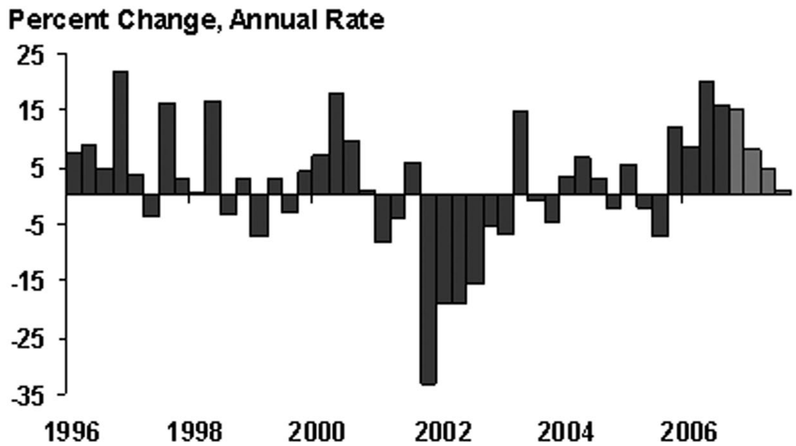
Median Home Prices



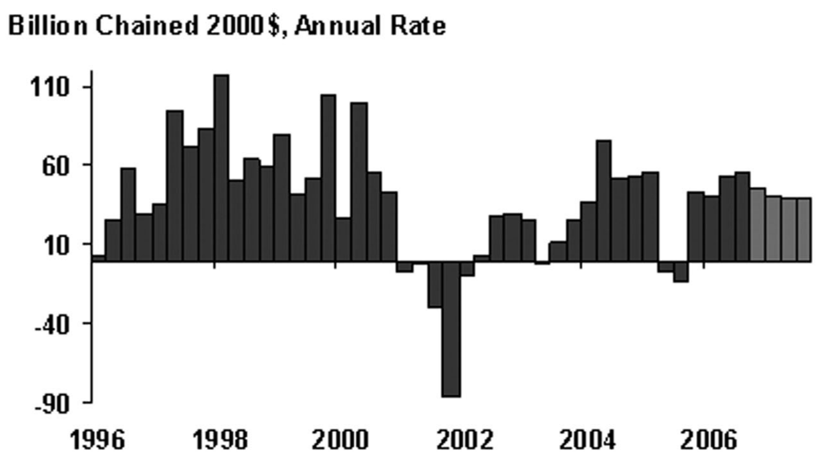
Housing Affordability Index



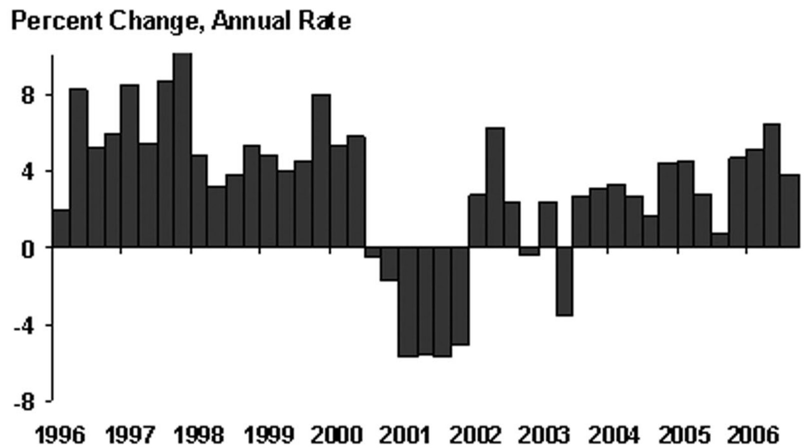
Real Private Investment in Equipment and Software



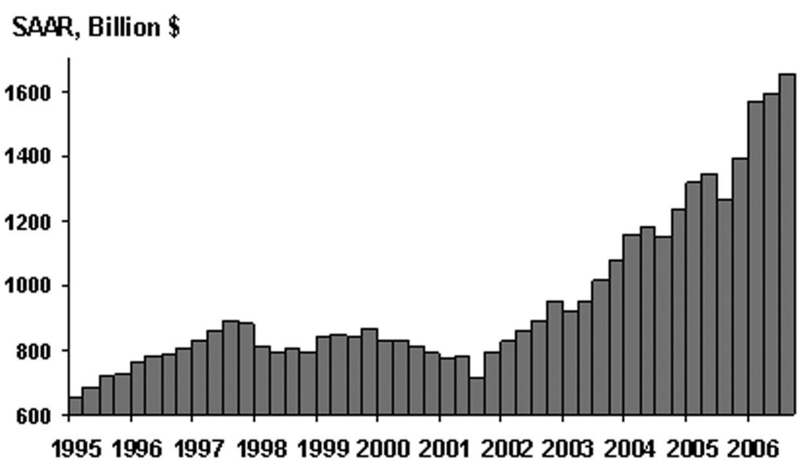
Real Private Investment—Structure



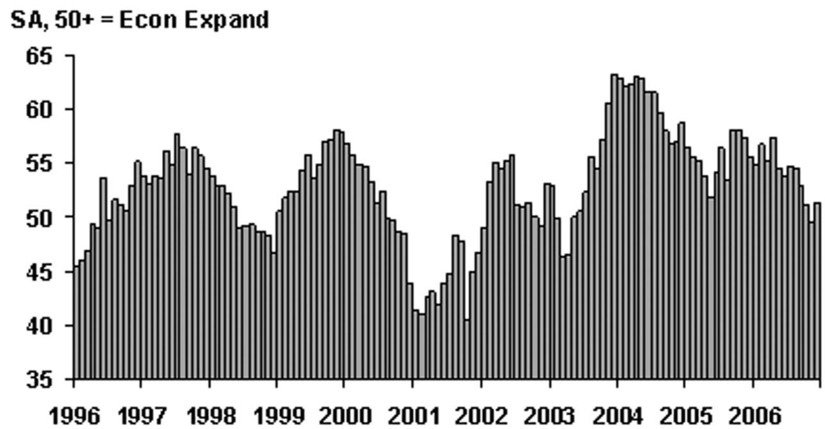
Real Change in Private Inventories



Industrial Production



Corporate Profits

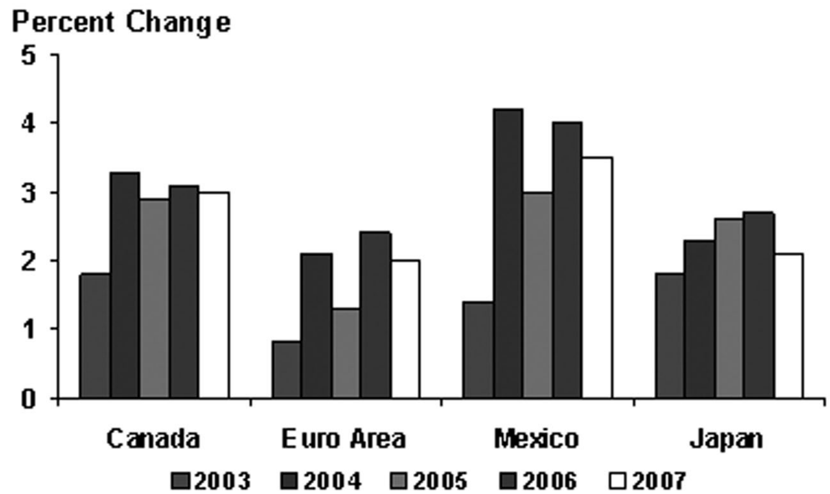


Purchasing Managers Index

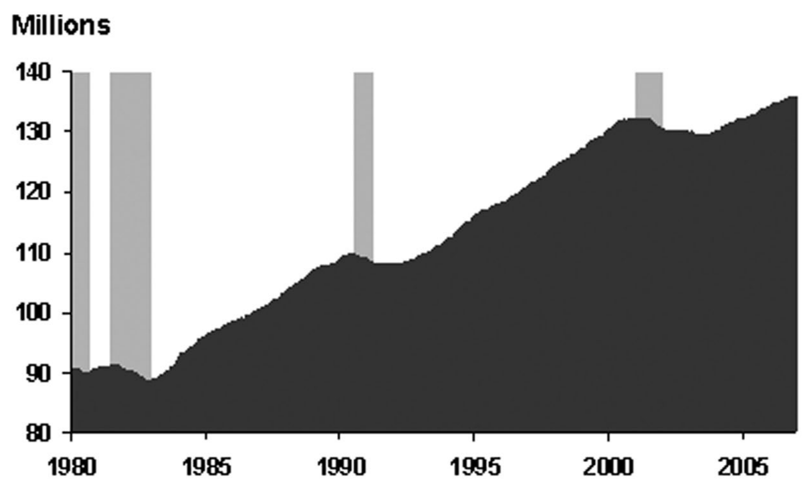
Inventory-to-Sales Ration: Total Business

U.S. Trade Deficit

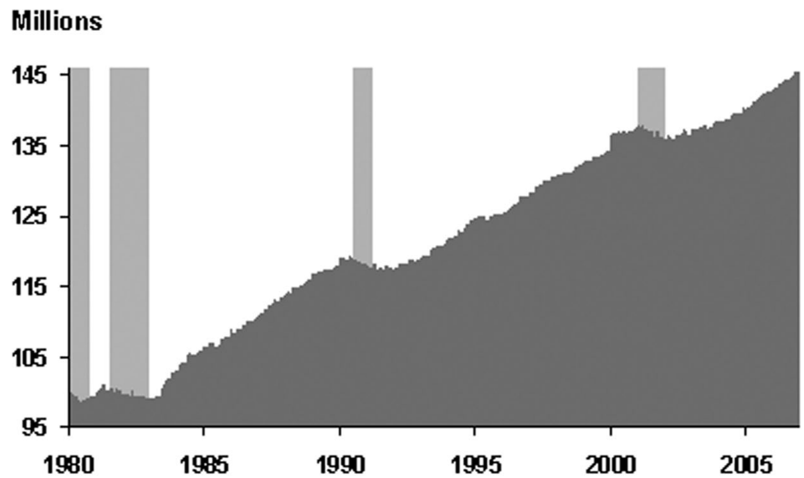
U.S. Nominal Trade Weighted Exchange Rate



Real GDP Growth of Top Trading Partners

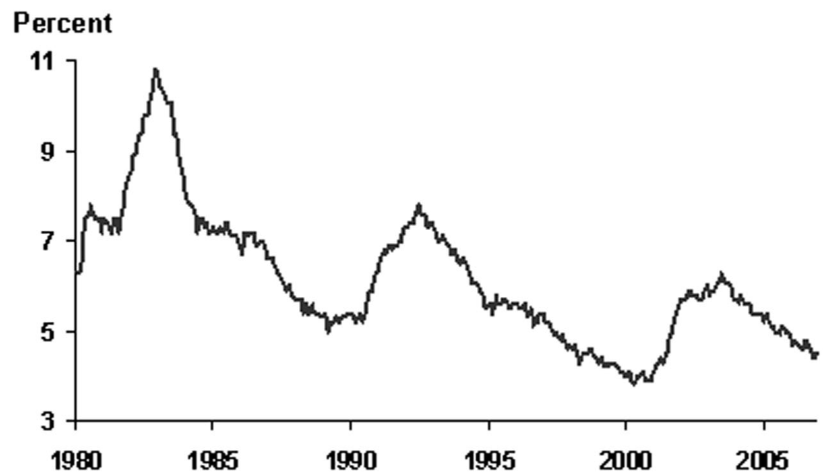


Total Non-Farm Jobs

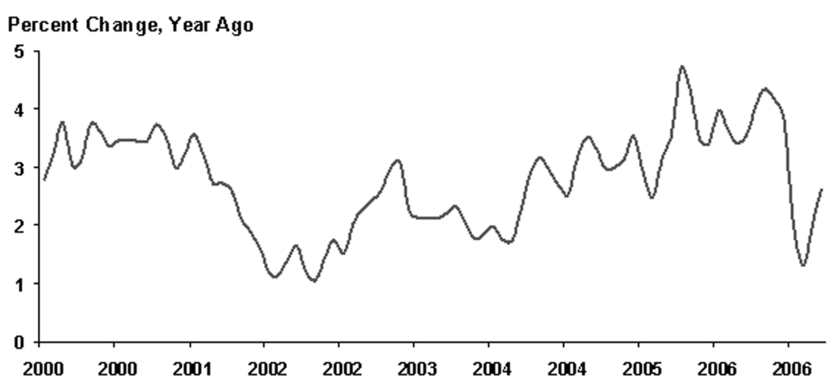


Household Employment

Initial Unemployment Claims

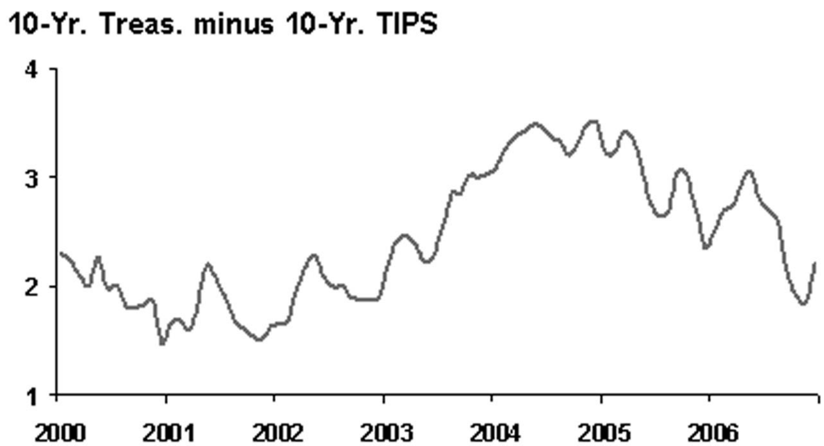


Unemployment Rate

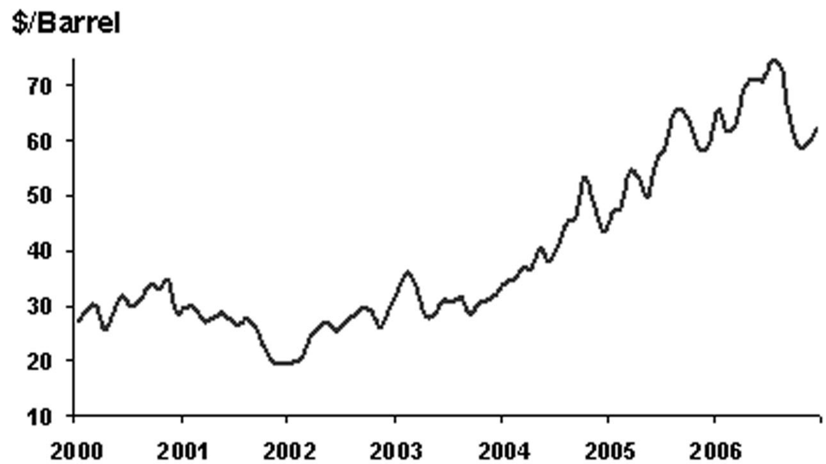


Consumer Price Index

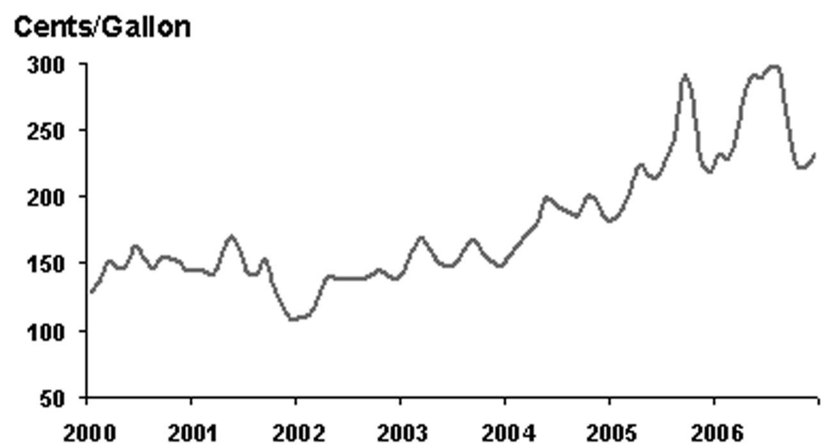
Core Consumer Price Index



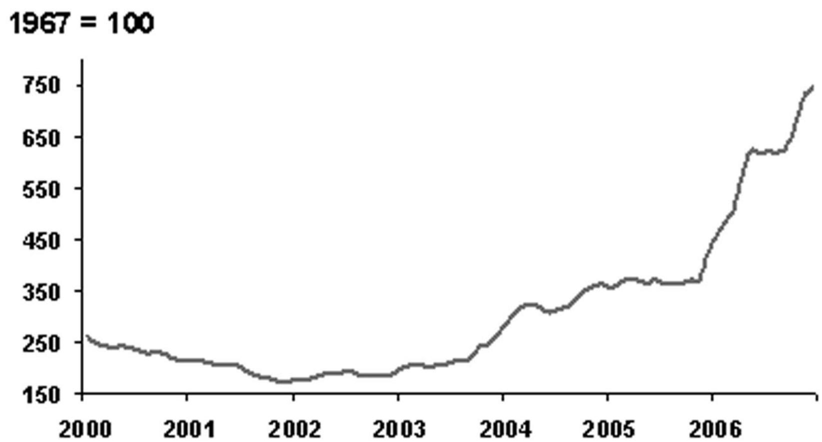
Market Inflation Expectations



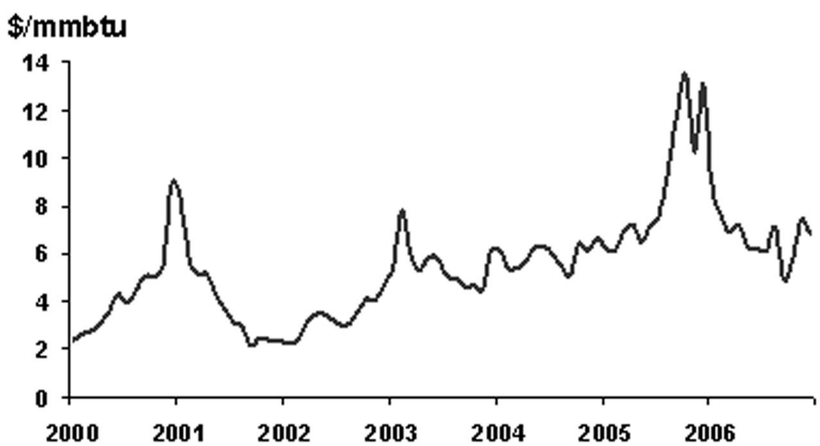
West Texas Intermediate Spot Oil Price



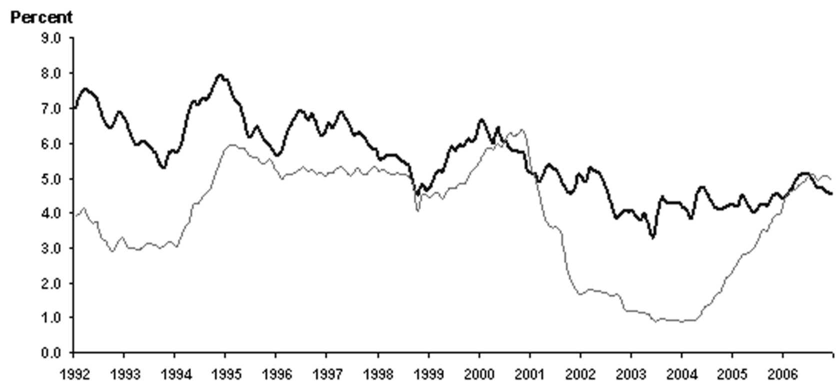
Retail Gasoline Price



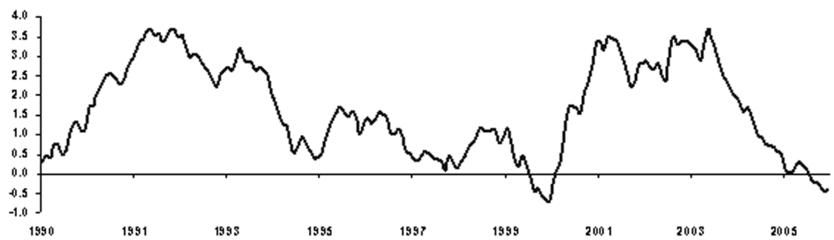
Spot Market Price Index: Metals



Natural Gas Price: Henry Hub, LA

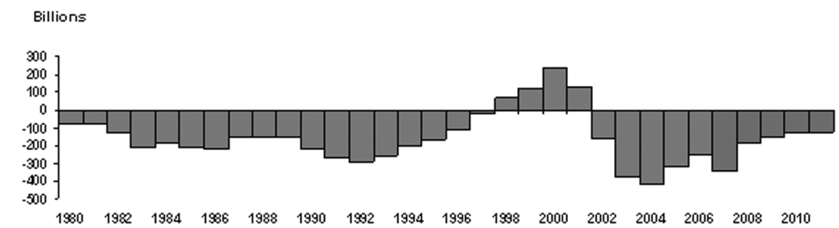


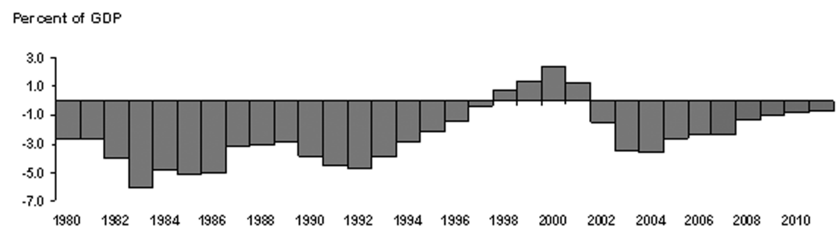
Interest Rates



Yield Spread: 10-Year Treasury Minus 3-Month Treasury

Risk Spread: Moody's Seasoned Baa Corporate Yield Minus Moody's Seasoned Aaa Corporate Bond Yield





The President Budget

Chairman RANGEL. Thank you, Doctor.

Richard Trumka, Secretary-Treasurer, American Federation of Labor.

STATEMENT OF RICHARD L. TRUMKA, SECRETARY-TREASURER, AMERICAN FEDERATION OF LABOR–CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. TRUMKA. Thank you, Chairman Rangel and other Members of the Committee. I welcome the opportunity to testify on behalf of the 10 million members of the AFL–CIO.

Any consideration of the American economy must address one central question: Why, in the richest country in the world, is it so difficult for so many families to make a living by working?

The U.S. economy is now producing over $13 trillion a year and is growing at a respectable pace. American workers are the most productive workers in the world, and they are now more productive today than ever. Today, American workers work harder, longer than any other workers in any other developed country. Nevertheless, the vast majority of Americans are struggling to maintain their living standard in the face of stagnating wages, rising economic insecurity, eroding health care and retirement benefits, and mounting debt.

At the richest moment in our nation's history, the American dream is fading for a majority of American workers. Through hard work, any worker should be able to participate fully in the benefits of a rapidly growing and competitive American economy. Achieving requires us to fundamentally rethink our country's economic policies.

Since 1980, labor productivity has increased over 80 percent, but the real median wage has hardly budged. Real median family income has increased at most 13 percent, but only because each job requires more hours, each worker is working more jobs, and each family is sending more family members to work. Moreover, the volatility of family income has increased sharply. The chance of a family suffering a 20 percent or greater decline in their income over a 2-year period has doubled since 1980.

As health care costs continue to rise, employers are also shifting more of the cost of health care onto workers, and the ranks of the uninsured continue to rise today. Today over 46 million Americans have no health care insurance at all, even though as a Nation we spend more on health care than any other country in history.

Only half of American families have an employer-provided retirement plan of any sort, and only 20 percent have guaranteed defined benefit plans, compared with 40 percent in 1980. In substituting defined contribution for defined benefit plans, employers are shifting the risk of retirement onto workers ill-prepared to carry this task.

The stagnation of wages has ruptured the crucial relationship between wages and productivity that was the heart of the post-World War II social contract that provided the foundation for building the American middle class. Over half of all gains from increased productivity since 1980 have accrued to the top 10 percent of American families, and most of that to the top 1 percent.

As a result of the rupture between wages and productivity, America today has the most unequal distribution of income and wealth that we have seen since the 1920s. The explosion of Chief Executive Officer (CEO) pay is both a cause and a symbol of this growth. Prior to 1980, a CEO earned 20 times what the average worker earned. Last year, it was 431 times the average worker. This means that the average CEO earns more on the first day of the working year than the average worker earns all year. Indeed, the same CEO earns more before lunch on the first day of the year than a minimum wage worker earns all year.

The central cause of stagnating wages and the rupture of productivity/wage relationship is the steadily growing imbalance of bargaining power between workers and their employers. America's CEOs once viewed themselves as stewards of our country's productive assets. Today, they present themselves as agents of shareholders in whose name they aggressively ship good American jobs offshore, reduce workers' pay, and walk away from their health care and retirement obligations.

Beyond the problem of excess compensation and conflicted corporate governance policies, however, American corporations are facing two new challenges that are changing the way they do business and poisoning their relationships with the employers.

First is intense competition in product markets produced by globalization abroad and deregulation domestically that has limited our pricing power. The second is pressure from institutional investors in capital markets to increase shareholder value by rising profit margins.

I will try to summarize quickly by asking the following questions.

Do Americans—to rebuild the relationship between wages and productivity, we must begin by reflecting on the purpose of the economy and the goals of our country's economic policies. Do Americans exist to serve the needs of the economy, or does the economy exist to serve the needs of Americans, the vast majority of whom earn their living by working?

I think we have to do three things, be guided by three principles.

One, anyone who wants to work in America should have a job. Two, people who work every day should not live in poverty, should have access to quality health care for their families, and should be able to stop working at some point in their lives and enjoy secure retirement. Three, all Americans should enjoy the fundamental freedom of association with their fellow workers.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Trumka follows:]

Statement of Richard L. Trumka, Secretary-Treasurer, American Federation of Labor–Congress of Industrial Organizations

Thank you, Chairman Rangel, and other members of the Committee. I welcome the opportunity to be here today to testify on behalf of the 10 million members of the AFL–CIO and share our views on the vitally important question of the state of the American economy.

Any consideration of the American economy today must address one simple, but central, question: "Why, in the richest country in the world, is it so difficult for so many families to make a living by working?"

The U.S. economy is now producing over $13 trillion a year and, despite a recent slowdown, has been growing at a respectable, if not spectacular, three percent a year. American workers are the most productive workers in the world, and they are more productive today than ever. Americans work hard and log more hours than workers in any other developed country.

Nevertheless, the vast majority of American's are struggling to maintain their living standards in the face of stagnating wages, rising economic insecurity, eroding health care and retirement benefits and mounting debt. At the richest moment in our nation's history, the American Dream is fading for a majority of American workers.

We can, and must, do better. But doing so requires us to fundamentally rethink our country's economic policies. We congratulate the Committee for holding these hearings and hope that this is the beginning of a thorough review of our country's economic policies.

We must restore the promise of America—that all of our citizens can expect that by working hard and playing by the rules, they can participate fully in the benefits of a rapidly growing and competitive national economy.

The Fading American Dream

American workers are suffering a now generation-long stagnation of family income and rising economic insecurity.

Since 1980, labor productivity has increased over 80 percent, but the real median wage has hardly budged, increasing only 2 percent over a quarter century. Real median family income has increased a modest 13 percent over this period, but only because each job requires more hours, each worker is working more jobs and each family is sending more family members to work.

Moreover, the volatility of family income—and with it the economic anxiety so many feels—has increased sharply over the same period. Jacob Hacker the Yale political scientist estimates that the chances of a family suffering a 20 percent or greater decline in their income over a two-year period have doubled since 1980.

Aggravating the economic anxiety of working families are rising health care costs and dwindling retirement assets. Only half of American families have an employer-provided retirement plan of any sort, a proportion largely unchanged for decades. However, whereas 40 percent of workers participated in employer guaranteed "defined benefit" pension plans in 1980, today only 20 percent have such plans. In substituting "defined-contribution" for defined benefit plans, employers are shifting the risk of retirement onto workers. And American workers are ill prepared to carry this risk.

And, as health care costs continue to rise, employers shift more and more of the cost of health care onto the shoulders of American workers. Again, working families with stagnating earnings are in no position to shoulder these costs and the ranks of the uninsured continue to rise. Today over 46 million Americans have no health insurance at all, despite the fact that as a nation we spend more on health care than any country in history.

The increased volatility of income and increasing burden of risk for family health care and retirement security are exacerbating the acute anxiety that so many working families are feeling.

However, the stagnation of wages and family incomes has ruptured the crucial relation between wages and productivity that was the heart of the "social contract" that American business and labor struck in the early post-WWII period and that provided the foundation for building the American middle class. When wages advanced with productivity from 1946–73, we grew together as a nation. Since then, increasingly, we are growing apart—economically, socially and politically.

Over half of all the gains from increased productivity since 1980 have accrued to the top 10 percent of American families, most of it to the top one percent. Indeed, the incomes of top .01 percent of American families—those earning over six million dollars a year—have increased by 497 percent over this period.

As a result of the rupture between wages and productivity, an enormous redistribution of income—perhaps the largest in our history—has occurred from poor and working Americans to the top twenty percent of our families. Today, America has the most unequal distribution of income and wealth of any developed country in the world. And income and wealth are more unequally distributed in America today than at any time since the 1920s.

The explosion of CEO pay is both a cause and a symbol of growing economic inequality. Whereas the average CEO of a major American corporation earned twenty times that of an average worker in 1980, today the average CEO earns 431 times what the average worker earns. This means that the average CEO earns more on the first working day of the year than the average worker earns by working all year. Indeed the same CEO earns more before lunch on the first day of the year than a minimum wage worker earns all year.

Our wealthiest families prosper as never before, but the vast majority of working families are left behind. Working families are struggling to make ends meet on stagnating earnings and, most of all, they are concerned about the future of their children. They are anxious about their ability to retire and terrified of what a serious accident or sickness might mean for their families' economic security. They are also increasingly angry about the sheer injustice of our country's growing inequality.

Failed Economic Policies

There are many contributing causes to the stagnation of wages and the rupture of the productivity-wage relationship over the past thirty years. Central to them all, I suggest to you, is a steadily growing imbalance of bargaining power between workers and their employers. The implicit "social contract" that allowed Americans to grow together, and build the American middle class, in the early post-WWII decades rested on a rough balance of power between workers and their unions on one side and employers on the other.

Today, this balance of power has eroded and the social contract with American workers is unraveling. America's CEOs, who once viewed themselves as stewards of our country's productive assets, today present themselves as agents of shareholders in whose name they aggressively shift good American jobs off-shore, reduce workers' pay and walk away from their health care and retirement obligations. Parenthetically, it is a point of some concern among shareholders, that such a large proportion of the gains from increasing productivity withheld from employees on shareholders' behalf, are finding their way into the compensation packages of the CEO's themselves.

Beyond the problem of executive compensation and conflicted corporate governance practices, however, American corporations are facing two enormous challenges that have changed the way they do business and are poisoning their relationship with their employees. The first is intense competition in product markets—produced by globalization abroad and deregulation domestically—that have limited their pricing power. The second is pressure from institutional investors in capital markets to increase shareholder value by raising profit margins.

If corporations must increase margins, but cannot raise prices, they must reduce costs. And most of the costs of business are in employee compensation in one form or another. Therefore, "the market," as business leaders say, is forcing American corporations to aggressive reduce compensation costs however they can: by outsourcing and off-shoring work, by reducing worker pay and by shifting the costs of health care and retirement onto workers. These same forces are behind corporation demands to lower their tax and regulatory burdens in the name of "competitiveness."

Behind these changes in the business and competitive strategies of America's corporations, however, there is a much more fundamental change in our country's economic policies that I would like to briefly explore with you. The shift in economic policies in the late 1970s from a "Keynesian consensus" to what George Soros has called "free market fundamentalism" explains much, in my view, about changing corporate behavior, the imbalance of power between workers and their employers, stagnating wages and the growing divide between productivity and wages.

I think of the policies that make up "free market fundamentalism" as a box that is systematically weakening the bargaining power of American workers, constraining their living standards and driving the growing inequality of income and wealth in our country.

- On one side of the box is "globalization," unbalanced trade agreements that force American workers into direct competition with the most impoverished and oppressed workers in the world, destroy millions of good manufacturing jobs and shift bargaining power toward employers who demand concessions under the threat of off-shoring jobs.
- On the opposite side of the box are "small government" policies that privatize and de-regulate public services and provide tax cuts for corporations and the wealthy, all to "get government off our backs."
- The bottom of the box is "price stability." Unbalanced macroeconomic policies that focus exclusively on inflation and ignore the federal government's responsibility to "maximize employment," even out the business cycle and assure rapid economic growth.
- The top of the box is "labor market flexibility," policies that erode the minimum wage and other labor standards, fail to enforce workers' right to organize and bargain collectively and strip workers of social protection, particularly in the areas of health care and retirement security.

Each of these economic policy groups—"globalization," "small government," "price stability" and "labor market flexibility"—may sound innocent enough. But they each undermine employment security of American workers. And together they powerfully weaken the bargaining power of workers and provide corporations with both the incentive and the means to enrich themselves at the expense of their employees.

Restoring America's Promise

To balance bargaining power between employees and their employers, rebuild the relationship between wages and productivity and restore America's promise, we must begin by reflecting on the purpose of the economy and the goal of the economic policies that guide our country's economic development.

Do Americans as workers exist to serve the needs of the economy? Or does the economy exist to serve the needs of Americans, the vast majority of whom earn their living by working? In our view, the economy exists to serve the needs of the American people, not the other way around, and the goal of economic policy is to support a strong and internationally competitive national economy whose benefits are shared broadly by all Americans.

We must change direction in our country's economic policies to assure that the economy meets the urgent needs of the majority of American workers. To do so, we must reconnect with three important economic values that resonate powerfully with all Americans. Our country's economic policies should assure that:

First, anyone who wants to work in America should have a job. We need more balanced macroeconomic policies that serve the dual goal of "full employment," as well as "price stability," that is, the Fed's goal should be to maximize growth and employment consistent with reasonable price stability. The Humphrey-Hawkins Act mandates the Federal Reserve to serve these dual objectives, but only Congress can hold the Fed accountable for serving both.

We also need more coordination between the fiscal policy of Treasury and the monetary policy of the Fed. In recent years, the Treasury has been absent from its responsibility to help smooth the business cycle and support rapid growth and full employment. One school of thought at Treasury is to cut taxes and hope for the best. Another school of thought has been to balance the federal budget and hope for the best. Neither school well serves the country's need for rapid growth and full employment. Moreover, both schools have supported "strong dollar" policies that have contributed to mis-aligned exchange rates, particularly with China and other Asian trading partners, and left American manufacturers at a distinct competitive disadvantage in global markets.

Second, anyone who works every day (a) should not live in poverty, (b) should have access to quality health care for themselves and their family and (c) should be able to stop working at some point in their lives and enjoy a dignified and secure retirement.

The increase in the minimum wage to $7.25 an hour recently approved in the House is desperately needed and long overdue. But this increase will still leave a family of three in poverty and dependent on public assistance. To allow low-wage workers to participate equitably in our country's productivity growth, we need to restore the minimum wage to its traditional level of one half the average wage for non-supervisory workers in the private sector. Today that would be over $8.00 per hour.

We must also reform our failing health care system to provide affordable, quality care for every American. As I have already mentioned, we spend twice as much on health care as other developed nations whose citizens enjoy superior public health outcomes. There are a variety of approaches to health care reform that would cover the uninsured, without increasing our national health care expenditures. Many of these approaches would also provide better means for improving quality and restraining health care cost increases. They would also help reduce the burden on employers and improve their competitive position in global markets.

Reforming our health care system and restraining cost increases would also contribute greatly to our ability to provide a secure retirement for American workers. There are an increasing number of voices in Washington calling for "entitlement spending" reform to address long-term costs of Medicare and Medicaid. Reforming our health care system should relax some of the pressure to cut retirement benefits and allow space for bolstering Social Security and our fragile pension system.

And third American workers should enjoy the fundamental freedom to associate with their fellow workers and, if they wish, organize unions at their workplace and bargain collectively for dignity at work and a fair share in the value they help create.

Over 20,000 workers are illegally fired every year for exercising their most fundamental rights—freedom of opinion, expression and association. The Congress should take immediate action to pass the Employee Free Choice Act to allow workers the freedom to organize free of employer interference and the fear of job loss. This Act would represent an enormous step toward restoring balance between workers and their employers and helping repair the ruptured productivity-wage relationship.

I will conclude by briefly mentioning one other, particularly important, question: The policies we need to assure a competitive American economy in a rapidly globalizing world.

We have lost 3.4 million good manufacturing jobs since 1998 partially as a result of misguided exchange rate policies, unbalanced trade policies and corporate strategies to aggressively off-shore manufacturing operations. Moreover, Princeton economist, Alan Blinder warns that as many as 42 million service sector jobs are also vulnerable to off-shoring, many held by highly educated and highly paid American workers.

In addition to the exchange rate policies I have already mentioned, I suggest we need a strategic pause in negotiating new international trade agreements until we can formulate the policies we need—internationally and domestically—to assure a competitive American economy able to produce more of what we consume. We simply cannot continue to borrow six percent of GDP a year, much of it from the central banks of our trading partners. Either we find a way to produce more or, one way or another, we will be forced to consume less.

Internationally, this requires more balanced trade policies that protect the rights of workers as well as they protect intellectual property. Only with effective worker rights globally will the benefits of globalization be equitably shared with workers in the U.S. and abroad.

Domestically, it requires a national economic strategy to rebuild our manufacturing capacity. This is important not just because of the need for more good manufacturing jobs, but crucial if we are to reduce our trade deficit and dependence on foreign borrowing.

The American economy can work for all Americans, but to do so will require a change of course for our country's economic policies. I do not pretend to have all the answers to the many economic challenges we face. But I believe workable policies to these challenges can emerge from a national dialogue that involves business, labor and the public at large. I commend the Committee for beginning this dialogue.

Thank you again for the opportunity to be with you today and share the views of the American labor movement.

Chairman RANGEL. Thank you, Doctor.

Dr. William Spriggs, Professor and Chair of Department of Economics, Howard University.

STATEMENT OF WILLIAM E. SPRIGGS, PH.D., PROFESSOR AND CHAIR, DEPARTMENT OF ECONOMICS, HOWARD UNIVERSITY

Mr. SPRIGGS. Thank you, Mr. Chairman. If I can be allowed just one little personal comment here, there is a lot in the news about the Super Bowl and celebrating having two African American coaches in the Super Bowl. However, for economics, I wanted to let you know that appearing here is the Super Bowl. If I can make my own little personal note, having you as the Chairman is much more important than having an African American coach in the Super Bowl.

Chairman RANGEL. Take as much time as you need.

[Laughter.]

Mr. SPRIGGS. If I may, since 2001, the U.S. economy has been in recovery, as we have noticed. We have had gross domestic product, the broadest measure of our nation's economic activity, grow. Aggregate consumption is increased. The unemployment rate has fallen. All of that sounds very rosy.

At the same time, in an unprecedented way, we have the U.S. Census Bureau showing us that during this recovery, we have had inflation-adjusted median income for families, working-age families, fall. We have never had a recovery in which for four years straight, the median income of working-age families fall. The poverty rate has been rising. We have never had the poverty rate rise four years during a recovery.

The share of private sector workers covered by employer-provided health insurance has fallen, and the share of private sector workers covered by employer-provided pension plans has fallen. So, this is a unique recovery and it has trends which, if they are not corrected soon, will have important implications for fiscal policy.

We have talked and other witnesses have talked about wage and income inequality, which has grown in the United States since the 1970s. There are many economists who have liked to tell this as a story of skill-biased technological change, that we are simply seeing the rewards to those who are better educated.

A closer look by many economists has shown that this probably isn't a very good way to try and explain what is going on. If you look at the difference between wages of workers of different education levels, the big runup in inequality between workers of different education levels occurred in the 1980s, prior to when most think of skill-biased technological change taking place. The difference between inequality, inequality between workers of different education levels actually didn't increase very much during the 1990s when we would think of computer use as being much more ubiquitous.

Instead, what is really rising at a tremendous rate since the 1970s is the growth in inequality among workers who have the same level of education, who are otherwise similar. That has been the big runup in wage inequality. That is far more difficult to understand and explain than what the skill-biased hypothesis would have you believe.

The other sort of anomaly is the huge amount of variation in inequality within states. If you look across states, all states have to face the same trade because they are part of international trade. All of them will face the same technology. So, this great difference and inequality across states helps us to highlight the differences that aren't caused by skill-biased technological change. It does appear that the structure of labor markets has a great deal to do with that inequality.

The most disturbing thing about this growth in inequality that has taken place during this recovery has been that it has been so unequal. Only those at the very highest end of incomes have seen gains. It is not those in the bottom half. It is those who are in the bottom 80 percent who in fact have seen losses.

Even when we look at it from the perspective of consumption, those who are in the bottom 20 percent have simply fallen behind because their wages have not kept up with inflation. They actually are living a lower lifestyle during this recovery. Those in the middle have barely held on. The disturbing is the borrowing of those are in the top 20 percent because that is what has kept consumption growing, is actually the borrowing of those in the top 20 percent.

We have seen a tremendous runup in household debt which has taken place during this recovery, the fastest growth in household debt in a five-year period that we have seen in the postwar era. This runup in debt has been at a much faster rate than the modest growth in household net worth. So, that means that we are seeing households shift to having a very high debt-to-asset ratio.

This has severe implications going forward when you think about fiscal policy concerns. It means that Americans, the vast majority of Americans, the bottom 80 percent, are facing the prospect—if we don't see a reversal trend, are facing the prospect of lower permanent incomes. They will have to reconcile their personal household debt balance sheet, meaning in the future they will have to consume less in order to pay off their debts.

So when you think forward about how do we resolve the drop in private health care coverage? How do we resolve the drop in private pension care coverage? That households themselves will be in a more fragile position to try and self-insure themselves.

You also have to think from a public policy perspective about the small share of income that now goes to workers, the shrinking share of national income that goes in the form of earned income. So, if you put more of a tax burden on earned income as opposed to capital income, you are going to actually increase the overall burden on earned income because it is a smaller share of national income than it was before.

Finally, I would say you need to think about the growth in inequality when you think about Social Security reform. We did not anticipate this growth in income inequality. Already that growth in income inequality, if we would go back to taxing 90 percent of the wage income in the United States, that would account for 40 percent of the gap that we have in Social Security funding. So, income inequality has to be taken into consideration as you think about tax policy and Social Security reform.

[The prepared statement of Dr. Spriggs follows:]

Statement of William E. Spriggs, Ph.D., Professor and Chair, Department of Economics, Howard University

I wish to thank Committee Chairman, Congressman Charles B. Rangel for the invitation to offer this testimony. It is an honor and a privilege to offer this evidence.

Since 2001, the U.S. economy has been in a recovery as defined by the National Bureau of Economic Research's Business Cycle Dating Committee. Gross Domestic Product, the broad measure of the nation's economic activity has grown, aggregate consumption has increased and the unemployment rate has fallen. Those are broad measures to confirm a sense that the economy is in recovery. However, data from the U.S. Census Bureau shows this recovery has also seen a fall in the inflation adjusted median income for working-age families, poverty rates rise, the share of private-sector workers covered by employer-provided health insurance fall and the share of private-sector workers covered by employer-provided pension plans. These latter trends, if not corrected soon, will have important implications for fiscal policy.

Wage and income inequality have been on the rise in the United States since the late 1970s. It appears that the bulk of increase in wage inequality between workers of different education levels took place in the 1980s. That period was marked with an increase in the premium paid to college-educated workers, relative to the wages of high school-educated workers, and prompted debate among economists that the economy was now experiencing growth that increased rewards to skills; or "skill biased technological change." During the 1970's, men with college education actually suffered a drop in their premium, from about 25 percent higher than their high school-educated counterparts to a low of about 20 percent by the decades end in 1979. But, in the 1980s, the premium for men grew to reach 35 percent by decade's end, a significant increase.

But, economists are not in agreement that the skill biased technological change can explain the growth in wage inequality that has taken place since the 1970s.[1] A major concern, is that the build-up in wage inequality between workers of different education levels took place in the 1980s before the broad introduction of computing, and did not expand greatly in the 1990s when computer use became ubiquitous and productivity increases returned to their long-run trend after a slowdown in the 1970s and 1980s. What has continued to rise, and what is the larger component of over-all wage inequality, are differences in the earnings of workers who have equal education and experience. Some economists attempted to reconcile this apparent anomaly by arguing for increases in the returns to unobserved productivity characteristics (like school quality) that were linked to schooling differences.[2] But, a closer look suggests that using more accurate data, and controlling for shifts in the structure of employment, would show the rise in the returns to unobserved characteristics took place in the 1980s as well. And, the greatest growth in inequality among similarly educated workers is among college and graduate-educated workers, not among workers with high school or less education.

There are other problems with the skill-biased hypothesis. One of them is that there is great variation between states in the amount of wage inequality within states, even though the same technology that drives skill demands affects all states. Observing inequality within states over time, economists have noted that the decline of large manufacturing accounts for increases in overall wage inequality within states. This is not consistent with the skill-biased hypothesis.[3] Another is that returns to skills by race diverged during that period, which would be inconsistent if firms truly faced skills shortages that bid up the wages of skilled workers.[4] It would also be difficult to explain the much higher use of skilled workers by foreign-owned companies operating in the U.S. than for domestic producers, and for the racial disparity in the skilled work forces between foreign-owned and domestic firms suggested by the patterns of employment in those sectors with high foreign direct in-

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[1] See for instance, Thomas Lemieux, "Increasing Residual Wage Inequality: Composition Effects, Noisy Data, or Rising Demand for Skill?" *The American Economic Review, 96* (Number 3, 2006): 461–498, David Card and John E. DiNardo, "Skill-Biased Technological Change and Rising Wage Inequality: Some Problems and Puzzles," *Journal of Labor Economics, 20* (Number 4, 2002): 733–783 and Daron Acemoglu, "Technical Change, Inequality, and the Labor Market," *Journal of Economic Literature, 40* (Number 1, 2002): 7–72.

[2] Chinhui Juhn, Kevin Murphy and Brooks Pierce, "Wage Inequality and the Rise in Returns to Skill," *Journal of Political Economy, 101* (Number 3, 1993): 410–442.

[3] J. Bradford Jensen and Andrew Bernard, "Understanding Increasing and Decreasing Wage Inequality," NBER Working Paper 6571 (May 1998).

[4] Patrick L. Mason and William Darity, Jr., "Evidence on Discrimination in Employment: Codes of Color, Codes of Gender," *Journal of Economic Perspectives, 12* (Number 2, 1998): 63–90.

vestment in the U.S.[5] Economists have found the decline of unionization in the 1980s, and the effects of trade to be important in explaining the growth in overall wage inequality. The importance of unions and labor market institutions are not consistent with the skill-biased hypothesis.[6]

Perhaps more of an issue is the break between productivity gains and wages. During this recovery, productivity has continued to grow at its post-1995 rate, suggesting a return to its long-run trend. Yet, median wage levels have not kept pace with inflation. Fast productivity growth is a way to keep inflation in check, but also a way to improve the lifestyles of America's workers. Yet, noted economist Robert Gordon has found that only the wages of those in the very top ten percent of earnings have kept above productivity growth over the 1966–2001 period. The redistribution of gains to the top explains the stagnation of those in the middle.[7]

During this recovery, wage inequality has continued to grow. It has grown not because of an increase in the returns to education, because in the initial phases of the recovery, the wage premium of college educated workers fell, as they became the larger share of the long-term unemployed.[8] Instead, it has been the continued expansion of inequality of earnings for workers who are similarly educated. Apparently, an important source of the growth of that inequality is traced to declines in the inflation-adjusted value of the minimum wage.[9]

But, the other source is the redistribution of corporate income, from wages to capital income. The latest data from the Bureau of Economic Analysis shows that the share of corporate-sector income going to wages is down to its lowest share in over 25 years, according to an analysis done by the Lawrence Mishel and Jared Bernstein at the Economic Policy Institute.[10] They also point to new figures from the Congressional Budget Office showing an increased concentration of corporate capital income among America's richest one percent. The latest CBO figures show that almost 60 percent of capital income goes to the top one percent in the U.S. income distribution.

During this recovery, U.S. Census data show that income for those in the bottom twenty percent, those in the middle twenty percent and those in the top twenty percent have all fallen. Yet, aggregate consumption has increased. This anomaly has occurred, because the aggregate savings level of Americans has become negative, and household debt has risen dramatically. But, a closer look at the data shows that those in the bottom twenty percent have in fact suffered from a drop in consumption. Real wages for them have fallen, and because they are credit constrained, they have not borrowed to maintain consumption. Those with middle incomes have apparently maintained consumption, with some modest borrowing, and some modest benefit from lower taxes. The big gains in consumption have come from those at the top of the income distribution, where incomes in the highest ranges have gone up, and by borrowing, and from larger benefits from tax cuts. The relative gains in consumption by those in the top twenty percent were more rapid than during the 1980s or 1990s recovery. By 2005, the top twenty percent of the income distribution accounted for almost 40 percent of all consumption. The bottom twenty percent consumed only 8.2 percent.[11]

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[5] Abera Gelan, Kaye Husbands Fealing and James Peoples, "Inward Foreign Direct Investment and Racial Employment Patterns in U.S. Manufacturing," *The American Economic Review*, (*Papers and Proceedings*, forthcoming) [http://www.aeaweb.org/annual_mtg_papers/2007/0106_1015_2103.pdf]

[6] Richard Freeman, "How Much Has De-Unionization Contributed to the Rise in Male Earnings Inequality?" in Sheldon Danziger and Peter Gottschalk (eds.), *Uneven Tides: Rising Income Inequality in America* (Russell Sage Foundation: New York, 1993) and Lawrence Katz and Kevin Murphy, "Changes in Relative Wages, 1963–1987: Supply and Demand Factors," *Quarterly Journal of Economics, 107* (Number 1, 1992): 35–78.

[7] Ian Dew-Becker and Robert J. Gordon, "Where did the Productivity Growth Go? Inflation Dynamics and the Distribution of Income," Presented at the 81st Meeting of the Brookings Panel on Economic Activity, September 8–9, 2005.

[8] Andrew Stettner and Sylvia Allegretto, "The Rising Stakes of Job Loss: Stubborn long-term joblessness amid falling unemployment rates," EPI & NELP Briefing Paper (May 2005).

[9] John DiNardo, Nicole M. Fortin and Thomas Lemieux, "Labor Market Institutions and the Distribution of Wages, 1973–1992: A Semi-parametric Approach," *Econometrica, 64* (Number 5, 1996): 1001–1044; William M. Rodgers III, William E. Spriggs and Bruce W. Klein, "Do the skills of adults employed in minimum wage contour jobs explain why they get paid less?" *Journal of Post Keynesian Economics, 27* (Number 1, 2004): 38–66.

[10] Lawrence Mishel and Jared Bernstein, "New data reveal unprecedented income inequality," EPI Economic Snapshots (January 17, 2007).

[11] Jared Bernstein and Jason Furman, "A Tough Recovery by Any Measure: New Data Show Consumer Expenditures Lag for Low- and Middle-Income Families," CBPP and EPI (November 28, 2006). [http://www.epi.org/issuebriefs/230/ib230.pdf]

Of course, this personal borrowing spree is not sustainable. Household debt is growing at annual rate of almost 11 percent during this recovery, compared with a more modest growth of 3.7 percent in household net worth, leading to a very high household debt to asset ratio.[12] This means that unless incomes rise to sustain consumption growth, instead of borrowing, the permanent incomes of Americans are falling. That is, at some point, consumption must fall so households can balance their incomes.

Further, with the federal budget deficit, it means that the nation has been borrowing from the rest of the world at an astounding rate to fuel our consumption. The current account deficit has mushroomed from about 4 percent of GDP in 2001 to 6.8 percent, as of the third quarter of 2006. That is a significant claim on future U.S. income by foreign interests.

There are several important fiscal policy implications from these current trends. The lower permanent incomes of Americans, particularly those in the bottom eighty percent of the income distribution, means they will face real constraints that will ill prepare them to take on added responsibilities, such as the current shifts away from employer-provided health care, and the changes in their household balance sheets toward increased risks resulting from current shifts away from employer defined-benefit retirement plans.

There are already implications from the shift of shared prosperity that ended in the 1970s. The shift to rising incomes only at the highest ends of the income distribution has led to a significant drop in revenues for the Social Security system, despite continued growth in the economy, and an apparent return to long run productivity growth that was not anticipated in the early 1980s. If the Social Security system were to return to receiving revenue on ninety percent of payroll, almost 40 percent of the projected shortfall in benefits could be accounted for.[13]

The shift in the nation's income shares, toward a lower share of national income in the form of wage and salary means that tax revenues from earned income, as opposed to capital income, will need to be re-calibrated. Continued heavy reliance on earned income as a source of revenue will mean that a rising burden will be placed on earned income to pay off current federal obligations. Yet, if the current trends do not change, it will already be the case that wage earners will face lower permanent incomes than the earners anticipated.

Chairman RANGEL. The last witness is Dr. John Diamond, Edward A. and Hermena Hancock Kelly Fellow in Tax Policy Research. Thank you for coming all the way from Houston to be with us.

STATEMENT OF JOHN W. DIAMOND, PH.D., EDWARD A. AND HERMENA HANCOCK KELLY FELLOW IN TAX POLICY RESEARCH, JAMES A. BAKER III INSTITUTE FOR PUBLIC POLICY, RICE UNIVERSITY, HOUSTON, TEXAS

Mr. DIAMOND. Thank you for having me. Chairman Rangel, Ranking Member McCrery, and other Members of the Committee, it is an honor to testify before the Committee on Ways and Means on the economic issues confronting the Nation.

The U.S. economy continues to grow at a solid pace, and the U.S. unemployment rate is low. The Beige Book published by the Federal Reserve on January 17th generally reported that labor market conditions are improving and that businesses are having difficulty filling some job openings. It also reported that while monetary wages are growing at a relatively modest pace, compensation in the form of benefits is increasing rapidly, especially for health care.

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[12] Financial Markets Center, *Household Financial Conditions: Q3 2006* (http://www.fmcenter.org/atf/cf/{DFBB2772-F5C5-4DFE-B310-D82A61944339}/HFC_dec06rev.pdf)

[13] Virginia P. Reno and Joni Lavery, "Options to Balance Social Security Funds Over the Next 75 Years," NASI Social Security Brief No. 18 (February 2005). [http://www.nasi.org/usr_doc/SS_Brief_18.pdf]

The latest Beige Book reports indicate that economic activity in most sectors is strong except for the housing sector. An encouraging note is that some of the latest data suggests that the residential housing market correction is at least nearing its end.

In spite of this, the Nation must confront several challenges to maintain a robust level of economic growth. The most important of these challenges is the enormous budget pressures that are associated with the increase in entitlement spending.

Additionally, the trend toward globalization presents other challenges such as promoting labor productivity, encouraging innovation, and increasing the economic security of U.S. workers. I believe that in addressing these challenges, it is imperative that U.S. fiscal policy support long-term economic growth and ensure that U.S. businesses remain competitive at home and abroad.

Reform of Social Security and Medicare should be at the forefront of any policy discussion. These are the heart of the budget problems that face the Nation. Regarding this, Federal Reserve Chairman Bernanke recently testified that to some extent, strong economic growth can help to mitigate budgetary pressures. All else being equal, fiscal policies that are supportive of economic growth would be beneficial.

Tax rate increases scheduled under current law are almost certainly not consistent with fiscal policy that would support economic growth because they impose economic costs by distorting individual decisions regarding work and savings. Distortions are also related to tax complexity. Moreover, the corporate income tax is drawing more attention as globalization and the declining corporate tax rates around the world have drastically changed the competitive environment facing U.S. firms.

Given the ever-increasing importance of globalization, especially cross-country flows of both goods and mobile capital, reforming the corporate income tax to maintain the competitiveness of U.S. business is a critical issue that deserves careful attention. Overall, our Federal tax system is unnecessarily complex, often counterproductive in terms of promoting economic growth. In short, the current Federal tax system is in need of a comprehensive overhaul.

Reforming the Federal system would require tough economic choices. It is my belief that dynamic analysis of the macroeconomic effects of various policies could prove useful in determining tax policy changes that would support economic growth.

Two other concerns are the topic of much recent discussion. These include the widening income gap between high and low income households over time, and the slow recovery of household income from 2001 to 2005. There are many potential explanations for the widening income gap between high and low income households. I will touch on three.

Immigration of less-skilled workers into the United States is an important factor that reduces the growth of wages of less-skilled workers. In addition, anecdotal evidence and several economic studies support the view that outsourcing is also a potential factor in some of the recent decrease in the demand for skilled and unskilled workers.

Technological change also plays a role as technological improvements have decreased the demand for unskilled labor relative to skilled labor, and therefore has resulted in larger wage growth for skilled workers.

I do not believe that drastically increasing taxes on the rich would be a desirable or effective means of attempting to reverse these effects. Most importantly, this would decrease the incentives to work and invest, and may be detrimental to U.S. economic growth. Currently, the top 50 percent of taxpayers pay more than 95 percent of all personal income taxes, while over 40 percent of families in the United States have no tax liability or receive a refund.

The shifting economic landscape that leads to a more global economy is certain to increase and reduce the well-being of some U.S. workers during the transition. Thus, U.S. policymakers and businesses will face the chore of ensuring that U.S. workers have the opportunity to adapt in this ever-changing environment by engaging in education and training to learn new skills.

Thank you for this chance to testify before your Committee.

[The prepared statement of Dr. Diamond follows:]

Statement of John W. Diamond, Ph.D., Edward A. and Hermena Hancock Kelly Fellow in Tax Policy Research, James A. Baker III Institute for Public Policy, Rice University, Houston, Texas

Chairman Rangel, Ranking Member McCrery, and other members of the Committee, it is an honor to testify before the Ways and Means Committee on the economic issues that are confronting the nation. Let me start by stating that these are my views and should not be construed as representing the views of the James A. Baker III Institute for Public Policy, Rice University or any other organization.

I. State of the Economy

The U.S. economy continues to grow at a solid pace and the U.S. unemployment rate is at or near the full employment rate. The Beige Book, published by the Federal Reserve on January 17, 2007, generally reported that labor market conditions are improving and that some businesses are having difficulty filling job openings. It also reported that while monetary wages are growing at a modest pace, compensation in the form of benefits is increasing rapidly, especially for health care. The Beige Book reports were also generally positive for services and manufacturing activity, excluding residential construction. Activity in commercial real estate, nonresidential construction, energy production and exploration, and mining was strong. An encouraging note is that some of the latest data on home sales and consumer attitudes on home buying suggest that the residential housing market may be nearing the end of the correction for the unsustainable surge in housing construction in 2004 and 2005. U.S. business profits continue to rebound from the corporate scandals in the late 1990's, the 2001 terrorist attacks in the U.S., the effects of hurricanes Katrina and Rita on production, and the recession of 2001. Moreover, larger than expected revenue growth from individual and corporate income taxes led the Congressional Budget Office to reduce its estimate of the 2006 deficit.

In spite of all this, the nation must confront several challenges to maintain a robust level of economic growth. The most important of these challenges is the enormous budget pressures associated with the projected increase in entitlement spending which threaten to undermine the strength of the economy. Additionally, the trend toward globalization presents other challenges such as promoting labor productivity growth, encouraging innovation and entrepreneurialism, and increasing the economic security of U.S. workers. I believe that in addressing these challenges it is imperative that U.S. fiscal policies support long term economic growth, and ensure that U.S. businesses remain competitive at home and abroad.

II. Fiscal Policy: Where to Go From Here

Reform of Social Security and Medicare should be at the forefront of any policy discussion since these are the heart of the budget problems facing the nation. The cost of these programs is projected to rapidly increase for two main reasons: the changing demographics of the U.S. population and rapidly rising medical costs. These changes will have major implications for tax and spending policies in the U.S. for years to come. Regarding this, Federal Reserve Chairman Bernanke recently testified that "to some extent, strong economic growth can help to mitigate budgetary pressures, and all else being equal, fiscal policies that are supportive of economic growth would be beneficial."

The Congressional Budget Office (CBO) projects that tax revenues will be 18.3 percent of GDP in 2006, which is up from 17.5 percent of GDP in 2005. From 1962 to 2005, revenues were 18.2 percent of GDP. Over the next ten years, the CBO projects that revenues will increase steadily as a percentage of GDP, and that by 2016 revenues will be $4.2 trillion, or 19.8 percent of GDP. Under current tax law, including the scheduled expiration of the 2001 and 2003 tax cuts, the CBO projects that revenues will increase to 23.7 percent of GDP by 2050. This increase would result from a one-time tax increase in 2010 related to the expiration of the 2001 and 2003 tax cuts, and a steady increase in tax rates as real and nominal income growth shifts taxpayers into higher tax brackets and onto the Alternative Minimum Tax (AMT).

As a share of GDP, personal income taxes are 8.1 percent, corporate taxes are 2.6 percent, social insurance taxes are 6.4 percent, and other revenues are 1.3 percent. Over the next ten years, personal income taxes are projected to increase from 8.1 to 10.5 percent of GDP. As discussed above, this increase in personal income taxes results from the expiration of the temporary tax provisions passed in 2001 and 2003, including the higher exemption amount under the AMT. Reforming the AMT will be necessary to keep the ratio of federal tax revenue to GDP from increasing far above historical levels. Under current law, in which all of the 2001 and 2003 tax cuts expire by 2011, the CBO projects that over 20 million taxpayers will pay $60 billion more in taxes because of the AMT in 2014, and even more than that will be required to calculate their taxes under the AMT to see if they are affected. By comparison, in 2003, approximately 3 million taxpayers were subject to the AMT. The number of taxpayers and the increase in taxes will continue to increase over time if no changes are made to the AMT. Corporate income taxes are projected to decrease steadily from 2.6 to 1.7 percent of GDP over the next ten years as a result of slower growth in corporate profits. Social insurance taxes are projected to remain close to 6.3 percent of GDP over the next ten years.

The tax rate increases scheduled under current law are almost certainly not consistent with fiscal policy that would support economic growth. While taxes are necessary to raise revenue to pay for government operations, they impose an economic cost by distorting individual decisions regarding how much to work, how much to invest in training and education, how much to save, the allocation of saving across assets, and tax avoidance opportunities. Distortions are also related to tax complexity and the haphazard pattern of marginal tax rates created by the interplay of statutory tax rates, eligibility requirements, phase-ins, and phase-outs.

A. Disincentives to Work

The empirical evidence on the responsiveness of hours worked to the after-tax wage rate generally ranges from nil to a small but significant effect. This ambiguity arises from two offsetting effects: (1) that higher marginal tax rates reduce the incentive to work at the margin; and (2) that higher taxes reduce disposable income, and therefore, individuals must work more to finance a given level of consumption. However, individuals make other labor supply decisions that may also be affected by taxes such as whether or not they should participate in the labor force, how much to invest in training and education, and how hard they should work. Currently, there is no consensus view on the magnitude of the effect of wage taxes on all of these labor supply decisions. Some observers argue that such responses are sensitive to wage tax rates and therefore wage taxes have a significant impact on long run economic growth. By contrast, others argue that the effects of wage taxes for primary workers are small or negligible, while recognizing that the labor supply of secondary earners is more responsive to wage tax changes. In addition, reported taxable income of high income taxpayers is responsive to changes in tax rates over time.

B. Disincentives to Save and Invest

The disincentive to save and invest that is inherent under an income tax system is perhaps its most costly distortion. An income-based tax is levied on capital and labor income, regardless of whether the income is saved or consumed. Thus an income tax system penalizes future consumption. There is substantial evidence that reducing the taxation of capital income could increase saving, investment, productivity, and national output in the long run. In addition, the allocation of saving across different asset types is influenced by the haphazard pattern of tax rates on different types of assets. The distortions that are caused by this differing tax treatment are as large as distortions that would be associated with a several percentage point increase in overall capital income tax rates, indicating the importance of eliminating differential capital income taxes.

C. Economic Costs of Tax Complexity

A compelling argument for tax reform is the need to simplify the incredibly complex current tax system. The complexity of the current tax system imposes substantial costs on taxpayers in the form of time and money spent to understand and comply with the tax law. The President's Advisory Panel on Tax Reform estimates that individual taxpayers spend 3.5 billion hours doing their taxes (an average of 26 hours each) and about $100 billion on tax preparation and compliance. In addition, businesses spend about 3 billion hours and $40 billion. The cost of complying with tax system can be particularly burdensome for taxpayers that claim the Earned Income Tax Credit (EITC), that must pay the Alternative Minimum Tax (AMT), and for small businesses. The panel reported that almost seventy-five percent of taxpayers that claimed the EITC or paid the AMT used a tax preparer. The panel reported that 45 percent of taxpayers with tax liability will be subject to the AMT by 2015, indicating that financial costs of tax complexity are likely to rise over time under current law. In addition, the complexity of the current tax system creates the opportunity for some taxpayers to avoid or evade taxes and thus perpetuates the notion that the tax system is unfair. Since the tax reform of 1986, Congress has enacted more than 15,000 changes in the Tax Code (p. 16). This includes a number of provisions that are temporary, and set to expire in 2010 such as the tax rate for ordinary income, the child tax credit, the lower tax on dividends and capital gains, and the repeal of the Estate and Gift Tax. The high costs of tax compliance are increased by the volatile nature of the tax code, which creates more uncertainty and complexity for both businesses and families.

D. International Competitiveness and the Corporate Income Tax

Proposals for reform of the corporate income tax are drawing more attention as globalization and declining corporate tax rates around the world have drastically changed the competitive environment facing U.S. multinational firms. Moreover, the increase in multinational firms and globalization has substantially increased complexity associated with taxing cross-border corporate income. The U.S. corporate income tax, which taxes all repatriated and "foreign source" income after allowing for a limited credit for foreign taxes paid, is riddled with potential tax avoidance and evasion schemes that reduce corporate taxes and create costly economic distortions in the production and distribution of corporate products. However, evaluating proposals to reform the corporate income tax is a daunting task as we must account for the effect of corporate income taxes on a number of important corporate decisions such as the location of tangible and intangible capital, income repatriation, the location of income for tax purposes, financial decisions, incentives to export, incentives to lower foreign tax burdens, and foreign country tax treatment of U.S. corporations.

Two general directions are commonly suggested for corporate tax reform. The first would include some form of integration of the corporate and individual income taxes to ensure that all income is taxed once, with much recent attention devoted to plans that would accomplish this at the individual level (reducing dividend and capital gains tax rates), rather than the business level (reducing the corporate tax rate or allowing deductions or exemptions for dividend payments to shareholders). A second approach would introduce a new consumption-based tax to replace the current federal income tax system which is a hybrid tax that has both income tax and consumption tax elements, including the corporate income tax. Given the ever-increasing importance of globalization, especially cross-country flows of both goods and mobile capital, reforming the corporate income tax to maintain the competitiveness of U.S. business is a critical issue that deserves careful consideration. Note also that lowering individual taxation rather than business taxation is problematic in terms of attracting foreign capital.

E. Tax Reform

Our federal tax system is unnecessarily complicated and burdens millions of taxpayers and businesses who must comply with its many convoluted provisions. It hampers U.S. business from competing in an increasingly integrated global marketplace. It is it is riddled with loopholes, haphazard provisions, and often undermines our perception of fairness. Most importantly, it is often counterproductive in terms of promoting economic growth. In short, the current federal tax system is in need of a comprehensive overhaul. All of the issues discussed above could be addressed by a well-designed tax reform plan that created a simple, fair and pro-growth federal tax system. The 2005 report of the President's Advisory Panel on Federal Income Tax proposed two alternatives: (1) a reformed and integrated income tax (the

"Simplified Income Tax"), and (2) a consumption-based system supplemented with an "add-on" layer of capital income taxation at the individual level (the "Growth and Investment Tax") that is broadly similar to the dual income tax. The panel also discussed at length a true consumption-based tax—its "Progressive Consumption Tax" (PCT) option—although the panel ultimately decided against recommending this approach. Reforming the federal tax system would require tough economic choices that would require presidential leadership and ample bi-partisanship to achieve a viable reform option.

F. The Importance of Comparing Alternative Tax Policies

A useful example of comparing the growth effects of alternative tax proposals is provided in a report by the Office of Tax Analysis (OTA) published in July 2006 that examines the dynamic effects of the President's proposal to permanently extend a variety of tax provisions enacted in 2001 and 2003. The report provides information on the macroeconomic effects of the various tax provisions, similar to an analysis by the Joint Committee on Taxation (2005), as well as the aggregate macroeconomic effect of all the provisions. This information allows for a comparison of the macroeconomic effects of various policies and, if used appropriately, could prove useful in determining tax policy changes that would support economic growth. For example, the OTA report analyzes the following three groups of provisions:

- Extension of lower capital gain and dividend tax rates;
- Extension of lower ordinary income bracket rates for the 25, 28, 33, and 35 percent brackets and an extension of the repeal of personal exemptions and itemized deductions; and,
- Extension of the increase in the child credit from $500 to $1,000 per child, the increased standard deduction and bracket width for joint filers, and the 10 percent rate bracket.

Table 1 shows that lowering capital gains and dividend taxes increased gross national product (GNP) by 0.3 to 0.4 percent in the long run, depending on the assumed fiscal offset. This increase in GNP occurs because lower effective tax rates on capital income increased saving and investment. In fact, permanently extending the dividend and capital gains tax cuts increased real GNP in the long run for all of the options considered in the OTA analysis. However, as noted by OTA, changes in a variety of simplifying assumptions underlying the economic model used in this report could strengthen or weaken these results. This includes assumptions about the economic effects of dividend taxes and a variety of other economic distortions that are not included in the model.

For the base case parameter values, Table 1 shows that permanently extending the cuts in the top four ordinary income tax brackets increases real GNP by 0.0 to 0.7 percent in the long run, depending on the assumed fiscal offset. By comparison, permanently extending the increase in the child credit, the increase in the standard deduction and bracket width for joint filers, and the 10 percent rate bracket reduces real GNP by 0.4 to 1.2 percent, depending on the assumed fiscal offset. These provisions are inframarginal changes for most taxpayers and thus would not increase the incentive to work or save.

Purely from an efficiency perspective, a permanent reduction in dividend and capital gains tax rates has the most positive effect on the economy in most of the cases that were examined by OTA. In addition, lowering the four highest ordinary income tax rates increased GNP more than the permanent extension of the increase in the child credit, the marriage tax relief, and the 10 percent bracket. However, efficiency is not the only important factor in determining fiscal policy—fairness and simplicity in administration and compliance are also factors that should be considered.

The adoption of efficient, fair, and simple tax and spending policies is critical given the fiscal gap facing the nation, which has been estimated to be as high as $98 trillion in present value terms.

III. Trends in Household Income

Promoting labor productivity growth is crucial to increasing living standards since real wages increase with productivity in the long run. The growth of productivity is determined by technological changes that increase the amount of goods and services that can be produced with a given level of capital and labor, increases in the capital to labor ratio, and increases in human capital. Thus, policies that are likely to promote productivity growth include encouraging innovation and entrepreneurial ventures, lower taxes on capital income, and increasing investment in human capital. Recently, labor productivity growth has been roughly 3 percent annually or higher from 2002 to 2005. However, an anomaly is that monetary wages have not been increasing at a similar pace. Recent increases in non-monetary compensation in the form of benefits may explain a part of this trend. Other factors also affect real wages by changing labor supply and demand, such as immigration and competition from abroad. Wages are the largest source of household income for most families in the U.S. Figure 1 shows the growth in household income for different income percentiles over time. It illustrates two concerns that are the topic of much recent discussion in academic, political, and policy circles: the widening gap between high- and low-income households over time and the slow recovery of household income from 2001 to 2005.

Figure 1 shows that the widening gap between high- and low-income households accelerated in the 1980's and 1990's. There are many potential explanations for the widening of the income gap between high and low income households including: an inflow of less skilled immigrants, international trade, technological change, transfers of production activities to foreign countries, a reduction in the quality of education, the decline of labor unions, and deregulation. Immigration of less skilled workers into the U.S. is an important factor that reduces growth in wages of less skilled workers. It is important to note that immigration reforms that would reduce the negative impacts of immigration on the wages of less skilled workers would potentially increase the prices of other goods and services and perhaps limit wage increases for higher skilled workers. In addition, anecdotal evidence and several economic studies support the view that outsourcing is also a potential factor in some of the recent decrease in the demand for less skilled (and even some skilled) workers. However, it is not likely to explain fully the widening income gap between more and less skilled workers. Technological change also plays a role as many technological improvements have increased the demand for skilled labor relative to unskilled labor and therefore have resulted in larger wage growth for more skilled workers. In any case, there does not seem to be a simple policy solution to the widening gap between more skilled and less skilled workers. Moreover, it is not at all clear that the U.S. can reverse the trend toward increased globalization or that we would be better off if we did.

I do not believe that drastically increasing taxes on the rich would be a desirable or effective means of attempting to reverse the effects of increased competition from foreigner workers on the widening gap in household incomes. Most importantly, this would decrease the incentives to work and invest, and may be detrimental to U.S. economic growth. Moreover, given the progressivity of the current federal income tax system, it is not clear that such a policy would be supported politically. In 2003, the top one percent of taxpayers ranked by adjusted gross income (AGI) paid 34.3 percent of all personal income taxes. The top five percent of taxpayers paid 54.4 percent of all personal income taxes. Taxpayers that ranked in the top 50 percent of taxpayers paid 96.5 percent of all personal income taxes in 2003. In fact, the top 50 percent of taxpayers have paid more than 95 percent of all personal income taxes in every year since 1993. The President's Advisory Panel on Federal Tax Reform estimated in 2006 that the bottom 50 percent of tax filers would have a negative average tax rate and that over 30 percent of tax filers would have no tax liability or receive a refund. In addition, 15 million households would not be required to file an income tax form. This implies that over 40 percent of families would have no liability or received a refund.

However, this does not imply that nothing should be done. Increased competition from abroad threatens the security of many workers in the U.S. as businesses struggle to compete with low cost foreign producers for customers and capital. This has created a situation of increasing financial insecurity for many U.S. citizens. At the same time, this process reduces prices for goods and services that U.S. residents consume and thus increases the well being of many U.S. residents. While competition and production efficiency are necessary for long run growth and increased economic well being worldwide, the shifting economic landscape that leads to a more global world economy is certain to increase insecurity and reduce the well being of some U.S. workers during the transition phase. Thus, policymakers and U.S. businesses will face the chore of ensuring that U.S. workers have the opportunity to adapt in this ever changing environment by engaging in education and training to learn new skills. The role of tax policy should be to ensure that U.S. businesses remain competitive. For example, reforming the corporate tax system to reduce the burden of capital income taxation and costs of tax compliance is imperative to maintaining the competitiveness of U.S. businesses. In addition, transforming the role of unemployment taxes and the benefits and training that U.S. workers receive in spells of unemployment may also be an important course of action to help U.S. workers cope with increased competition from abroad.

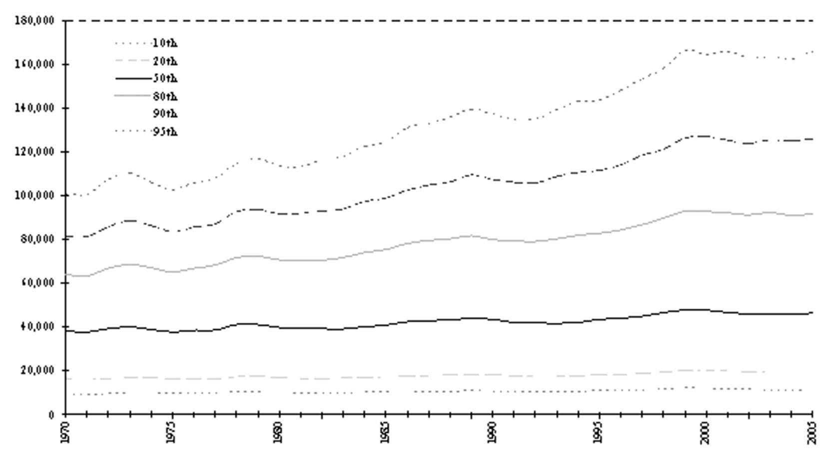
Table 1

Macroeconomic Effects of Extending The 2001 and 2003 Tax Cuts with Base Case Parameter Values: Percentage Change from Initial Steady-State Values

	(1) Lower Dividends and Capital Gains 2011-2016	(1) Lower Dividends and Capital Gains Long Run	(2) (1) Plus Lower Top 4 Ordinary Rates 2011-2016	(2) (1) Plus Lower Top 4 Ordinary Rates Long Run	(3) (2) Plus Remaining Tax Cut Extensions 2011-2016	(3) (2) Plus Remaining Tax Cut Extensions Long Run
Base Simualtion*						
Financed by Decreasing Future Government Consumption						
Real GNP	0.1%	0.4%	0.7%	1.1%	0.5%	0.7%
Capital Stock	0.2%	1.2%	0.1%	2.3%	-0.3%	2.3%
Labor Supply	0.0%	-0.1%	0.7%	0.2%	0.5%	-0.3%
Consumption	0.1%	0.6%	1.1%	2.5%	1.3%	3.5%
Investment	0.5%	1.6%	-0.5%	2.6%	-3.0%	2.3%
Financed by Increasing Future Income Taxes						
Real GNP	0.2%	0.3%	0.9%	0.3%	0.8%	-0.9%
Capital Stock	0.3%	0.7%	0.6%	0.3%	0.6%	-1.8%
Labor Supply	0.1%	-0.1%	0.9%	0.0%	0.7%	-0.8%
Consumption	0.0%	0.1%	0.7%	0.4%	0.5%	-0.7%
Investment	1.1%	1.1%	2.1%	0.5%	1.8%	-2.0%

Department of the Treasury
Office of Tax Analysis
* Assumes the U.S. is a large open economy with a simple representation of limited international capital flows

Household Income at Selected Percentiles: 1970 to 2005
(In 2005 adjusted dollars)



Data Source: U.S. Census Bureau, Current Population Reports, P60–231, "Income, Poverty, and Health Insurance Coverage in the United States: 2005."

Chairman RANGEL. Thank you so much.

Dr. Regalia, I am concerned about the fact that trade, U.S. trade, is appearing not to be nearly as popular among the American people. There are complaints that we are transferring jobs from the United States overseas, that we are the losers in these trade agreements. Then others would say that we are losers because of changes in technology and the needs of our businesses.

Knowing the Chamber's strong support for free trade, do you believe that in addition to the U.S. Trade Representative, that our team, in order to sell a particular free trade agreement to the Congress, should include people that would be specifically dealing with the problems that communities are having, such as Buffalo and other parts of the country, so that when a citizen or politician sees these losses, it is not all attributed to our trade policy?

Mr. REGALIA. Well, Mr. Chairman, I am not the Chamber's resident expert on the Chamber's trade policy. I will try to do the best I can to answer your question.

I think that when we look at trade in a global sense, it is an overwhelming benefit to the U.S. economy. Much of that benefit occurs to U.S. consumers. It has been estimated that the increase in purchasing power over the last 15 to 20 years per family can be as much as $1,500 to $2,000, which is a considerable benefit to the entire consuming economy.

The openness of the global economy today does cause dislocations in certain areas, and increased trade can lead to job dislocations in specific areas. I think when that happens, it is imperative that we address those issues to try and reincorporate the displaced workers, reeducate them if necessary, and bring them back into the productive workforce as quickly as possible, and to help them transition from their old job to the new job.

The question of how to do that is long and involved. I think that the goal of reincorporating those workers is clearly in the best interests of the U.S. economy, and is part of the Chamber's policy toward trade.

Chairman RANGEL. We could better sell why trade is so important.

Mr. REGALIA. Yes, sir.

Chairman RANGEL. So, it should be on the table.

Mr. REGALIA. Yes, sir.

Chairman RANGEL. Let me ask Mr. Trumka, the same way the Chamber appears that they have never seen a trade agreement that they didn't like, one might say that the unions never saw one that they did like.

If there was a trade agreement and it appears as though the consumers would have increased purchasing power, and it was generally accepted that technology almost dictated that America should be competitive, could you outline some of the things that labor leaders would look for, in addition to just a trade agreement, to alleviate the negative impact that that agreement would have on American workers?

Mr. TRUMKA. Thank you, Mr. Chairman. The first thing we would look for is whether there would be enforcement in general of any trade agreement. Over the last several years, we have seen trade agreements that have not been enforced—the Chinese trade agreement that we have. They manipulate their currency. They get a major advantage over American manufacturers.

There are other things that they could be doing to enforce that agreement. So, the first thing would be general enforcement of the trade agreement. Second would be whether workers' rights would be treated the same as intellectual property rights, whether there would be some mechanism in a trade agreement that would allow us to enforce those rights so that globalization doesn't continue to skew the imbalance that currently exists between employers and employees.

Third, we would look for the Tax Code, what the Tax Code would do, whether it would continue to reward people that took jobs offshore or not. We would continue to do that. We would also look for environmental things in the agreement as well because the environmental costs put us—if no other nation has to comply with them, put us at a disadvantage as well.

So, we would look for an agreement that, one, enforces and treats workers' rights with the same authority as any other right, property right, in the agreement, similar to the Jordanian agreement. We did support that agreement, Mr. Chairman. Those are the type of things we would be looking at.

Chairman RANGEL. I hope you would think, though, in addition to that, since it is difficult to sell these trade agreements politically here based on how we are improving the quality of life of foreign workers. It would be even more difficult to sell it to members who represent a city that was going through just an economic depression. It appear as though, as the doctor said, that if we could do something meaningful for workers who are out of work, that it might not cause trade to have the sting where it does, and that is as job losers here.

So, if you could draft something and get your office to think of things that would allow us to believe that we are not losers, but that we all can gain through trade, besides the things you already testified, it would be very helpful as we move forward.

Mr. TRUMKA. Mr. Chairman, that is precisely why we are calling for a strategic pause in trade agreements, so that we can figure out how to correct the agreements both internationally and domestically, things that we can do to help people on both sides of the border as well. So the American people become the winners.

We have lost 3.5 million manufacturing jobs since 2000, the vast majority of which are from trade agreements, the trade agreements that have been unevenly enforced and unevenly applied to the various rights of workers. So, we are calling for a strategic pause where we can have this dialog with labor, government, and business to figure it out.

We are not anti-trade. However, the rules that have existed to date have inured to the disadvantage of the American worker.

Chairman RANGEL. Well, Mr. McCrery and I have agreed that in addition to these hearings, from time to time we are going to have forums where people can sit around the table and talk about winners and losers and how we can make it more equitable for American workers as we try to protect those abroad.

Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman. I think your question is an excellent one, and especially put to Dr. Regalia representing the U.S. Chamber because it is a fact, I believe, that support generally around the country for trade agreements has diminished over the last few years. It is incumbent upon the business community, if they are convinced that it is in their best interests and the nation's best interests to expand trade through trade agreements, they have got to help point out the benefits of those.

They also have to help, I think, cure some of the symptoms, or at least what people think are symptoms, of trade agreements, which is job loss. You mentioned Buffalo. I don't know if that is a good example, but it could be—places like that. Business has got to be involved in providing solutions to the displacement caused by massive job loss; whether it is because of trade or not, trade gets blamed.

I happen to believe trade is not to blame. Mr. Trumka, your example of China is a good one because we don't have a trade agreement with China. If you look at the countries we do have trade agreements with, I believe the data will indicate that our exports to those countries have increased substantially since we entered into those trade agreements. Increased exports means increased jobs due to those trade agreements.

That is maybe a subject for another hearing that we should get into. It is, I think, part of this phenomenon of the income gap and so forth that we do need to look at. It is a part. It is a piece of the puzzle.

Dr. Diamond, is there anything that the other panelists said that you would like to address in particular? I noticed you scribbling some notes as they were talking. Is there anything that you would like to address in particular?

Mr. DIAMOND. I would probably make one point on——

Mr. MCCRERY. Is your microphone on?

Mr. DIAMOND. I would probably address one point on this issue of trade, and start by saying that while trade is important, I don't think it is by any means the most important factor that is affecting the American worker. The three factors I mentioned, I think, are all more important. I think deregulation is more important.

I think the economic literature generally finds that U.S. trade has had a small effect on U.S. workers' wages. I think there are larger effects associated with immigration and outsourcing that we are currently seeing.

So, I think the trade debate is kind of old and we should move our focus somewhere else because we are not going to be able to—whereas we can control trade agreements, it is a much more difficult problem to deal with businesses that are taking jobs overseas. If our only mechanism is to punish them by raising their taxes, all we are going to do is force more jobs overseas.

So, to the extent that people phrase it as the Tax Code benefits firms that takes jobs overseas, I think that is kind of a misleading statement and we need to just recognize that U.S. businesses are in a very competitive environment. They are doing their best to compete with foreigners who are actively trying to get a piece of the pie, just like lower income workers in the United States want a larger part. Poor countries around the world want a bigger piece of the world pie. These are not easy problems that we can solve with a simple tax increase, and we need to think outside of the box.

Mr. MCCRERY. Thank you. Implicit in your comment about outsourcing and your comment about the lack of importance in trade and the job situation is that the outsourcing is due not to trade agreements but to other factors. You mentioned a couple of them.

Mr. DIAMOND. That is correct.

Mr. MCCRERY. Health care. Mr. Trumka, I believe, one of the reasons that workers' wages have not increased more than they have is because employers are spending more and more on health care benefits. Would you agree with that or disagree with that?

Mr. TRUMKA. I would agree that one of the reasons why wages haven't increased is because of health care and the lack of a health care policy in the country. Yes, more and more is being spent on health care for worse and worse results. If you look how much we spend and what we get out of it, where we are with infant mortality, mother mortality or maternal mortality, things of that sort——

Mr. MCCRERY. I don't have any quarrel with that. I don't have any quarrel with that. You agree with me. So, one important thing——

Mr. TRUMKA. I agree that——

Mr. MCCRERY. One important thing that we could do, we could do together, to help the future of wages in this country is to take that burden of health care off of the employer community and allow them to pay their workers in wages what they are worth, and not worry about the health care benefit, assuming that we could find some suitable replacement for the employer community to provide that to people in this country.

Mr. TRUMKA. I would agree that that would be part of the solution. Trade would be part of the solution. A manufacturing policy to help American manufacturers would be part of the solution to it. It is not simple at this time, but there are more solutions. Yes, health care is an important ingredient in that solution.

Mr. MCCRERY. Thank you.

Chairman RANGEL. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman. We are going to be talking about trade, Mr. Chairman, next week. Right? So, we are going to be talking about trade next week. I think it is useful to have raised it, but I will refrain from discussing it except to indicate the importance of addressing the question of whether and how we shape trade agreements, and not only how we handle the problems of those who don't benefit from them.

By the way, the numbers on the trade deficit have dropped a bit these last few months. I just want to remind everybody of the overall trade deficit figure. In 2004, it was 611 billion, in 2005, 716 billion, and the projection now for 2006 is 765 billion.

So, we face a major trade deficit issue, I think. Mr. McCrery, it is true in a few cases our surplus has gone up after trade agreements. However, with our largest trade partners, we have seen a major increase in our deficit.

Mr. MCCRERY. If the gentleman will yield just a second.

Mr. LEVIN. Yes.

Mr. MCCRERY. I don't doubt that. What I said was exports from this country have gone up with our trading partners that we have agreements with, and that creates jobs.

Mr. LEVIN. True. However, while the exports have gone up, the imports have risen dramatically. You can't just take one of the two. Look, we will have a chance next week to talk about trade.

So, let's, if I might, in addition to the appropriate focus on trade, spend a few minutes talking about income distribution because I think the Treasury Secretary and the Federal Reserve Chairman have spoken about this. It was somewhat new to hear them talk about it.

Dr. Spriggs, I think what you have pointed out needs to be discussed among the five of you. It is not only the lower 50 percent, but I think as you say it is more accurate to talk about the 80 percent. There has been a disconnect between productivity and income.

So, why don't you talk about it a bit. I saw a figure. It was so striking I am having it checked out. This was an article based on Census Bureau income figures in 2004, the latest ones that are complete. Here is the quote. "The very top households, which include about 300,000 Americans, reported significantly more pretax income combined than the poorest 120 million Americans earned in 2004, a sharp change from 1979."

So, talk—you have just a few minutes of my time—about what has been happening and its import. Maybe, Dr. Spriggs, you want to lead off, and others join in.

Mr. SPRIGGS. Thank you, Congressman. Well, it has profound implications. We talk about the tax burden on those at the top half of the income distribution. They have the income. It is almost—that is where the money is. So of course they are going to have the highest tax burden. They have overwhelmingly most of the money.

The disturbing trend, and having productivity growth only go to those at the top, means that we have lost what our labor market institutions used to do, create for us shared prosperity, so that all Americans could easily believe that policies are really for the benefit of all Americans.

The issue of the growth in income inequality is a belief on the part of many Americans that we don't have policies that benefit everyone, in absolute terms, and during this recovery, in absolute terms, those in the bottom 80 percent have lost. So it appears that you are passing policies that are sort of a winner-take-all, and we are going to only benefit those at the top.

It has real, profound implications when you think about tax policy. Now, today, we have the smallest share of national income is in the form of earned income. So, to constantly harp on taxing earned income means that you are increasing the burden on the shrinking share of national income, not only the growing share of national income. So, there is that implication.

As you know because you are so involved in the Social Security debate, the growth in inequality has profound implications on the revenues for the Social Security system. We based the tax for that system assuming that we would be taxing 90 percent of the wage income. As a higher and higher share of income growth goes only to those at the top, we are taxing a shrinking share of the wage base and creating a bigger deficit for Social Security than we anticipated in 1981 when we put the changes in.

So, there are profound implications about how we think about the tax structure. Because those in the bottom 80 percent have been trying in the last five years to maintain their living styles by trying to maintain their consumption levels, they have been doing that by borrowing. That is not sustainable.

We will have to deal with how they get out of debt. How Congress respond to this debt burden that has been taken on is really important because if trends don't reverse and people will have lower permanent incomes, they are going to have to lower their consumption level.

The problem is going to be they are going to lower their consumption level at their retirement age, when they are facing less certainty about their private pension. They will have lower savings because at the current moment they are dis-saving. They are taking away from their savings. They are taking the equity out of their homes.

So they are going to be in a much weaker position to self-insure themselves in terms of health insurance and in terms of pension or income insurance that people try and do on their own. These are profound effects that really have to be addressed.

Mr. LEVIN. Thank you. Thank you, Mr. Chairman.

Chairman RANGEL. Thank you.

Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman.

I want to thank each of our witnesses. I would like maybe a comment, if I could, from maybe Dr. Diamond and Dr. Regalia on the importance of trade, the fact that our Nation is the number one trading Nation in the world, far more than any other nation.

My own district, even though it is one of the richest agricultural districts in the world, we cannot eat all the rice, the walnuts, the almonds that we grow in northern California. We are dependent on export. This is so characteristic not just of agriculture but basically our manufacturing, our service, our financial, really is a mainstay of our economy.

So often you would think by hearing—and I did not really hear that in your testimony, Mr. Trumka, today. I know you referred to it briefly in your written testimony—would almost conclude that globalization is bad by definition, and that workers can be dislocated because of trade. We definitely need to be doing more and everything we can to help these workers adjust to the realities of our world. However, dislocation is really the exception to the rule, and the general rule is that globalization has created literally millions of jobs in our economy.

Just using the example with labor, the case of United Parcel Service (UPS), every time UPS adds 40 new international packages per day into its system, it can add one new job. That is going to be good, well-paying jobs with full benefits, including health insurance. UPS is the largest employer of Teamsters, which comprise two-thirds of their workforce or 407,000 employees. So, trade does not just create jobs, but it creates union jobs as well.

Dr. Diamond, would you like to comment on this, your thoughts?

Mr. DIAMOND. I agree with you. I think trade is very important to sustaining economic growth in the United States. I think the tax system has a role to play, and that we need to simplify the tax system.

I think one of the things that globalization has caused is it is harder and harder for firms to—or it has become more complex to tax the income related to multinational firms. I think if the tax system is not restructured, we are going to continue to see a growing burden in terms of complexity, compliance cost on corporations in how they calculate income that comes from as many as five, six, seven, eight countries for the multinational firm.

So, I think we need to think about reforming the corporate income tax in terms of, A, global income taxes; corporate income taxes around the world are decreasing. B, we need to make sure that we reduce tax complexity so the compliance costs on corporations are reduced.

Mr. HERGER. Well, I thank you. I would like your comment as well, Dr. Regalia. Let me state a goal that I certainly have. I think Chairman Rangel summed it up. I think this is tragic because it seems like we have labor unions on one side that seem to be against any trade—it would appear that way—against any trade agreement; and then we have business on the other side that seems to be for everything, as Chairman Rangel said.

I believe it is in our interests that we be working together. I believe that we look at the example of UPS, and I believe this is characteristic of so much in business, that we have so much more to gain if we can lock hands and work together to help those that are dislocated maybe move to areas where we can compete better and help everybody.

Dr. Regalia, would you like to comment?

Mr. REGALIA. Yes. I think that when you look at trade, as I said, the gains from trade accruing to the entire economy are overwhelmingly positive. Even many of the researchers that have looked at some of the issues of trade on wages and immigration on wages and outsourcing on wages, all of which are generally treated in a negative vein and are all parts of the same puzzle because the outsourcing, the immigration, and trade are all parts of the global integration that we are seeing in the world economies today.

So, with 95 or over 90 percent of new markets outside of the United States, and with more education and more competitive enterprises growing up abroad to compete with our domestic industries, it is imperative that we figure out how to stay competitive and how to turn trade even more to our advantage.

However, doing away with trade agreements or suspending trade agreements would be counterproductive because while we are sitting here not engaging on a global scale, all our competitors around the world are. What we have to do is make sure that the trade agreements that we enter into are enforced. The Chamber is very much in favor of enforcing the trade agreements and making sure that our trading partners compete on a fair basis so that we are not giving away the farm in any case.

To withdraw from engagement, though, on the global stage is suicidal in an economic sense. We cannot decide to sit here and try to do away with engaging on the global stage. We have to learn how to out-compete them. The Tax Code is certainly part of that. Additional trade agreements, opening new markets, is a part of it;

and then figuring out how to deal with those areas within our own economy where trade, outsourcing, immigration, whatever has caused dislocations or economic problems, and to reengage those people in a productive way.

So, you really have to focus on all the facets of it. Pulling back is simply not an option in this day and age.

Mr. HERGER. Thank you.

Chairman RANGEL. Dr. Regalia, no one said we want to pull back. You have to understand that when we have a trade bill, we don't have consumers coming here knocking at our door saying, let's have another FTA because we are the beneficiaries.

We are trying to help the Chamber to think outside of just the merits of that, and to have American people to believe that the trade agreements are good.

Mr. REGALIA. Mr. Chairman, I would——

Chairman RANGEL. As Mr. McCrery said, if someone thought of a job, it doesn't make any difference who they are blaming. They blame China on everything, but the truth of the matter is, is it good for our economy to have people out of work? The answer clearly is no.

So, wherever the Chamber and private sector can help the government to train the people, to have them back to work, to come up with programs, not just for the beneficiaries of that trade agreement but for America, it would be helpful.

Dr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

I made the mistake of picking up a book by Jacob Hacker called the Great Risk Shift, which I have been reading. Listening to you gentlemen today, I ask myself, in one specific area we have obviously shifted the risk in this society from a societal handling of risk to individuals and said to them, you are on your own, folks. We are gradually doing it in Social Security, and we are doing it in health care. We are doing it in retirement. We are doing it everywhere.

The President tonight is going to talk about health care. The big business guys are now coming around here for the first time in a long time saying we are spending more on health care than we are on steel, or we are spending more on health care than we are on this or that. They want the government to help.

The President is going to suggest tonight we ought to give tax breaks to the working people who don't have—the 46 million who don't have health insurance. I would like to hear whether you really think health care is a big issue. Is it one that we ought to deal with in this society, or is it one that we ought to just play with the Tax Code and hope for the best for the folks floating around out there?

I would like both Dr. Spriggs and Mr. Trumka to at least give your view of that.

Mr. TRUMKA. Well, first of all, health care absolutely must be dealt with for a number of reasons. Number one, when you have 46 million Americans who don't have health care, you have a problem on your hands. Two, when you have a health care system that you spend more than twice what anybody else in the world spends on health care, and you have results that are nowhere near as good, you have a problem on your hand.

The problem we have seen, we doubt ourselves. Americans doubt ourselves when they know that they are having a problem with health care. Their drug costs are continuing to rise, and yet this Congress passes a bill that says that the government can't negotiate down drug costs. They can get the same drug by going to Canada, the same exact drug from the same manufacturer in the same packaging, and it will cost them half as much. They wonder where they have been left out.

To fool with the Tax Code, the proposal that we hear tonight is, quite frankly, another proposal for the rich. It will actually hurt people at the bottom. Let me give you a couple of concrete examples.

Right now, two out of three Americans get their coverage from employers. This will erode employer coverage because employers may either shift more costs onto workers, as they will have to when they lose their deduction here, or they will eliminate coverage altogether. They will send workers off to buy their own coverage with the new deduction.

Now, here is what happened. Since workers can take the full amount of the deduction for buying coverage on their own regardless of the costs of the plan, younger and healthier workers will buy the cheapest, most bare bone proposal. Older workers, people that come under the industry that I came out of, the mining industry, that are spent, their health is spent during their working years, will have an adverse selection.

The younger workers will be going out of those plans. Those plans will cost more. Then the people at the bottom don't enough money now to pay for health care, and the deduction that is going to subsidize them of 10 to 15 percent of their premium cost isn't really going to help them.

According to the census data, two-thirds of the uninsured have low incomes. That is below 2000 percent or $2,700 for a family of three. They either owe no Federal taxes or they are in a very low tax bracket, no more than 15 percent. That means the Bush deduction would subsidize between zero and 15 of their premium, not enough——

Mr. MCDERMOTT. Could you let Dr. Spriggs have one minute? Thank you.

Mr. TRUMKA. I apologize.

Mr. MCDERMOTT. That is all right.

Mr. SPRIGGS. Thank you, Congressman. I think at least the President will highlight something clear, and that is that we do have two systems. We think about social insurance, as you mentioned, sharing the risk. Then we have self-insurance. Through our Tax Code is how we implement self-insurance.

So, as your Committee is well aware, the tax expenditure of the medical deduction is the biggest tax expenditure that we have. The next one in size has to deal with how we do self-insurance for saving for retirement. Those are tax expenditures. Because we don't make them explicit, we often don't make the comparison between what is it really costing us from the fiscal side of self-insurance versus social insurance.

So at least the President is going to get us finally talking about what is the cost of this self-insurance model, of the ownership society. That will make it explicit. The real problem our Nation faces is the rising cost of health care, and that is whether you—no matter how you pay for it, that is the big issue, and what share of our National income can we devote to health insurance, whether it comes from private sources, whether it comes from the government. The issue is, can we have a growing share of national output devoted simply to health care.

So the Congress is really going to have to confront what do we do with that rising amount of money regardless of who pays for it that is going to go to health insurance. Then you need to ask what is the most efficient way of delivering that health insurance.

Given the large amount of money that in the United States that goes simply to administrative cost, not to health care cost, we have to think seriously about whether the current system and the large amount of money that goes simply to administrative cost and not directly to health care cost should be thought about.

The Medicare system, for instance, has a lower administrative cost than our private health insurance companies currently have. So, when people say that entitlements are the problem, well, entitlements would be the problem if Medicare had huge administrative costs.

So, Congress needs to think about efficiency and the delivery of the system, how much is going to go to administrative cost. You have to think about how do we rein in those increasing costs. We need to put on the table the tax expenditures that undergird this idea that people can self-insure themselves, and the idea that we are going to give more tax breaks or have tax-preferred saving accounts, which are tax expenditures, and——

Mr. MCDERMOTT [Presiding.] I will have to cut you off.

Mr. SPRIGGS. Yes. I may.

Mr. MCDERMOTT. Thank you.

Mr. SPRIGGS. That is the comparison we need to be making.

Mr. MCDERMOTT. All right. Mr. Camp.

Mr. CAMP. Thank you. I just have a couple questions.

Dr. Diamond, in your statement you mention the top half of taxpayers pay 95 percent of all taxes. What income level is that?

Mr. DIAMOND. I think they earn about 75 percent of all income. It is——

Mr. CAMP. What dollar amount?

Mr. DIAMOND. —about 50 percent of taxpayers. So, they pay—they are the top 50 richest taxpayers. I am not sure of the income share.

Mr. CAMP. What income level would that be to put you in that category? Does anybody know?

Mr. DIAMOND. Probably 40-, $50,000.

Mr. CAMP. Between 40- and $50,000?

Mr. DIAMOND. Yes.

Mr. CAMP. Dr. Diamond, do you know?

Mr. REGALIA. It is 30,000.

Mr. CAMP. $30,000? In income?

Mr. REGALIA. Yes. Adjusted gross income threshold on percentile for the top 50th percentile, $30,122.

Mr. CAMP. $30,122 places you as a taxpayer in the United States in the top half?

Mr. DIAMOND. That is correct.

Mr. CAMP. All right. Does that statistic take into account the age of the workers in that pool or the number of workers per household? For example, at top income levels, many households have two working families as opposed to at lower income levels often have one work-earner per household. Is that offset anywhere in that statistic, or can you just help me understand that?

Mr. DIAMOND. It is not really in this. It is just a—so a tax filing unit files a tax form. It will have—if it is a joint return, all the income will be reported jointly. It is not broken out.

Mr. CAMP. So, nothing is taken into account that at the very top levels, you have two earners as opposed to one. So, you are really comparing two different aspects of—two different kinds of earners, frankly.

Mr. DIAMOND. That is correct.

Mr. CAMP. Is there anything that takes into account the age of the workforce now as you compare these trends? Now the baby boomers are at the peak of their earning capacity, so we have more people potentially in a higher earning category. Is that taken into account when you compare what is trending now as opposed to the previous trends? Is there a comparison of that?

Mr. DIAMOND. Not in this data, no. However, you can find data. There is data that you can look at these trends with.

Mr. CAMP. Is that a factor?

Mr. DIAMOND. I couldn't say right off the top of my head.

Mr. CAMP. Is there anything to suggest that the mobility between one income—These are clearly a snapshot of workers at one time. Is there anything to suggest in the data that the mobility between one income level and another is more difficult or that it is harder to get ahead?

Mr. DIAMOND. I can say that when we talk about wage inequality, that family structure—and we have continually talked about the diverging wage rate across income groups. However, the wage rate is only a small part of explaining family income differences. Other factors would include divergence in other income sources; changes in employment or labor hours; and, most importantly or one of the most important, would be changes in family structure.

What you have occurring is at the high end, you often have two workers working lots of hours, each making a lot of money. Therefore, they end up being in a very high earner group. On the bottom end, you have a lot of—more and more we are shifting to more single families. So, family structure is an important component of this trend in income inequality that we should look at.

Mr. CAMP. So, there is—yes, Doctor?

Mr. REGALIA. There is a study that just was released in July of 2006 by the Bureau of Labor Statistics on "Earnings Mobility: Low Wage Workers in the United States." Their top line finding is that the persons initially with low income who work full time, remain in good health, and receive more education exhibit upward earnings mobility, significant upward mobility.

It says the picture is quite opposite, however, for those who are not working who start out at the lowest end of the income distribution and do not receive any additional education. They almost certainly stay in the lowest income quintile.

Mr. CAMP. So, it would be fair to say that there is no evidence to suggest it is harder to get ahead if you work hard at school and at your job?

Mr. REGALIA. Absolutely not. In fact, the conclusion is that if you get a job, stay in the job, work hard, and get more education, you will move up in the income distribution.

Mr. CAMP. Thank you. Yes, Doctor?

Mr. DIAMOND. I have actually done research on lifetime—looking at lifetime income in different groups, where you separate the groups into ten deciles, the highest decile and the lowest decile. There are many low income workers that out-save the highest income people, depending on their——

Mr. CAMP. All right. Thank you. My time has expired.

Mr. Chairman, I would just ask to submit to the record an article by Alan Reynolds on this topic.

[The article follows:]

Class Struggle?

by Alan Reynolds

Alan Reynolds is a senior fellow with the Cato Institute and a nationally syndicated columnist.

Major newspapers are in the throes of Mobility Mania: who "makes it" in America, and why; who doesn't, and why not. The Wall Street Journal began a series last week titled "Challenges to the American Dream." The New York Times followed suit with a multiparter on "Class in America," which aims to disparage the notion that the United States is a land of opportunity by claiming that "new research on mobility, the movement of families up and down the economic ladder, shows there is far less of it than economists once thought and less than most people believe."

Yet the scholarship commonly cited in support of such assertions—new research by Gary Solon of the University of Michigan, David I. Levine of Berkeley, and Bhashkar Mazumder of the Chicago Fed, among others—says no such thing. A paper last fall by Mr. Solon observed that several of the newest estimates, including two from Messrs. Levine and Mazumder, suggest that it has become substantially easier to move from one economic class to another (as a 1997 Urban Institute study also concluded). Those new results were statistically weak, however, and an alternative estimate from Messrs. Levine and Mazumder pointed in the opposite direction—implying family background might have grown more important between the early 1980s and early 1990s. But they described the latter result as merely "suggestive," and Mr. Solon now suspects the data were distorted. As for the latter's own research, he concluded that "our estimates are still too imprecise to rule out modest trends in either direction."

The discovery that something has not changed, or might have moved imperceptibly in either direction, would not normally be considered front-page news. But income distribution is an agenda-driven ideological fixation that frequently impairs journalistic judgment. To fully understand this non-news about unchanged class mobility, it helps to focus on a few reasons why some people earn more than others—they work harder, and have more experience and/or more schooling. Some observations:

- Households with two full-time workers earn five times as much as households in which nobody works. Median income for households with two full-time earners was $85,517 in 2003 compared with $15,661 for households in which nobody worked. Median income for households with one worker who worked full-time all year was $60,852, compared with $28,704 for those who worked part-time for 26 weeks or less.
- Alan Blinder of Princeton emphasized this point in a 1980 study: "The richest fifth of families supplied over 30% of the total weeks worked in the economy," he wrote, "while the poorest fifth supplied only 7.5%. Thus, on a per-week-of-work basis, the income ratio between rich and poor was only 2-to-1. This certainly does not seem like an unreasonable degree of inequality."
- Experienced supervisors earn twice as much as young trainees. Median income for households headed by someone age 45 to 54 was $60,242 in 2003, compared with $27,053 for those younger than 24. When we define people as poor or rich

at any moment in time, we are often describing the same people at earlier and later stages of life. Lifetime income is a moving picture, not a snapshot.

- Those with four or more years of college earn three times as much as high school dropouts. Median income for college grads was $68,728 in 2003, compared with $22,718 for those without a high school diploma.

To repeat, there is no evidence that it has become harder to get ahead through hard work at school and on the job. Efforts to claim otherwise appear intended to make any gaps between rich and poor appear unfair, determined by chance of birth rather than personal effort. Such efforts require both a denial that progress has been widespread and an exaggeration of income differences. To deny progress, the Times series claims that "for most workers, the only time in the last three decades when the rise in hourly pay beat inflation was during the speculative bubble of the 90's." Could anyone really believe most workers have rarely had a real raise in three decades? Real income per household member rose to $22,966 in 2003 from $16,420 in 1983 (in 2003 dollars)—a 40% gain.

To exaggerate inequality, the authors claim that "the aftertax income of the top 1 percent of American households jumped 139 percent, to more than $700,000, from 1979 to 2001, according to the Congressional Budget Office." But that is mainly because the CBO subtracts corporate income taxes from its idiosyncratic measure of the "comprehensive income" of individual stockholders. Because the top 1%'s share of corporate taxes rose to 53.5% in 2002 from 35.6% in 1980, the CBO records that as an increasingly huge individual tax cut and therefore as an invisible increase in stockholders' after-tax incomes. Arbitrarily subtracting corporate taxes from after-tax incomes of investors has nothing to do with labor income, though occupational mobility is the essence of the income mobility debate.

Since the Census Bureau overhauled the way it counts income in 1993–94 (making the figures incomparable with prior years), the share of income earned by the top fifth rose to 49.8% in 2000–03 from 49% in 1993–94. Because differences in household income can largely be explained by the number of workers and their education, it follows that a rising share of income earned by the top fifth of households should be largely explainable by work and education.

There are two workers per household in the top fifth of income distribution, but fewer than one in the bottom fifth, which relies heavily on transfer payments that generally keep pace with inflation. Yet by definition, rising real wages mean incomes of two-earner families rise more rapidly than inflation. Real median income among families with two full-time workers was $85,517 in 2003 and $75,707 (in 2003 dollars) in 1987—a 13% increase. But median income among families in which neither spouse worked ($27,130 in 2003), was just 1.4% higher than in 1987. The gap between two-earner families in the top fifth and no-earner families in the bottom must grow wider when salaries rise in real terms.

It is statistically dubious to compare long-term growth of average income in any top income group with growth below. Only the top group has no income ceiling, and the lower income limit defining membership in that top group rises whenever incomes are rising. In 2003, a household needed an income above $86,867 to make it into the top 20%, but an income above $68,154 (in 2003 dollars) would suffice in 1983. When the Census Bureau averaged all the income above $86,867 in 2003, they were sure to come up with a larger figure than in 1983, when the average was diluted by including incomes nearly $20,000 lower.

The endless academic fascination with murky income distribution figures generally ignores differences in work effort and focuses on formal schooling—a wider "skill premium" between those with and without a college degree. And when it comes to differences in schooling, we can't talk sensibly about the struggles of poorly educated people without mentioning immigration: 52% of male immigrants from Latin America did not finish high school (usually in their home countries, though we count many as United States dropouts). Most were legal immigrants because they had relatives here. Because the United States has humanely imported millions of poorly educated people in recent decades, it is unreasonable to compare U.S. income mobility with countries—e.g., Germany—that are far more restrictive about admitting unskilled immigrants.

A kernel of truth within the income mobility confusion is that good parenting matters to a child's lifetime success. Economics Nobel laureate James Heckman notes that "good families promote cognitive, social and behavioral skills," but "single-parent families are known to produce impaired children who perform poorly in school, the workplace and society at large." Yes, there are many attentive parents with low incomes who spend hours reading to toddlers, and there are negligent parents with high incomes. But many dysfunctional families do have low incomes, and collecting more taxes from functional families in order to send more transfer payments to dysfunctional families can have perverse results. Mr. Heckman points out that "generous social welfare programs . . . discourage work and hence investment in workplace based skills. . . . Subsidizing work through the EITC . . . can reduce the incentives to acquire skills and so perpetuate poverty across generations."

Recent "news" reports implying it has become more difficult for young Americans to live better than their parents fail to identify any genuine problem. And they suffer from one added handicap: They are demonstrably untrue.

This article appeared in the Wall Street Journal on May 18, 2005.

Chairman RANGEL. Mr. Lewis.

Mr. LEWIS OF GEORGIA. Thank you very much, Mr. Chairman.

Mr. Chairman, I want to thank the members of the panel for being here today. As a Nation and as a people, we are spending millions and billions of dollars on bombs and missiles and guns and wars while hundreds and thousands and millions of our fellow citizens are not sharing in the American dream. I think Dr. Zandi, Mr. Trumka, Dr. Spriggs, you all indicated that hundreds of our citizens are being left out and left behind.

How can we use the Tax Code for the common good, for the greatest good of all Americans? I think one of you indicated we have people who are living in the same city, in the same State, our large urban centers, in rural America. What do we do to include people that are left out and left behind?

It is an unbelievable gap. The working poor, people who are striving and struggling to stay in the middle class. They do not feel like they are going anyplace. They are standing still, or running in place, maybe. Dr. Zandi?

Mr. ZANDI. Well, my view is that the Tax Code should not be used exclusively to address this problem, that spending policy is more adept at addressing this issue than tax policy, but both tax and spending policy should be considered together as a whole.

Simply looking at tax policy creates significant disincentives, incentives that we don't understand, unintended consequences. Sort of to try to write this skewing of the distribution of income and wealth by using the Tax Code by itself I think would be a mistake.

I think spending policy is more efficacious because I do think that at the most fundamental level, the problem is that we need to reeducate and retrain workers more quickly as they become dislocated as a result of globalization and technological change. That can be done through better spending policies, more resources, and better-directed resources.

Having said that, I think though we need to consider both tax and spending policies together, that trying to address issues with just the Tax Code or just with spending policy in isolation is going to create increased budgetary problems in the long run, and that we need to consider both together when trying to address issues like income and wealth distribution, and our budgetary health in the longer run.

So, if I were addressing this, I wouldn't—my first inclination would be not to look at the Tax Code. It would be to look at the programs that we have to address this issue. What are the resources we are devoting to them and how well are they working?

Mr. LEWIS OF GEORGIA. Mr. Trumka?

Mr. TRUMKA. I think my first question to my colleague would be reeducate and retrain workers for what? Reeducate and retrain them to do what, and in what period of time? I have heard people say that it will be two to three generations before we work our way out of this thing. We don't have two or three generations to work our way out of it.

Now, the Tax Code is a powerful incentive. It rewards people that are currently taking R&D, not only manufacturing facilities but high tech R&D facilities, offshore. They should not be rewarded for doing that. We should figure out a way to reward people for building those facilities here.

One of my other colleagues says we have to learn how to compete. It is like competing with your other brother Darrell. When they take the same technology that you have and they take the same capital that you have and they locate something else, it is difficult to compete if the only variable is the wage base and trade agreements that don't favor the working people of either country.

So, I think we need to look at very carefully the Tax Code, and eliminate those incentives that reward people for going offshore, and actually reward people for manufacturing here at home. I think you will find strong support for that in the business community.

Mr. LEWIS OF GEORGIA. Dr. Spriggs?

Mr. SPRIGGS. Well, I think——

Mr. LEWIS OF GEORGIA. Could you also comment on this unbelievable unemployment gap in many of our rural communities and inner cities between the African American population and the overall population?

Mr. SPRIGGS. A large part of the wage gap between blacks and whites, the bulk of it, is explained by gaps in the unemployment rate. We have walked away from trying to solve the disparity in unemployment rates for the same level of education. For the same level of education, African Americans are twice as likely to be unemployed as whites. So, there is a huge area of enforcement that we have just ignored when it comes to the employment question.

In response to your original question, I think an important rule that the Committee on Ways and Means could adopt would be to finally balance the issue of tax expenditures versus expenditures so that you get a clear picture.

For instance, I brought up the health insurance issue. There is a tendency to look at Medicaid and Medicare, and you do that in one debate. Those are expenditures. Then you have the tax expenditure in terms of the tax-favored way we currently treat the health insurance premium.

There is a huge disparity when you look at savings, for instance, or health insurance and who benefits from the tax expenditure side. There is a difference in the income distribution of who benefits from the expenditure side. Only when you put the two pictures together can you get a picture of what is the total expenditure that we are doing.

We treat these tax expenditures as if they don't affect balancing the budget. We treat Medicare and Medicaid as if they do affect balancing the budget, but they both do. It would be great for the Committee on Ways and Means to say, every time we are going to look at health policy or every time we are going to look at saving for retirement, that we are going to put the tax expenditure and the income impact, the distribution of that tax expenditure, against the income distribution of the actual expenditure. We are going to compare what is the total impact that we are looking at in terms of our total policy.

Then you will have a clear picture, and you will be able to balance out between those who prefer the ownership society and self-insurance versus those who prefer expenditures as a way to resolve these inequalities.

Mr. LEWIS OF GEORGIA. Thank you. Thank you, Mr. Chairman.

Mr. MCDERMOTT. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

Dr. Spriggs, that was a fascinating exposition on tax expenditures. It is always interesting the ideological content of some of the analysis that comes before this Committee.

Dr. Diamond, would you comment on your analysis of the notion of tax expenditures and whether that is an adequate lens through which we can judge tax policy and all of its dynamics?

Mr. DIAMOND. That is a hard question to answer. I think we can definitely look at a tax expenditure and then look at the effects it would have on the U.S. economy in terms of the taxes we would have to raise to pay for it or government consumption that would be cut.

It would depend on the expenditure. Different expenditures are going to have different effects. One that was brought up here today is this——

Mr. ENGLISH. Reclaiming my time, Dr. Diamond, I realize it is a difficult question. I thought maybe you would give us an insight on how maybe it is not quite as clean and neat, but in your testimony, you cite the need for policymakers to respond to globalization's challenges, including labor productivity growth and encouraging innovation. Would you say that repealing, for example, the corporate Alternative Minimum Tax would be a significant step in the right direction with respect to increasing labor productivity and encouraging innovation, and certainly taking the burden off of certain sectors of our economy that are prone to cyclical downturns?

Mr. DIAMOND. I think corporate tax reform in general would be, yes, and I would add to that overall reform of the tax system. Because it is not only corporations that compete overseas. There are many self-employed individuals, S corps, partnerships.

Mr. ENGLISH. Okay. Since you are not prepared to answer my direct question, Dr. Diamond, you discuss in your testimony the parallel consideration of international competitiveness and the corporate income tax. As you know, the United States runs a large current account deficit, which has been mentioned by other members of the panel and discussed a little bit here earlier.

One possible reason, unfortunately among several, for our disadvantage in the trade area may actually be a matter of the design of our tax policy. Currently, every single one of our major trading partners enjoys, for example, a border-adjustable tax system for their imports and exports, whereas we do not.

Taking into consideration that some of our largest trading partners also fail to apply free market principles to their economic and monetary policies, what would be the impact on economic growth here in the United States in general if we were to utilize border-adjusted taxes as well? In particular, please discuss the short- and medium-term impacts, if you can.

Mr. DIAMOND. I don't think border-adjusted taxes would have much of an effect. I think most of that is taken care of through the exchange rate. It changes in exchange rates for most countries.

Mr. ENGLISH. So, you think that, say, our exchange rate with China adjusts?

Mr. DIAMOND. Well, now, I was—there is this issue of countries that are not letting markets perform. Then yes, you have an issue. I think it is important that we address countries that don't operate as free markets.

Dr. Regalia, what is the position of the Chamber on border adjustability and taxes, if any?

Mr. REGALIA. Well, we think that whatever could be done to put the United States on the same competitive footing as its foreign competitors would be advantage to the U.S. economy. That could be done through possibly border-adjustable taxes, or it could also be done through addressing the territorial nature of our competitors' tax system versus our global nature.

We double-tax our corporations: The income they earn abroad is taxed there. It's taxed when they bring it back. This increases the tax burden, and it encourages—it discourages the growth within the economy. It's also a part of the border adjustability. I don't think border adjustability is the only way to do it, but it certainly is one way that would address that.

Mr. ENGLISH. Mr. Trumka, does the AFL–CIO take a position on border adjustability? Does it matter that we tax our exports in a way that other countries don't, and don't place an equal impost on imports coming in representing the cost of our tax system?

Mr. REGALIA. Yes. I think we don't take enough account of that. I think we should take into account a number of different things. They are worth discussing, particularly if we can make them progressive in nature—not regressive but progressive in nature. Other countries actually subsidize their products through their Tax Code, and I think that should be eliminated as well.

Mr. ENGLISH. Thank you, Mr. Chairman.

Mr. MCDERMOTT. Mr. Neal.

Mr. NEAL. Thank you.

Mr. Trumka, you spoke of extraordinary gains in productivity, but at the same time, you mentioned wage stagnation. I think the one thing that we might agree on is that globalization has put pressure on the whole wage issue.

Tell me a little bit about why trade adjustment and the Assistance Act as it relates to retraining workers has failed.

Mr. TRUMKA. First of all, the system was so cumbersome, there are so few people that qualify under the Adjustment Act to get to retraining. It takes a long time to do it. So, that's one reason why they fail.

Second of all, again, what do you retrain people for? If you have lost 3½ million manufacturing jobs and there is nothing to retrain them for, you have a difficult problem. Everybody keeps saying, retraining is the issue. Retraining is the issue.

If you just look at the markets, if there was such a shortage of trained people in this country, wages should be accelerating. They are not. They are stagnated. They are stagnated for a number of different reasons. We have talked about a bunch of them here. Trade is one of them. Health care is one of them.

However, the primary reason for that shift is all the policies combined have created an imbalance of power between employers and employees. Employers not only send jobs overseas, they threaten to send jobs overseas. The threat lowers wages, causes workers to take cuts in pay, give up health care, do away with their pension plans. All of those things impact us.

The reason why they haven't worked is I think they are ill-designed right now and they don't—you can't define them quick enough. Not very many people—I don't know the statistics off the top of my head, but not many people qualify even though they lose their jobs to trade.

Mr. NEAL. Dr. Spriggs?

Mr. SPRIGGS. Well, I think they don't work because it actually is far more complicated to locate who the losers are. The labor market is very dynamic. So, if we shut down a steel plant or an auto plant, all of those workers don't end up unemployed. They find other employment.

So, the worker who ends up losing their jobs may well be a worker who is out-competed by a skilled, experienced worker. So, it may be a young worker who can't find the job because suddenly there is someone with 15 years' experience in front of them in line.

So, it is much more diffuse than the workers at that old plant who need the retraining and a new opportunity. It is the young worker who thought they were going to get the job who may need the retraining because they may have tried to prepare themselves for that job.

So, it is not so straightforward to locate the actual workers impacted because of this diffuse nature of the response because of the dynamic nature of the labor market. We have not really put together an unemployment insurance system aimed at this kind of labor market. We design an unemployment system based on the 1930s model based on a previous century, where business cycles were dominated by buildup in inventory in manufacturing, and workers would go back to their old jobs.

As Mr. Trumka has made clear, we are changing industries. We aren't just changing a business cycle. Even this business cycle, which is unique for us and as economists we can't fully put our hands around, the information industry, the broader group of folks who are engaged in information from communications to the Internet, actually has lost jobs and continues to lose jobs during this recovery.

So, we have not in the past seen what does a business cycle look like for that industry because for most of the history that we have looked at it, those jobs have continued to increase regardless of the manufacturing business cycle or the construction business cycle.

Now this downturn is hard to read. Is that what a cycle looks like for this industry, and will it be a long-term cycle or is the loss of jobs and information short-lived? We are talking about folks who are doing Internet jobs, and we all know about the dotcom bust, but it continues. We continue to shed jobs when it comes to looking at Internet publishers, people who do Internet provider jobs, people in telecommunications.

Those jobs are also declining during this recovery. Those are the jobs—as Mr. Trumka said, train them for what? Those are the jobs we told everybody we would train you for because those are the jobs that we would be adding. In fact, that industry has been shedding jobs during this recovery as well.

So, that is why it is hard, when a plant closes because of a trade agreement, to locate exactly which workers we are impacting and how do we retrain the workforce.

Mr. NEAL. Thank you.

Mr. MCDERMOTT. Mr. Weller.

Mr. WELLER. Thank you, Mr. Chairman, and welcome to our panelists. Thank you for joining us today. This is an interesting hearing.

Mr. Chairman, I represent—you and I have discussed this—a manufacturing district. Of course, Caterpillar is our biggest manufacturer. Over 50 percent of their product that they produce in my district, and they are growing by leaps and bounds right now, is exported. Thanks to the removal of trade barriers, they are enjoying good years. Hired more workers and selling more product. We produce a lot of plastics, a lot of steel fabrication.

This campaign and previous campaigns in the election cycle, we always hear the rhetoric about tax incentives that reward shipping jobs overseas. I would like to really get a greater understanding of what that rhetoric means when it comes to specifics.

I was going to say, Mr. Regalia can you just very quickly tell us how when manufacturers, for example, are making a decision to site or expand a manufacturing facility and they are serving the global market, they have a choice of different countries to locate, how the Tax Code factors in on their decision of where to build, expand, or relocate?

Mr. REGALIA. Well, when you are siting a plant globally, there are a whole host of factors that you kind of go through to determine where you want to cite that plant. First and foremost, it is where are your factors of production—land, labor, capital, that go into the production of the product. Second, where are your markets, so that you cut down your logistics costs of having to ship your product.

Then you look at other factors—stability in the region, an economic rule of law in the host country, so that investment is in some sense protected from risk. Then after that, one of the factors that comes into play, of course, is the Tax Code because when you decide to produce abroad, you absorb more in the way of double taxation because you have to pay taxes in the host country. You get a credit against those taxes when you repatriate that but in many cases it is not a complete credit.

One of the discussions about tax expenditures here seems to focus on tax expenditures as an end point when in fact many tax expenditures arise in the Code out of an attempt to correct for other imbalances, not social policy.

Mr. WELLER. Mr. Regalia, specifically can you identify the provisions in the Tax Code that reward shipping jobs overseas? Is there one?

Mr. REGALIA. Well, that wasn't my argument so I don't look at specific pieces of the Tax Code——

Mr. WELLER. If you are making a decision?

Mr. REGALIA. There is no credit that I know of that says if you locate a plant overseas, we will cut your U.S. taxes.

Mr. WELLER. Are there provisions that actually punish you for investing in the United States?

Mr. REGALIA. There are no provisions that I know of that punish you for investing in the United States, no. There are differential tax rates, but no provisions that I know of.

Mr. WELLER. Our tax burden on manufacturing, for example, where do we rate compared to other countries around the world?

Mr. REGALIA. We are not at the highest, but we are in the upper echelons.

Mr. WELLER. Okay. Mr. Trumka, in your statement earlier, you talked about the Tax Code rewarding shipping jobs overseas. Can you give me a specific provision in the Tax Code, an example, not just a statement but a specific provision that you believe rewards shipping jobs overseas?

Mr. TRUMKA. I will do better than that. I will give you a whole list of them. Rather than focus on one, what I would like to do is give you a whole list of those codes so that you can take away from this and some time to reflect on them the provisions that we think and that, quite frankly, that manufacturers in the United States think also affect them. So, we will give you a whole list of them. I will provide that as a supplement to my testimony. I would like to be able to do that.

I would also like to say that it is not just the Tax Code. It is the enforcement of the existing laws that we have.

Mr. WELLER. Yes. Mr. Trumka, my time is limited here and I just want to focus on the tax consequences. I look forward to your list. Thank you. I look forward to receiving it.

Mr. Diamond, if we were to make a change in the Tax Code that would encourage greater investment, rewarding investment in manufacturing in the United States, what would one initiative be that you would suggest?

Mr. DIAMOND. You could lower corporate tax rates. That would be a good one.

Mr. WELLER. What would you suggest we would have to lower them to to make investment in the United States competitive, factoring in the other costs that a manufacturer has to consider?

Mr. DIAMOND. To be competitive with other countries, I would say somewhere around 20 percent.

Mr. WELLER. So, a 20 percent tax rate is what you would suggest?

Mr. DIAMOND. A 20 to 25. You need to be careful. There is some amount of coordination between individual and corporate tax rates because you don't want to give individuals and corporations incentives just to shift income across.

Mr. WELLER. Okay. Mr. Regalia, representing the Chamber, would you agree with that rate?

Mr. REGALIA. I think cutting corporate tax rates would be one avenue. Another avenue to stimulate investment would be increasing the cost recovery, that is, shortening depreciation lives to encourage——

Mr. WELLER. Shorten depreciation?

Mr. REGALIA. —investment in the U.S., would be a big help and go a long way toward stimulating domestic investment.

Mr. WELLER. So, full expensing of capital assets would be a big help?

Mr. REGALIA. Full expensing of capital assets would be a great idea in terms of stimulating investment in this country.

Mr. WELLER. Okay. Thank you, Mr. Chairman. You have been generous.

Mr. MCCRERY. Thank you.

Mr. Pomeroy.

Mr. POMEROY. Yes. Thank you, Mr. Chairman, and thank you, panel. This is an extremely interesting discussion.

I want to talk about wage insecurity as opposed to wage inequities, not to in any way diminish the critical importance of the growth in wage inequity, income inequity in our country. Let's talk about the insecurity part.

Mr. Diamond, you indicate that there has been—as kind of a compounding trend, you note both components present in our present economy, a growth in the disparity in income distribution, but also a growth in the insecurity felt by the average American household. Is that correct?

Mr. DIAMOND. That's correct.

Mr. POMEROY. You also note that this can lead to adverse economic ramifications across the economy as an insecure household is likely to shrink consumptive behavior and act in other ways reflecting the insecurity that might diminish their optimistic participation in the economy, consumer confidence being a critical economic indicator.

So, is it bad for the economy when we have a great number of workers that are feeling insecure?

Mr. DIAMOND. I am not sure I would classify it as a great number. I think I said in my testimony that there are some U.S. workers and the number—I don't think it would be great.

Mr. POMEROY. Well, let's pursue that, then. Let's pursue that, then, Dr. Diamond. I will actually invite the panel participation in this factor. What do you think is the status of wage security in the workforce?

Mr. DIAMOND. Well, I think it has changed quite a bit. I think that the real problem we are facing is the way that insecurity used to rise up in the economy and the way that it is going to do now under globalization. So, it used to be that one industry was affected, and it was relatively easy to think of ways in which we could help workers in that industry or that industry itself. Now it affects a wide range of people, from computer programmers to Certified Public Accountants (CPAs), who get their jobs shipped to India.

Mr. POMEROY. If I hear you——

Mr. DIAMOND. There is no industry——

Mr. POMEROY. —that is kind of what I understood your testimony to provide. Therefore, that seems to me, to the extent that it is now more broadly affiliated across the economy in this transitional period that we are in, this is a pretty big deal, worker insecurity.

Mr. DIAMOND. It is a big deal. It is not—I was just saying it is not most workers. It can affect one CPA instead of all CPAs.

Mr. POMEROY. Let's run down the panel on it, and then I have got a follow-up.

Mr. SPRIGGS. If I may, I think a way of judging people's insecurity and pessimism has to do with the debt level they are willing to take on to maintain their income. That can be a bad thing if they do that. It can be a good thing if they do that. As you indicate, if people become too insecure and they draw back on consumption, we know that causes really bad things.

So, what we have seen recently is that people are willing to take on less debt. They are beginning to signal us that they no longer are optimistic that this current 4-year wave of not seeing their inflation-adjusted incomes rise, they don't think that that's going to turn around. They aren't willing to take on betting that in the future, their income is going to rise and they are going to pay out of that.

Mr. POMEROY. I am just going to so quickly run out of time, Dr. Spriggs.

Mr. SPRIGGS. Yes. So, the bottom line is, it is beginning to show itself, and not willing to take on more debt. As they do not take on more debt, if their incomes aren't rising, that means consumption is going to fall. So that, I think, is the best barometer of how to think about the insecurity and how to think about the implications unless we can reverse the trend about incomes and having incomes rise and making people change their views.

Mr. POMEROY. I am not going to have time to continue the question down the panel. I have got some other questions for the panel. I know you would love to tackle that one. I think it is a very big deal.

I take some issue with, Dr. Diamond, your testimony where you say the first thing we need to do is go in and reform entitlements. Well, to the extent that you have got private insurance programs being health insurance, being pensions, under attack and being diminished in the private sector, the role of public programs providing support in these areas, through Social Security, through Medicare, through workers comp, workers unemployment compensation, rather, are even more critically important in this period of greater wage instability and therefore insecurity. I think that that has to be really a foundation of our economic policies going forward.

I have got one final note to kind of put a point on this. We spent some time—we didn't spend much time—last Congress talking about pensions. The Labor Department told us pensions were absolutely going insolvent in huge numbers. The funding crisis was critical. The Administration advanced a pension bill. Regrettably, this Committee, Republicans or Democrats, were not allowed much participation, although the Chairman had substantial input in the ultimate pension bill.

Today's Wall Street Journal, and I want to add this in the record, talks about pension plans taking a healthy turn after years of steep under-funding thanks to several years of double-digit investment gains and rising interest rates—having nothing to do with the bill we passed, just the long-term ebb and flow of a snapshot picture of solvency in light of their investment holdings.

So, we have pensions healing up, but we have now passed a bill. I want to point your attention to a paragraph in this. "The transition from prior accounting rules to the new ones, however, mean that the Fortune 100 companies"—that now, by the way, are 100 percent funded, as reflected in the article—"the Fortune 100 companies are likely to see a combined decrease in shareholders' equity of about $160 billion." That is much better because it was 245 billion before the re-estimate.

[The Wall Street Journal article follows:]

Pension Plans Take Healthy Turn

Rising Markets Aid Big Firms' Funds; Failure Risk Lessens

By THEO FRANCIS

January 23, 2007; Page A4

After years of steep underfunding, pension plans are now healthy, thanks to several years of double-digit investment gains and rising interest rates, separate studies from benefits consultants suggest.

The pension plans of Fortune 100 companies ended 2006 with 102.4% of the assets needed to pay pensions indefinitely, according to an estimate expected to be released today by Towers Perrin, a Stamford, Conn., benefits consultant. That is up sharply from a low point of 81.9% in 2002, though still below the 125.8% recorded at the height of the stock-market boom in 1999.

PENSION HEALTH

- The News: Pension plans have enough funds to cover their obligations, a study found.
- The Background: Concern over underfunded pensions helped legislation through Congress last year. Stock gains were the biggest factor in the plans' recovery.
- Outlook: Estimates for 2006 show further improvement.

Consultants and pension experts said the change suggests fewer pension plans are at risk of failing. That bodes well for workers dependent on the plans for retirement income and for the Pension Benefit Guaranty Corp., a federally run pension insurer that pays basic benefits if the plans aren't able to.

'The Right Direction'

"There's no reason why their funding shouldn't have improved—everything's going in the right direction," said Jack Ciesielski, a pension-accounting expert who writes the Analyst's Accounting Observer newsletter. While some companies faced serious funding shortfalls, for many employers "it was cyclical in nature," he added.

Similar findings are echoed by a separate study of pension funding based on 2005 data, released yesterday by benefits consultant Watson Wyatt Worldwide. That study found that pensions for a group of 1,000 companies were about 91% funded in 2005, up from a little more than 80% funded in 2002.

Widespread concern over underfunded pensions and corporate decisions to freeze or cut pension benefits has helped pension legislation through Congress last year. The legislation was billed as shoring up pension plans weakened by a "perfect storm" of low interest rates and poor stock-market performance early this decade. Few provisions of the new law took effect before this year, so any improvements they may bring about aren't reflected in the estimates by the benefits consultants.

Towers Perrin's study examined the 79 companies in Fortune magazine's list of the 100 largest U.S. firms that sponsored defined-benefit pension plans. Pension plans are backed by trust funds that typically pay retirees a set amount each month for life, or a one-time payout based on that stream of payments. A plan's funded status is a measure of any gap between the fund's assets and the company's obligations under the plan.

Company Contributions

Stock-market gains were the biggest factor in the plans' recovery, averaging about 12% in 2006. In addition, rising interest rates likely reduced plan liabilities by about 3%, Towers Perrin estimated. Interest rates determine how the company converts future pension payouts into a liability on its books today.

Company contributions also improved pension funding, with average contributions rising more than fivefold since 1999. But these contributions boosted plan funding by only about 1%, Towers Perrin said.

One factor unexamined in the study: How big a role pension freezes and cuts have played in improving pension funding. Freezing or cutting benefits reduces a company's pension liabilities, which means the existing assets cover more of the company's obligations.

Towers Perrin used publicly disclosed data for each company, including asset, liability and asset-allocation figures, and took into account subsequent market returns and interest-rate changes.

Improving plan fortunes could encourage some companies to stop contributing to their plans, as many did in the late 1990s; however, pension-industry officials say last year's legislation makes that less likely.

Separately, new pension-accounting rules taking effect this year mean companies must start reflecting net pension liabilities on the balance sheet, instead of recording them in a footnote as they have for years. Under Towers Perrin's projections, "on average, the Fortune 100 will be booking an asset" rather than a liability for their plans, said Bill Gulliver, Towers Perrin's chief actuary for human-resource services.

Big Exposure to Stocks

The transition from prior accounting rules to the new ones, however, mean that the Fortune 100 companies are likely to see a combined decrease in shareholders' equity of about $160 billion, improved from prior estimates of $245 billion, Towers Perrin said.

Watson Wyatt's study showed that plan funding improved by about $10 billion in aggregate between 2004 and 2005. Investment returns improved funding by about $114 billion, and company contributions added about $51 billion, offset by the growth of benefits for employees in the plans, Watson Wyatt said.

"The bottom line is, things are getting better," said Mark Warshawsky, Watson Wyatt's director of retirement research and a former Bush Administration Treasury official. He said preliminary estimates for 2006 show further improvement.

Still, Watson Wyatt's analysis shows that pension assets were invested about 64% in stocks, on average—meaning another sharp downturn could wreak havoc with pension funding once again.

Mr. POMEROY. Now, I want to ask Mr. Trumka whether he believes corporations——

Mr. MCDERMOTT. Your time has expired.

Mr. POMEROY. Okay. I will just—you may submit in writing your answers to this question. I will conclude with a point, Mr. Chairman.

It is my belief that we have done horrible damage with pension funding requirements. We responded to those that said the system was in crisis when it isn't in crisis, and it is already reflecting better results right now. The funding rules we have imposed will create a crisis. They are not going to put in $162 billion, and we are going to see tremendous assaults on pensions going forward without further review and action by this Committee. Any statements you would like to add to that effect, I would appreciate.

Thank you, Mr. Chairman. I yield back.

Mr. POMEROY [Presiding.] Mr. Lewis is recognized.

Mr. LEWIS OF KENTUCKY. Thank you, Mr. Chairman. I certainly appreciate the panel and your being here today.

Dr. Diamond, Mr. Bernanke just recently talked about some of the challenges that are out in front of us, and not really too far away. The U.S. Comptroller General, David Walker, has been before this Committee on several occasions, and he has talked about those challenges.

In fact, in the past 19 years, Medicare and Medicaid spending has risen from 1 percent of the Federal budget to 19 percent. In 2040, entitlements will consume the entire Federal budget. A 50 percent tax increase on workers or drastic benefit cuts for seniors will be required to pay for defense and other government services.

The unfunded obligations for Social Security and Medicare will have grown in the past 6 years from $20 trillion to $50 trillion, amounting to a $440,000 debt for every household in the United States. In the next 25 years, the number of Americans age 65 or older is expected to double. Those are overwhelming challenges.

My son and daughter—my daughter is 24 and my son is 35—and they are not expecting anything in Social Security. They are putting a lot in, as much as they can, into 401(k)s. What can we do to solve these challenges by creating incentives for the American people, for our children and the children to come, to be able to be part of an ownership society and be able to invest in their future through things like 401(k)s and savings and so forth? What can we do in the Tax Code, or what can we do to try to meet these challenges now before it is too late to solve them?

Mr. DIAMOND. I think there are several things we can do, all of which would focus on increasing national savings. Reduce taxes on capital income so individuals save more. Cut government spending so the government deficit is lower. We could reform the tax system just to have a tax system that is more conducive to economic growth, shifting to some type of consumption tax system, or corporate tax reform in which we incorporate the corporate and personal income tax to reduce the double taxation of capital income, would be an example.

Furthermore, on the point of Social Security is I think it is a necessity, not just something we should think about, but I think it is a necessity that we move to at least a mixed system of Social Security, meaning part pay as you go and part investment-based. Other countries are moving to mixed systems—China, Britain, Sweden, Chile, Australia. President Clinton almost proposed moving to a mixed system when he was President.

The way Social Security works is that to keep paying benefits to each successive generation, we have to keep raising taxes on future generations. Right now we are at the point where we have to raise the payroll tax from 10.6 to somewhere above 15 percent, 15.6, 15.7 percent, assuming no negative economic growth effects, just to pay the current level of benefits over the next 50 years or so.

Come a generation or two later, we are going to have to raise it even more if we don't switch to some kind of system that allows people to have private accounts where their money can grow with the stock market and with corporate profits, as we see going on in public pensions.

I think the whole point that Representative Pomeroy made about public pensions being in good health now is directly related to growth of the economy, what happens when you own an asset and it increases in value. We need to switch Social Security to that system.

Mr. LEWIS OF KENTUCKY. How many Americans now have some type of investment in stocks? Do you know? Anyone know?

Mr. DIAMOND. It is a growing number. I can't—I think the number is somewhere over 50 percent——

Mr. LEWIS OF KENTUCKY. I think that is right.

Mr. DIAMOND. —but I can't say right off the top of my head. Dr. Zandi may know.

Mr. ZANDI. Yes. According to the survey of consumer finance, it is just about 50 percent.

Mr. LEWIS OF KENTUCKY. Yes. So, a lot of the—well, the goose that is laying the golden egg needs to be encouraged to keep laying that golden egg if we are going to have a prosperous future for our kids and grandkids. I see my time is up. Thank you.

Chairman RANGEL [Presiding.] Mr. Thompson of California.

Mr. THOMPSON. Thank you, Mr. Chairman.

I have a question for Mr. Zandi. Sir, before this Committee—or, actually, before the Senate Banking Committee, the Chair of the Federal Reserve spoke recently about a vicious cycle in which large deficits lead to rapid growth in debt and interest payments, which in turn add to subsequent deficits.

Then before this Committee, we heard from David Walker, who told us that at some point in the year 2040, the amount of revenue coming into the Federal Government will match the amount that the Federal Government has to pay to service our debt, this growing and I think troubling national debt.

I am very concerned about the amount of money that we owe. I am interested in your thoughts on the role that the deficit and the debt play in determining our economic health and how they might impact future economic growth.

Mr. ZANDI. Well, I think this will be our most significant economic problem. Not this year, not next——

Mr. THOMPSON. Our most significant?

Mr. ZANDI. Far and away our most significant economic problem. Not this year, not next, not the year after, but certainly, as we make our way into the next decade, it will quickly become clear that if we do not address the what will then be very large and growing budget deficits, it will undermine our economy's ability to grow and thrive.

If you do the math and make some very reasonable assumptions, something is going to break. We are just not to get out to 2030 with these projections. Something has got to change because it just won't work.

Mr. THOMPSON. Thank you. Mr. Walker, the Comptroller General, David Walker, also on his—he has gone across the country on this fiscal wakeup tour. He has stated on numerous occasions that our current fiscal policy is unsustainable and that faster economic growth can't solve our deficit problem.

I would like to hear from—maybe just a yes or no down the line if you agree with David Walker's comments.

Mr. DIAMOND. I agree.

Mr. SPRIGGS. Yes, I agree.

Mr. TRUMKA. Yes.

Mr. REGALIA. Yes.

Mr. ZANDI. Yes, sir.

Mr. THOMPSON. So, it is not going to be—we are not going to grow our way out of this. Thank you very much.

Dr. Spriggs, if you would, in your testimony you discussed borrowing to maintain consumption levels. You note that household debt has been growing at a rate of almost 11 percent over the past few years vis-a-vis the 3.7 growth in our household net worth. As a result, our savings rate has reached record lows.

I am just wondering if you have any suggestions as to what we should or what we could do or should we be putting policies in place to promote savings, especially among our lower and middle class families.

Mr. SPRIGGS. We have to help people lower their debt level, which is a form of savings. From an economist's perspective, that is savings.

Mr. THOMPSON. That is a kind of vicious circle, though.

Mr. SPRIGGS. It is the vicious circle that people find themselves in. So, the first thing that households will tend to want to do is to make their debt level lower. We need to think about policies for that.

We favor people and terms of the interest deduction they have on home equity-based debt. We don't do anything to help people get out of debt if it is not home equity debt in terms of how we think about the interest payments that they are making.

I think the Committee on Ways and Means really needs to have a set of hearings to think through how you can give incentives for people to lower their debt level. Too much of the discussion on long-term savings and on their retirement, I think, divert us from this immediate need.

Because if this trend doesn't turn itself around, the bad way that people would do it, of course, is to just stop consuming. That is called a recession. The preferred way is of course we have people's incomes rise, and we encourage them to use the rise in income to get rid of the debt.

There has to be a lot more explicit discussion of how do we get people's debt levels down without having consumption fall at a dramatic rate. Homeowners and American families cannot sustain the current debt-to-asset ratios, and they will correct them.

Mr. THOMPSON. Thank you very much.

Chairman RANGEL. Mr. Blumenauer.

Mr. LINDER. Mr. Chairman, am I not next?

Chairman RANGEL. I am so sorry. I meant to share with you that we have such an overwhelming number of Democrats that are present that I shared with the Ranking Member that we were going to do two for one to try to bring it down based on when they came here.

Mr. Blumenauer.

Mr. BLUMENAUER. Thank you, Mr. Chairman.

I noted, Mr. Zandi, in your testimony on page 3, there was one paragraph that you chose not to read where you are talking about "financially pressed lower income households who heretofore have been able to mitigate the impact of constrained incomes on their living standards by significantly increasing their borrowing."

You are talking here about it being increasingly difficult for them to be able to maintain this. We are looking at pressures with the housing bubble. We have got impacts in terms of new bankruptcy laws.

Do you want to just—can you elaborate on that for a moment?

Mr. ZANDI. Sure. I only skipped it because I know you are a stickler for 5 minutes, and I was at 5:30 anyway. So, that was the only reason.

My view is that lower income households have been under significant financial pressure for a quarter century. It hasn't materially affected their standard of living in large part because they have been able to take on a significant amount of leverage. That has been only—that has been facilitated by a steady decline in interest rates more or less for the past quarter century; and, moreover, financial innovation, which has allowed lenders and creditors to extend out more credit.

However, that process is now over. Going forward, it is hard to argue that interest rates are going to go lower for any extended period of time. Debt service burdens are at record highs. We are starting to see financial stress develop. Initially, we will see that very clearly in a surge in mortgage delinquency and default.

Foreclosure rates are going to rise very rapidly in many parts of the country. That is indicative of the fact that it is now going to be very difficult for lower income households to supplement their income by taking on even more leverage. So, the constraint on their standard of living is just going to become more obvious going forward. It has been masked by their ability to borrow.

Mr. BLUMENAUER. I appreciate that. Mr. Chairman, I know you have been of great concern about the impact on society of having an increasing number of poor and lower income people, that that bears a direct cost to us. I appreciate, Mr. Trumka, you are talking everybody in your testimony who works every day shouldn't have to live in poverty. They should have access to health care and be able at some point to have income security in retirement.

Mr. Chairman, I hope that there will be an opportunity in the course of our discussions to zero in on this impact of how borrowing has sustained the standard of living and put more and more people at risk.

I happen to agree with Dr. Zandi that we are going to see—a number of these innovation mortgage products are going to result in a lot of people being under exorbitant stress in this year as the higher interest rates kick in, when the negative amortization runs out, as we start to see the impact of the change in mortgage laws—excuse me, in bankruptcy laws—that are starting to sort through.

Last but not least, as has been noted in terms of health care, where low and moderate income people get checked in, and they only get access to health care in a hospital if they produce a credit card, which they are going to be paying 20 or 30 percent interest.

I think this is an area that deserves our continued interest. I know, Mr. Chairman, you have deep concern. I have read some of your speeches that I think are helpful. I am hopeful that we can work with distinguished representatives like people on the panel here because it is not just government debt, but it is low and moderate income people who are stressed and have less margin that could have all sorts of ripple effects throughout the economy.

Thank you, Mr. Chairman, and I yield back.

Chairman RANGEL. It is my hope that—and the Ranking Member agrees with me—that it is one thing to listen for 5 minutes to what the problem is. We wish we could get your time to come and sit with us to work toward the solution of these problems because this information verifies what a lot of people think. However, because of your expertise, you help us with it.

Mr. Linder, according to the sheet that I have here—we follow the Gibbons rule as to who came here. Mr. Brady, Mr. Reynolds, Mr. Tiberi, and Mr. Porter would precede you. So, I didn't mean to pass over you if this is accurate that Mr. Brady—let's see. Brady is not here. Is Mr. Reynolds here? Mr. Tiberi? Mr. Porter.

Mr. PORTER. Thank you, Mr. Chairman.

I guess I really appreciate you being here this morning and I look forward to, as the Chairman has mentioned, that possibly we could have some time to have some discussion at a later date to find some solutions.

I would like to address maybe a regional aspect of discussions this morning. Now, we talk about some of the challenges in different quarters of the country. There are some areas that are in desperate need of help, from education to manufacturing to creating new jobs.

Take the Nevada experience for a moment. We have created close to 50,000 new jobs in the last year in a very resilient business community that has retrained, retooled constantly to remain on the cutting edge of visitors to our country and to our community.

It has been built upon labor and management working together. I think we are a true flagship for cooperation between business and labor. We have about 40 million and some visitors a year. We are constructing another 40,000 hotel rooms. All this says we are really a bellwether for the economy and the country. We are about 98 percent occupancy with 41 million visitors. That means people's attitudes are improving substantially. If there wasn't a positive attitude in this country, we would be out of business.

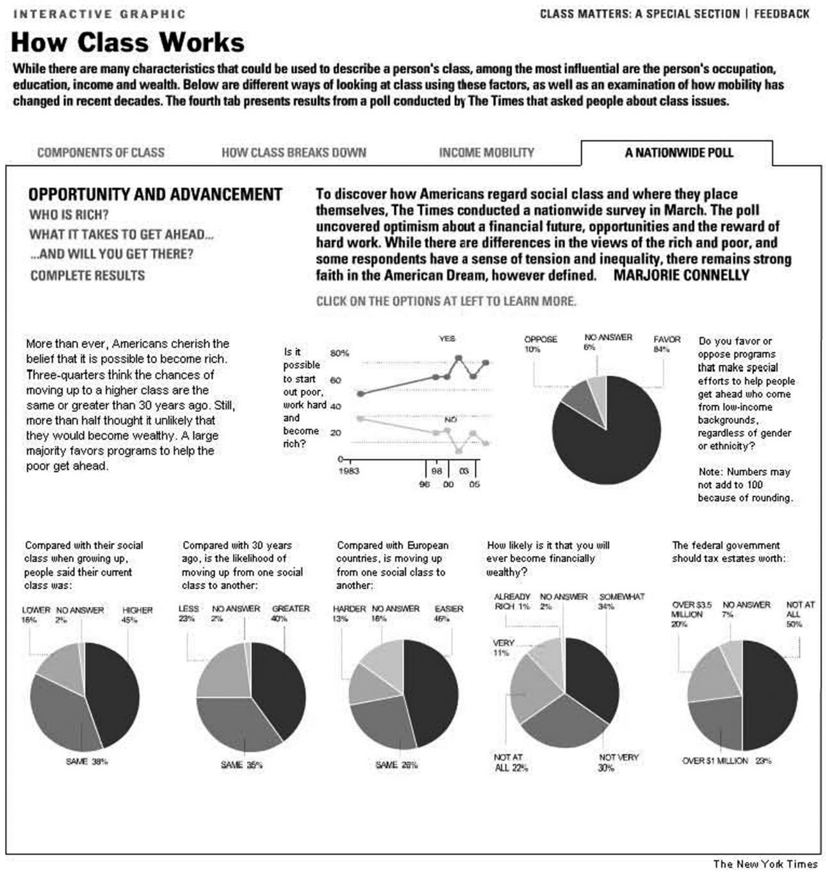
The New York Times—I will like to enter this into the record, without objection—the New York Times in May of '05 did a report on how class works. Wanted to ask Americans how they felt regarding their social class.

If I can just quote from the article, "More than ever, Americans cherish the belief that it is possible to become rich. Three-quarters think the chances of moving up to a higher class are the same or greater than 30 years ago." Compared with 30 years ago, the likelihood of moving up from one social class, 75 percent said that they felt they would be moving up. Eighty percent said that compared to their social class rowing up, things would get better.

In the last year, weekly earnings are up 4.8 percent. Pension and health benefits are up 6.1 percent. So, it is almost 11 percent improvement to the quality of life of Americans.

What I would look forward to, Mr. Chairman, with your encouragement earlier today is that we can sit down and work together, management and labor, and what we can do to get more money in the pockets of hard-working American people. Certainly health insurance and health benefits and health challenges, as Mr. McCrery mentioned, are a big part of that.

[The New York Times article follows:]



Mr. PORTER. So, if I could just ask one question as we move on: What can we do on the short term and long term with limited time to work on this health care challenge, with costs up? What are some specifics that you would suggest that we do immediately?

Mr. DIAMOND. I would support—I don't really know the specifics of what the President is going to address tonight. I know the President's advisory panel put forth a document in which they proposed a cap on health care, employer-provided health care deductions.

I have heard it stated several places that this is a giveaway to the rich, but I think it is exactly the opposite. You are actually capping the deduction they get. I think it would—I think it is an important policy because what happens now is the deduction is unlimited. So, even very high cost health insurance plans are completely deductible.

So, we are just encouraging an over-consumption of health care spending by very high income people. So, I think a deduction or a limit, a limit on the deduction that could be taken, would reduce consumption by high income people, and therefore it would help slow down the cost of medical spending.

Another very equitable thing that we need to do is extend this benefit to self-employed people. So, currently, if you're employed by someone and they buy your insurance, then you get a deduction. However, if you own your own company or you work for yourself and you buy health insurance, you get no deduction. That is inherently unfair. I think the proposal that was put forth by the President's advisory panel—I am not sure of the specifics tonight. I think something like that would be a good start.

I would also think that we should look at growing physician networks. Physicians get in large networks to do negotiations with insurance companies. The larger the networks, the more market power they have and the higher the prices they can negotiate with insurance companies.

So, I think there is a problem with market power there. In fact, the Justice Department found in 1998 that there was economic manipulation, and they had a ruling—or they imposed that networks could not negotiate from 2001 to 2006, although that is expiring.

On the flip side, there is a benefit to large networks in that it reduces contracting cost. I think that is an issue that the Committee should look at.

Mr. SPRIGGS. I think we have to at least do the easy pickings. First is the issue of administrative cost. Congress really has to get a chance to think again about the efficiency of our health care dollars.

Any dollar that is not going to health care is, in the current framework, just not going to work because we have too much of the share of our GDP from any source going to health care. There needs to be some sort of report card that can let everybody know what share of their deduction is going to that.

I think the President is inviting a very healthy discussion by letting us look at this tax expenditure. I don't think this is one that is regressive. In the case of our savings efforts, currently those are regressive. They help those at the high income much more than those at the low income.

Given that low income people can't afford health insurance given their incomes anyway, I don't think that this current tax expenditure is necessarily regressive. At least we get to have a discussion. So, I think it is very important that the President is having that. That is the other thing that Congress has to have, is this discussion about the tax expenditures. So, I am glad the President is doing this.

Third is we have to find ways to contain the increase in cost. There has to be a lot more examination about the dramatic rise in drug costs. Why do drug costs so differ across countries? We have to do those first steps because those are the easy ones. We have to solve those ones first, I think.

Then I think we can get to the more difficult ones because the more difficult ones really do get to issues of efficiency, differences in vested interests because some people have private health insurance. Those are more difficult, but I think we at least have to solve the easy ones.

Chairman RANGEL. Mr. Pascrell.

Mr. PASCRELL. Thank you, Mr. Chairman.

We spent—all of you touched upon the subject of redistribution. I am fascinated by the subject of redistribution because 20 years ago you would have had a discussion about communism and socialism.

Before I ask the questions about redistribution, I want to ask a question of you, Dr. Diamond. You suggest—we did have a solution, Mr. Chairman. One of the solutions that Dr. Diamond recommended is that we cut corporate taxes by 20 percent. That was one of your solutions to a question that was asked to you.

I would like to know in very—you only have a few seconds, now, to respond—I want to know how you would make up the revenue that is lost in that 20, the billions of dollars that would not be coming into the Treasury. How do you make up for that?

Mr. DIAMOND. You could actually make up for it. So, I guess what I was suggesting——

Mr. PASCRELL. How?

Mr. DIAMOND. —is we cut the corporate tax rate, but at the same time you could get rid of infra-marginal corporate tax breaks so that at the margin corporations are more competitive. You could have it completely. You could just reform the corporate tax to be revenue-neutral and create a more efficient corporate tax.

Mr. PASCRELL. So, you are suggesting a revenue-neutral plan that would cut corporate taxes 20 percent, but we would make up for it by increasing those other fringe corporate taxes? Is that what you are suggesting?

Mr. DIAMOND. I am not suggesting anything. I was just answering your question as how it could be done.

Mr. PASCRELL. Well, this is a question of accountability on that side of the table and obviously on this side of the table. So, I want to talk about accountability.

I want to ask the question to Dr. Regalia about the redistribution question. Did the redistribution of income in the United States of America just happen? Was it a consequence of economic policies? Was is intended? How did we get to this point that we are taxing income so much more than we are taxing assets, which is the reverse of what happened, what the situation was 20 to 30 years ago. You tell us in as short a time as possible, how did that happen?

Mr. REGALIA. Well, I think that we tax assets significantly in this country. So, I disagree to a certain extent with the assertion that we are taxing income and not assets. We tax——

Mr. PASCRELL. Dr. Regalia, that is not the case. In fact, we had the reverse of what happened 30 years ago.

Mr. REGALIA. We tax savings when it is earned. We tax the income on savings when that is earned. We tax the capital gain on savings. We tax the asset at death. I would assert that we tax saving a whole lot more than we tax income in this country.

Mr. PASCRELL. The record will show, Dr. Regalia, that the difference between now and 30 or 40 years ago is that we depend more on taxing income than we do in terms of assets, in taxing of assets. There is a particular reason for that, and that is, we have placed the middle class and the poor in a precarious situation. You know exactly what I am talking about.

I want to ask you this question. You talk about trade, the question of trade. We talked about the loss of jobs. Just in the Economist today, in an article that was written by—I will find out the author in a second—in the Economist today from Virginia, Galax, Virginia, one study suggests that during the 1980s and 1990s, 65 percent of manufacturing workers in America who lost their jobs to freer trade were employed two years later, but most took a pay cut.

No one wants to talk about the kinds of jobs that those folks who have lost their jobs through trade deals, which the Congress in bailing out of Article 1, Section 8 of their own responsibilities, gave to the Executive Branch—whether it was Clinton or Bush is immaterial to me—and the loss of those jobs, and the new jobs that they receive don't pay anywhere near the manufacturing jobs.

I don't want to go over with you the battle between Hamilton and Jefferson. It would be good to revisit it, to see that we decided at that time that we are going to move in the direction of a multibased economy. We weren't going to be an agrarian society forever.

We haven't even talked about the loss of the infrastructure of manufacturing. We talked about the jobs. The loss of the infrastructure has had a downward pressure on property taxes in those Rust Belt communities, be they in the Midwest or the East or anyplace, for that matter.

What are you going to do about that manufacturing infrastructure, Mr. Regalia?

Mr. REGALIA. Well, I think what we ought to do about it is to encourage it every way we can. What is interesting is that despite all of what you mentioned, we still produce more today than we ever have before. So, it really hasn't hurt our productive ability to have undergone these changes in the manufacturing sector. We produce more today than we did before in real terms.

Mr. PASCRELL. There is a larger scale. You have more people here. We understand that.

Mr. REGALIA. We have more capital, and——

Mr. PASCRELL. Let's talk about the very essence, though.

Mr. REGALIA. However, if we were losing all these jobs and we were not investing in the assets, then it would be hard to see how we could produce more today. I think what we are undergoing is changes in the manufacturing sector that in many cases are productivity driven and in many cases are the result of competition from abroad.

Mr. PASCRELL. So, you believe, Dr. Regalia, if I can get you straight here, that the same infrastructure that exists today, that infrastructure in manufacturing that exists today can produce the exact same—or more, in fact—than existed 20, 30, 40 years ago, even though we have had the loss of these jobs and places where these jobs take place?

Mr. REGALIA. Not that it could. It is.

Mr. PASCRELL. We still have the same manufacturing impetus today?

Mr. REGALIA. We produce more goods today than we did before.

Mr. PASCRELL. On scale, we do.

Mr. REGALIA. Pardon me?

Mr. PASCRELL. On scale. In proportion, we don't.

Mr. REGALIA. In proportion, the manufacturing sector is a smaller component of the U.S. economy today than it has been in the past.

Mr. PASCRELL. Do you think that we should have a manufacturing policy?

Mr. REGALIA. Yes. I think we should have a manufacturing policy.

Mr. PASCRELL. Why don't we?

Mr. REGALIA. Sir, you would be better to answer that question than I am. I don't make the laws. I try to influence what gets made.

Chairman RANGEL. Mr. Larson.

Mr. LARSON. Thank you, Mr. Chairman, and thank the panelists for your patience and endurance.

With the permission of the Chair and if I might prevail upon him, one of the—all of you touched upon the issue of globalization. This seems to be a term of art that everyone uses. I am not so sure myself, in listening to people talk about it and describe it what it means exactly. Or at least it seems to be viewed—beauty is in the eye of the beholder, so to speak, shall I say.

So I was hoping, Mr. Chairman, that perhaps I could prevail upon the panelists, if they could, just write for us what your definition of globalization would be. That would be an enormous help as we continue to discuss various tax and trade issues on this Committee as it relates to "globalization."

I have two questions within that context, one for Mr. Diamond and the other for Mr. Trumka. The first is, Mr. Diamond, in your testimony you talked about a progressive consumption as a means of taxation.

When you were talking about that, has there been any consideration given to, we will say, in this "era of globalization," where everything is shrinking; the world is flat; taxes, for example, as it relates to the Internet or over-the-counter trades?

Mr. DIAMOND. There have been papers written on—should we tax Internet trading and so forth. I am not real familiar with that literature.

Mr. LARSON. As part of a progressive consumption, would that be considered inasmuch as people are—the world is shrinking electronically. People are in touch with one another. We talk about a manufacturing policy, and yet we see that there is lack of manufacturing, and yet there is the means by which to share in a global economy, so to speak, via telecommunications and television, et cetera.

Mr. DIAMOND. The progressive consumption tax that I wrote about is a specific variant of the X tax, where it is basically a wage tax. It exempts capital income. However, you have a progressive wage tax instead of a flat wage tax. So, when I mentioned the progressive consumption tax, I was speaking about a shift from an income to a consumption-style tax, but taxing consumption progressively.

Mr. LARSON. Okay. You also mentioned, I believe, in the testimony something like a hybrid of that, where you also would have some kind of value-added tax to that. Is that correct? Am I——

Mr. DIAMOND. Well the debate on taxation really is should we tax income or consumption. I think a lot of countries are kind of meeting in the middle in what is called a dual income tax, which is a wage tax, a tax on wage income; and then some level of capital taxation, which is usually about 30 percent of the level of the wage tax. So countries——

Mr. LARSON. Has a tax on transactions in general ever been considered?

Mr. DIAMOND. The United States—I think it is safe to say the United States is the only country that does not have some time of Value Added Tax or national sales tax. There may be a handful, but——

Mr. LARSON. Thank you, sir.

Mr. Trumka, you talked about in terms of some of the problems that we face. You outlined, in the box, four areas, including globalization, and the small government, and price security.

I am also interested in what you meant by labor flexibility, market labor flexibility.

Mr. TRUMKA. Labor market flexibility is a generic term that we use to enunciate all the policies that, one, erode the minimum wage. That erode labor standards. That do away with overtime for working past 40 hours, all of those things. The failure to enforce workers' rights to organize and bargain collectively, that strip workers of social protections, particularly in the area of health care and retirement.

The bankruptcy laws would be part of that, where they can do away with the pension plan. They can shirk their legacy costs and do away with all those. So, labor flexibility, labor market flexibility, is just sort of a generic term that we use that says, you focus on workers and you further reduce the bargaining power they have.

We think that the wage stagnation in the country is primarily due to an imbalance of power between employers and workers that has been further exacerbated by all four sides of the box that I talked about in my testimony, and specifically about the labor market flexibility.

Mr. LARSON. Well, I thank you and I thank all the panelists for your contribution this morning.

Chairman RANGEL. Mr. McCrery.

Mr. MCCRERY. I also want to add my thanks to the panel today for your excellent testimony in response to our questions.

I have one last question because my good friend from wine country in California, Mr. Thompson, polled the panel as to whether we could grow our way out of this looming fiscal problem because of the entitlement growth, and each of you said no. We can't grow our way out of it. Economic growth alone won't solve the problems. I happen to agree with that.

My question to you is: If we maintain strong economic growth, will that make it easier or harder for us to deal with those long-term fiscal problems of the country? Dr. Zandi?

Mr. ZANDI. Certainly stronger economic growth is good, and it would make our budgetary problems easier. They won't solve them.

Mr. MCCRERY. Dr. Regalia?

Mr. REGALIA. Strong economic growth is imperative if we are going to solve the budget programs.

Mr. MCCRERY. Mr. Trumka?

Mr. TRUMKA. I am sorry. Strong economic growth that is equally shared among all facets of the population and the citizens would help the problem significantly.

Mr. MCCRERY. Dr. Spriggs?

Mr. SPRIGGS. I think I would have to add what Mr. Trumka said. Growth that all Americans benefit from, returning us to shared prosperity, will make your job a lot easier because all Americans will believe that whatever happens, this is in their interest.

Mr. MCCRERY. No. I get your point. However, weaker economic growth certainly won't make it easier for us to deal with those fiscal problems, will it, under any circumstances, however it is shared?

Mr. SPRIGGS. Well, strong economic growth with the continued growth in inequality will make it very hard for us to solve these problems because growth inequality——

Mr. MCCRERY. You didn't answer my question. Weaker economic growth under any circumstances won't make it easier for us for deal with those problems.

Mr. SPRIGGS. Weaker economic growth under any circumstance will make your job harder.

Mr. MCCRERY. Thank you.

Mr. SPRIGGS. Growing inequality will make your job harder.

Mr. MCCRERY. I understand, and I appreciate your making that point again.

Dr. Diamond.

Mr. DIAMOND. Stronger economic growth is imperative, and weaker economic growth would be catastrophic, in my mind.

Mr. MCCRERY. Thank you, Mr. Chairman.

Chairman RANGEL. Dr. Diamond, what impact would poverty have on a strong economic growth?

Mr. DIAMOND. Poverty has a substantial impact on economic growth. In fact, I just finished paper for a group in Texas on school vouchers, talking about an income-limited school voucher program for students who are in low income schools because I think that is the population most at risk for not receiving a good education, which they can then be successful in the labor market.

One article I read, I just cannot recall the number, but reducing poverty reduced government expenditures by a substantial amount. So, by reducing poverty, we can reduce government expenditures for crime and police protection and other things. Therefore, there are benefits to reducing poverty, and it is something we should take very, very seriously.

Chairman RANGEL. Would I be stretching it if I say that poverty and unemployability is a threat to our National security? I am thinking Katrina.

Mr. DIAMOND. I am not really ready to answer that question.

Chairman RANGEL. Well, I will take you one step at a time. Let me get those papers that you got so we can work together.

Mr. DIAMOND. Okay.

Chairman RANGEL. What I was telling the Ranking Member is that I don't want to revolutionize the Committee on Ways and Means. I love it, he loves it, and we really want to get something done.

So this process has to be good, as far as I am concerned, as an appetizer on a menu to get different views. At the end of the day, all of you, 90 percent of the time you are agreeing. If we are going to legislate up here, we have got to find something that all of you can say: it wasn't all—they didn't do all that they could have done but they sure made an improvement on what we have to work with.

So I really want to thank you for spending so much time with us. We understand it if you can't come back, but don't be surprised if we don't change the configuration here and just sit down and talk and maybe some time argue so that we are not yelling at each other, but trying to figure out how we can deal with the problems, most of which all of you agree that we have.

Thank you so much for your time and effort and look forward to working with you.

The Committee will now stand adjourned.

[Whereupon, at 12:35 p.m., the hearing was adjourned.]

[Submission for the Record follows:]

Statement of Executive Intelligence Review

The political evidence of the November election's results, and the nature of the campaigns in which the new Members were elected, is that the American people want not only an end to a war policy; they also want an end to globalization and de-industrialization of their economy by "free trade," low-wage outsourcing, deregulation. This is a strong message of the "New Politics" of the 110th Congress. It is also an urgent necessity, to forestall a severe plunge of the dollar and financial collapse of the U.S. economy.

The 110th Congress must act to reverse the ravages of globalization and deindustrialization upon the U.S. economy, before a threatening severe collapse of the dollar brings chaos to the banking and monetary system, and makes such Congressional intervention extraordinarily difficult or even impossible.

The Congress needs to intervene to protect and revive U.S. industry, and the dollar, restoring principles of fair trade and above all, launching major investments to rebuild and restore the neglected *economic infrastructure* of the nation: modern high-speed transport, energy and power supply, water management and clean water, flood control and navigation, public health and hospitals, and more.

Facing already very large budget deficits, the 110th Congress should establish a {Federal Capital Budget} for these urgent investments and public works. Congress can create large volumes of long-term, low-interest Federal credit through capital budgeting, based on the economic record of such modern infrastructure creating $5–7,000 of economic value in the economy for each $1,000 of such investment. It can, and must also act to stop the high-yield ("junk") leveraged debt markets from taking and looting remaining U.S. economic infrastructure through "Public-Private Partnerships (PPPs)," abetted by the extremely loose money-supply growth policy of the Federal Reserve.

These are the purposes of the Economic Recovery Act of 2006 (ERA), proposed by the Lyndon LaRouche Political Action Committee (LPAC). The idea of this legislation has been circulated by LPAC for two years, endorsed and lobbied for by scores of union locals and leaders, and by many state and city elected officials and several state legislatures (see below, supporters of ads calling for adoption of an ERA in *The Hill* and *Roll Call* on June 8, 2005). It focuses on the urgency of Congressional intervention to stop the collapse of the American auto industrial sector—by "retooling" considerable capacity in that sector for the purposes of building a new national economic infrastructure.

When the 109th Congress did not act, manufacturing job loss resumed through 2005 and 2006; 90,000 jobs were lost in auto and auto supply industries alone, which have lost 285,000 since 2000. Scores of plants closed in the auto sector, and literally hundreds of plants are now slated for closure or sell-off by the three major automakers and six largest auto-supply firms.

Combating Globalization, Investing in Productivity

One view of the clear and present danger of globalization, current among economic thinkers in Washington, holds that the only significant danger of globalization is the huge American trade, current account, and budget deficits and imbalances it has brought. Another view, is that the sole major problem of globalization is the persistent creation of one financial bubble after another—commercial real estate, communications stocks, commodities, residential real estate, junk credit, etc. This is attributed to the huge inflows of capital to U.S. and European markets, and the ultra-loose credit and money-supply policies of Alan Greenspan's Federal Reserve (continuing today), and of the Bank of Japan, over the period of globalization, and still continued by the Fed today.

While pointing to real dangers, both ignore the central, 35-year poisoning and destruction of our economy by globalization and deregulated international trade and financial markets: the lowering of productivity. The absolute loss of 5.5 million U.S. manufacturing jobs since 1979—including the elimination of nearly half the employment in the aerospace and auto industries, the two major machine-tool reservoirs of the economy—lowers the productivity of the entire world economy.

The outsourcing of skilled, technological work to lower-infrastructure areas and countries has lowered the productivity of the industries. The re-employment of American workers at less-skilled, lower-wage jobs has lowered the productivity of the American workforce. (Inclusively, the portion of the American workforce with a college education is actually declining in this "knowledge and information economy.") Then, the infrastructure of power, transport, energy, water management, navigation, sanitation, public health, etc. which was necessary for that lost industrial employment, is itself let go to neglect and decay, and new investments in modern infrastructure stopped. This dramatically lowers the productivity of the entire economy.

With the sinking of the housing price/mortgage bubble and threatened plunge of the dollar, we have now reached the trigger-point at which the characteristics of this trend could be expressed as a general breakdown-crisis of the economy, in the United States and internationally.

Worst, the destruction of the machine-tool capacity of industries such as aerospace and auto which are our machine-tool reservoirs—entire plants of machine-tools either destroyed or auctioned over the Internet to primarily overseas buyers—threatens to eliminate the nation's industrial capabilities for the future.

Save Machine-Tool Capacity

Without a deep and versatile machine-tool capacity, U.S. industry will no longer be capable of building the new economic infrastructure the economy requires to recover—as, for example, U.S. industry *already* has no capacity to build nuclear power plants, and *already* lacks the aerospace-industrial capabilities for Apollo Moon-landings we could make 40 years ago.

The machine-tool sector is the core of an industrial economy where scientific and technological ideas are turned into new economy reality. If the U.S. auto-manufacturing industry is destroyed, the U.S.A. becomes a virtual Third World nation overnight. The nation's machine-tool design capability, most of which is tied up in the auto-manufacturing and supply firms, is lost. The loss of the tool-making and closely related capabilities of that sector of industry would cause incalculable, chain-reaction consequences, within our nation, and also the world at large.

The loss of employment of that machine-tool design segment of that part of the labor-force, means many times that number of skilled employees out of jobs. Sixty million square feet of aerospace-defense capacity are closed and machinery auctioned off since 1990. Eighty-one hundred million square feet of auto capacity are being closed and machinery auctioned off over 2006–08, more capacity lost than in the last 30 Years combined. The United States' economy's consumption of machine tools is only 60% of the 1980 level, and 60–70% of that consumption is imported machine tools.

Nothing less than the nationwide "retooling" and recreation of advanced industrial capability, carried out to prepare for the war production of World War II, is the model for what the Congress must do now to build a new national infrastructure.

Infrastructure Deficits

The deficits of modern infrastructure in the United States economy have grown huge, requiring hundreds of billions of dollars of public investments {annually} for an economic recovery based on raising the real productivity of our workforce and our population. The American Society of Civil Engineers' (ASCE) estimate of $1.7 trillion in immediate infrastructure fixes needed, is well known, but does not even begin to address the need for a *new national infrastructure*.

Clean water infrastructure is the largest need, at $450 billion. The entire nation has only 1,300 miles of electrified railroad left; its power grid is falling below minimum reliable requirements, and requires $100 billion investments in distribution systems alone, which are not planned by the power industry. America's community hospitals can't meet public health needs.

Constructing a national network of high-speed, electrified railroad corridors will require $300 billion in investments, according to transportation consultants. For the land-side regions around America's ports on the East and West Coast, such new rail corridors are not a pleasant option: They are an urgent necessity to prevent collapse or chaos of completely overloaded transport modes.

ASCE's estimated need for waterway and port navigation infrastructure—especially, lock-and-dam systems on the nation's rivers—is $125 billion, and does involve new infrastructure projects, because these systems are so old, undersized, and obsolete that hundreds of them need urgent replacement with modern technology. But overall, ASCE's estimate is the barest minimum, measuring maintenance rather than new infrastructure technologies. If our mission is to build a new national infrastructure to raise the technological level and productivity of our workforce, and the standards of our people, to 21st-Century potentials, the infrastructure deficit is several times the ASCE's $1.7 trillion figure.

A Federal Capital Budget

Facing large deficits of budget and current account, very large capital-project investment needs, and a threatened dollar collapse, the 110th Congress can think anew—of the proven methods of Federal credit issuance used for the Transcontinental Railroad and the industrial boom which followed the Civil War; for the great infrastructure projects of the FDR Presidency; and during the earlier era of Hamiltonian national banking, which first secured our new nation's debt and built up its economic infrastructure.

Congress should institute a *Federal capital budget* for important public projects. A current White Paper written by Lyndon LaRouche and published by LPAC, "The Lost Art of the Capital Budget," explains this in detail.

The essential step is the issuance by the Treasury, of bonded credit into major new infrastructure investments which will raise economic productivity over one-two generations—issuance of government credit which is at a very low (such as 1–2%), regulated rate of interest, and for a long term, but nonetheless not as long as the term of that new infrastructure's productive, technologically advanced economic life.

As in the proposed Economic Recovery Act (ERA), Congress can authorize the Treasury to issue long-term bonds at low interest directly to an Infrastructure Corporation. By discounting these bonds for capital at Federal Reserve banks, that Corporation causes the Federal Reserve to act in the manner of a National Bank, and the credits issued to remain regulated at low-interest, and their value essentially at 100%.

Contrast the disastrous alternative of national, state, and local infrastructure being dependent on investments and privatizations from the so-called high-yield ("junk") capital markets, through private equity funds and hedge funds in "PPP"s—expecting not 1–2%, but 10% and higher annual returns on investment. These loot existing infrastructure, rather than building new. The Federal Reserve's "wall of money" policy repeatedly since the 1980s has created huge high-interest bubbles, particularly mortgage-debt-based. The U.S. banking system's assets are now 50% mortgage-based, and another 20% on loans into "leveraged" private-equity takeover markets: That banking system is bankrupt, and should be treated as bankrupt.

Federal capital budgeting by Congress directs the Federal Reserve away from feeding such speculative financial markets with "walls of money," into the function of monetizing *directed Federal credit issuance*.

The "bill of materials" for such major new infrastructure public works is produced in factories and shipyards with advanced machine-tool capacities; as demonstrated in the World War II buildup, the Manhattan Project, the Apollo Project and space programs, if the nation industry has lost or shut down such capacities, they must be recreated or "retooled." The capacity being discarded and underutilized by the automobile and related industries, as well as in aerospace industries, is the vehicle to be save and used for this infrastructure mission. An Infrastructure Corporation can assume control of and/or lease this capacity, exactly as did the Defense Plants Corporation created under the RFC in 1940.

Secondly: Regional, state, and local infrastructure rebuilding projects combine factory-built machinery and other elements of the new infrastructure, with large construction sites requiring semi-skilled and labor-intensive employment. For example, the replacement of the 19 obsolete locks and dams on the Ohio River Mainstem system alone, would generate approximately 20,000 construction-site jobs for a several-year period. This is the "CCC-like" impact of such investments on urban and rural unemployment and underemployment.

Compare the costs and real economic impact of such low-interest, long-term infrastructure credits; and compare them to the real cost ravages of "PPP" privatization of infrastructure. For example: If Congress were to authorize $2 trillion of new infrastructure credit issuance through Federal capital budgeting at $300 billion investments annually, Treasury's interest cost (net of tax recovery from the Fed) would rise toward $30 billion annually. Based on the past economic record of major new infrastructure, six million or more new jobs would be created {or saved in industry} over that time, and the new economic value added to the economy would conservatively raise Federal tax revenues alone, over a number of years, by $300 billion or more annually.

Congress can, in addition, designate revenue sources to these bonds, infrastructure user-fee trust funds, contractor lease payments for plant capacity. {The new Federal long-term debt issued can be retired over a term less than the long-term technological and productivity impact of the infrastructure built and renewed.} Thus, the $50 billion in credits issued through the Reconstruction Finance Corporation were repaid in full.

The fundamental support of this bond-credit issuance is the increased productivity, and technological and scientific level given to the American workforce and the entire productive economy by this modern-infrastructure "driver." Studies ever since the 1960s Apollo Project have shown that such high-technology infrastructure investments generate about $6 billion in direct and indirect income in the economy, for each $1 billion spent on them by government. The steadily increasing future tax revenues generated by this infrastructural investment, give the Treasury the capacity to retire these bonds as a matter of policy—{if} they are issued as long-term, low-interest special-purpose bonds not subject to short-term market speculations. This is served by the financing method of the Economic Recovery Act.

This draft legislation is circulated to Congress by the LaRouche Political Action Committee (LPAC)

1. TITLE: THE ECONOMIC RECOVERY ACT OF 2006

2. FINDINGS

Congress Finds the Following:

A. Under the impact of "globalization," there is a massive and ongoing loss in the machine-tool capabilities of the U.S. economy. This danger is centered in the accelerating "outsourcing" and shut-downs of plants in America's most important and versatile machine-tool industry, the auto industry. Eighty million square feet of auto capacity being are closed and machinery auctioned off over 2006–08, more capacity lost than in the last 30 years combined. Sixty million square feet of aerospace/defense capacity are closed and machinery auctioned off since 1990. U.S. consumption of machine tools is only 60% of the 1980 level; of that consumption, 60–70% are imported machine tools; much of this stock, in turn, is being destroyed or sold off overseas as plants are closed; machining vital to national security, including defense and aerospace production, has been and is being outsourced.

B. The machine-tool sector is the core of an industrial economy where scientific and technological ideas are turned into new economic reality. If the U.S. auto-manufacturing industry is destroyed, the U.S.A. becomes a virtual "Third World" nation overnight. The nation's machine-tool design capability, most of which is tied up in the U.S. auto-manufacturing and supply firms, is lost. The loss of the tool-making and closely related capabilities of that sector of industry would cause incalculable, chain-reaction consequences, within our nation, and also the world at large.

The loss of auto and auto-parts plants means an economic disaster, approaching ghost-town proportions, for entire towns, counties, and cities, even states of the union, which are already highly vulnerable.

The loss of employment of that machine-tool design segment of that part of the labor-force, means many times that number of skilled and unskilled employees out of jobs.

C. There were 250,000 net jobs lost in the automobile manufacturing/supply sector from 2000–05, leaving a total employment at end of 2005 of 1,090,000. During 2006, the shutdown/sell-off of 67 auto plants has been announced by major U.S. automakers and the biggest parts-supply companies alone, occurring and to occur in 2006–08, with the direct and indirect loss of another 250,000 net jobs occurring and to be expected in the auto sector.

D. Accepting the reduction in the number of automobiles produced by U.S. automakers, we must replace that work immediately with a switch to other categories of technologically very high-grade products which the auto industry's machine-tool capacity is uniquely qualified to design and produce. The alternative mission for this purpose is chiefly in the category of needed, new economic infrastructure.

E. The United States suffers a worsening crisis in its public infrastructure. This breakdown is clear: in the failure of water control, transportation infrastructure, and power infrastructure in the Gulf States during Hurricanes Katrina and Rita; in the long heat-blackouts of hundreds of thousands in major cities in Summer 2006 due to failure of obsolescent power distribution networks and inadequate power capacity; in the lack of refinery capacity and dependence on oil imports; in the spread of freshwater crises throughout the Western half of the country in the past decade.

The United States lacks railroad and mass transportation infrastructure, with shrinking air travel grids; its electric power infrastructure is falling behind under deregulation; it has lost fossil water and freshwater supplies for irrigation, and has inadequate drinking water supply in rural regions; its water control—especially upstream dams—and river navigation infrastructure are obsolescent; it has insufficient port and landside port-rail infrastructure; and insufficient hospital infrastructure for any serious public health crisis. This is given only a minimal estimate in the American Society of Civil Engineers' "infrastructure report card" which estimates the need for $1.7 trillion in investments merely to repair and replace obsolescent and broken-down infrastructure.

1. Each $1 billion of Federal funding invested in new, modern infrastructure creates approximately 50,000 jobs and $6 billion in economic activity.

2. States, cities, transit authorities, airport authorities, and other entities have thousands of ready-to-go infrastructure projects, which will create long-term capital assets for the United States and which can help stimulate the nation's economy.

F. Action, by the U.S. Federal government and others, is urgently needed, to prevent an across-the-board collapse of not only the U.S. auto industry, but the counties, towns, cities, and states, and their people.

3. PURPOSES

Congress Adopts the Following Purposes:

A. To prevent the wholesale loss of the U.S. auto industrial sector, with its vital, large-scale, and versatile machine-tool capabilities and skilled workforce; since it is rapidly being lost, Congress must act with speed and force.

B. To reverse by Federal investments the neglect, decay, and deregulation of critical economic infrastructure of the United States; and to foster the building of projects of a new national infrastructure using 21st-Century technologies of transport, power, navigation, water purification, and others.

C. To preserve a national strategic machine-tool design and production capability and associated skilled workforce, from among auto industry plants otherwise being idled and discarded and their production outsourced by the automakers.

D. To save skilled and industrial jobs, and to create new such jobs, by retooling these idle plants and capacity, to machine and produce the *bill of materials* for infrastructure projects in power, rail, transport, water management, and energy; to create many tens of thousands of semi-skilled and unskilled construction jobs indirectly, through the construction projects involved in the building of new infrastructure.

E. Congress adopts for these purposes, the model of functioning of the Reconstruction Finance Corporation (RFC) and its amendment, the Defense Plant Corporation (DPC) Act of 1940, by which thousands of auto and other industrial plants were retooled for—at that time—defense production. Half of all auto industrial capacity was idle at the time of the creation of the Defense Plants Corporation in June 1940.

4. TITLES:

Title 1: Federal Infrastructure Plants Corporation. A Federal public corporation is created, the Federal Infrastructure Plants Corporation, to assume control of, and operate—directly or by contract—the discarded and unused plant-and-equipment capacity of the automobile/auto supply sector; and other unused industrial facilities, military base, or shipyard facilities.

Title 2: Infrastructure. The Corporation shall fund and carry out, and may aid other public agencies or corporations and state or local government agencies in carrying out, projects of new, modern economic infrastructure including a) passenger and freight rail transportation, including regional and national high-speed rail corridors, magnetic-levitation trains on priority routes, and light-rail and mass transit systems; b) electric power production, including third- and fourth-generation nuclear power plants, and electric power distribution systems; c) freshwater purification and desalination infrastructure, d) modern water-control and water-management systems; e) ocean ports and inland navigation freight-transport systems; f) hospitals and public health infrastructure.

Title 3: Powers.

A. The Corporation is authorized 1) to produce, acquire, and carry strategic machine tools and other industrial machinery needed to produce bill of materials for infrastructure projects; 2) to purchase and lease land, to purchase, lease, build, and expand plants, and to purchase, and produce equipment, supplies, and machinery for the manufacture of bills of materials for new economic infrastructure; 3) to lease such plants to private corporations to engage in such manufacture; and 4) to engage in such manufacture itself.

B. The Corporation may make loans to, or purchase the capital stock of any corporation for the purposes of Title 3A.

C. The Corporation is further authorized to contract with state or local agencies wishing to use idled auto plants and machinery for infrastructure projects, subject to Title 3D; or to contract with firms wishing to lease auto plants and machinery for such contracts, subject to Title 3D; or to purchase auto product lines and auto-supply product lines where necessary to prevent loss of industrial employment to foreign producers.

D. Contracting and Employment: The state, local agencies, or contractors are required 1) to maintain all plant facilities open and in repair, and at least maintain work levels, 2) to provide for preferential hiring of members of the pre-existing workforce who want to continue to work at the plant facilities, 3) to be subject to Davis-Bacon rules for Federal contracting, 4) to spend 90–95% of issued funds within two years of commencement of the project.

Title 4. Engineering Survey of Plants and Facilities. An engineering survey of these plants and other facilities shall be carried out by the U.S. Army Corps of Engineers (USACE) within six months of enactment of this Act, to determine and plan for their potential employment in producing the bills of materials for modern infrastructure projects.

Title 5: Board. The Corporation's Board of Directors shall include the President; the Secretary of the Treasury; the Deputy Secretary of the Army for Civil Affairs; and the Secretaries of Transportation, Agriculture, Energy, Education, Labor, Housing and Urban Development, and Health and Human Services.

Title 6: Funding of the Corporation. The Corporation shall be provided a capital-budget stock by issuance of 2%-interest, long-term special-purpose bonds by the

Treasury to the Corporation, for discounting at Federal Reserve banks. The corporation shall be under the authority of the Secretary of the Treasury.

A. The authorization of issuance of credit from the Treasury, through issue of special-purpose bonds to this Corporation, is up to a limit of $200 billion in each of Fiscal Years 2007 through Fiscal 2011; and $300 billion in each of Fiscal Years 2012 through 2016.

LPAC placed this statement in **Roll Call***, June 8, 2006; and in* **The Hill***, June 9, 2006.*

CONGRESS MUST LAUNCH EMERGENCY ECONOMIC ACTION NOW!

In March of 2005, Lyndon LaRouche warned that General Motors was facing imminent collapse. He called for Congress to intervene with an emergency reconstruction policy designed to save the industry as a whole, as a crucial component of a drive for overall economic recovery. He proposed that the Federal government intervene by placing the productive capacity of the industry into government-supervised receivership, and then fund the retooling and expansion of that capacity to supply the components of desperately needed national infrastructure projects. He stressed that any liquidation of the present structure of the physical productive capacities of the auto industry, especially its machine-tool sector, would do irreparable damage to our physical economy and mean not only the end of the U.S. as a leading physical economic power, but would also result in related kinds of chain-reaction damage to the world economy as a whole.

The world financial system is already in a state of mixed hyperinflationary and deflationary collapse, which necessitates instituting an FDR-style recovery program to save civilization. The Congress's failure to act then has brought us to the point that today, 65 major auto sector plants, with over 75 million square feet of machine-tool capacity are being shut down this year and next. These shutdowns will cost 75,000 skilled industrial jobs directly, and 300,000 more through immediate radiating effects on smaller supply plants and machine tool shops. What is about to be shut represents the capacity to build over 2.5 million cars and light trucks a year. But, more importantly, in terms of urgent national economic investment, it represents a unique industrial capability to build an urgently needed new national infrastructure of transportation, power, and more.

LaRouche has authored a statement of principle called {The U.S. Economic Recovery Act of 2006.} It calls on Congress to intervene to save our auto capacity {now}; to retool the 50% or more unutilized capacity of the auto industry for production of new national infrastructure, particularly high-speed rail corridors and new electricity grids centered on nuclear power. It gives us the opportunity to save ourselves; to turn our nation, and the world, onto a course of prosperity, and away from the current descent into a New Dark Age. Already, state legislatures in Alabama, Vermont, and Rhode Island have weighed in with memorials to Congress demanding that Congress enact this retooling legislation. They have been joined by city and county councils across the nation's industrial heartland.

We urge members of Congress, regardless of party affiliation or geographic origin, to enact the urgently needed emergency Federal legislation specified in the {U.S. Economic Recovery Act of 2006} to prevent the threatened immediate collapse and shutdown of the physical productive capacity of the U.S. auto sector and to put our nation on the road to becoming, once again, the greatest productive economy in the world.

The names published then represented only a small number of the hundreds of endorsers representing elected officials, and trade union officials from across the United States. Affliliations were for identification purposes only:

ELECTED OFFICIALS

Rep. Ronald Grantland, Hartselle, Al.
Rep. Thomas Jackson, Thomasville, Al.
Rep. John Letson, Hillsboro, Al.
Rep. Bryant Melton, Tuscaloosa, Al.
Joycelyn Elders, former U.S. Surgeon General, Little Rock, Ar.
Rep. Otis Davis, Earle, Ark.
Rep. Steven Jones (former), Chairman-elect Ark. Asn. of County Dem. Officers, West Memphis, Ar.
Assemblyman Mervyn Dymally, Los Angeles, Ca., former Congressman, former Chair, Congressional Black Caucus

Rep. Felipe Reinoso, Bridgeport, Ct.
Rep. Bob Henriquez, Tampa, Fl.
Rep. Priscilla Taylor, West Palm Beach, Fl.
Rep. Art Turner, Chicago, Il.
Theodore Thomas, Alderman, Chicago, Il.
Cong. Andy Jacobs, Jr. (former), Indianapolis, In.
Sen. Billie Breaux, Indianapolis, In.
Sen. Sam Smith, E. Chicago, In.
Rep. Terri Austin, Anderson, In.
Sen. Perry Clark, Louisville, Ky.
Sen. Joey Pendleton, Hopkinsville, Ky.
Rep. Arthur Morrell, New Orleans, La.
Sen. Dianne Wilkerson, Boston, Ma.
Rep. LaMar Lemmons, Detroit, Mi.
Rep. Alexander Lipsey, Kalamazoo, Mi.
Rep. Lee Gonzales, Flint, Mi.
Rep. Earle Banks, Jackson, Ms.
Rep. Credell Calhoun, Jackson, Ms.
Rep. Jim Evans, Jackson, Ms.
Rep. John Bowman, St. Louis, Mo.; Chair, Leg. Black Caucus
Rep. Esther Haywood, St. Louis, Mo.
Rep. Terry Riley (frmr), City Council, Kansas City, Mo.
Rep. Juanita Walton, St. Louis, Mo.
Sen. Joe Neal (former), Las Vegas, Nv.
Assemblyman Gordon Johnson, Englewood, N.J.
Sen. Carlos Cisneros, Questa, N.M.
Sen. John Sampson, Brooklyn, N.Y.
Adam McFadden, City Council, Rochester, N.Y.
Rep. Dan Stewart, Columbus, Oh.
Rep. Sylvester Patton, Youngstown, Oh.
Rep. Jenine Perry, Toledo, Oh.
Rep. Catherine Barrett, Cincinnati, Oh.
Rep. Annie Key, Cleveland, Oh.
Kevin Conwell, City Council, Cleveland, Oh.
Sen. Bill Morrisette, Springfield, Or.
Rep. Harold James, Philadelphia, Pa.
Rep. Peter Ginaitt, Warwick, R.I.
Sen. Theresa Two Bulls, Pine Ridge, S.D.
Rep. Joe Towns, Memphis, Tn.
Sen. Tracy Dempsey, Harts, W.V.
Rep. Christine Sinicki, Milwaukee, Wi.

TRADE UNION OFFICIALS

Frank Barkley, Bus. Agent; former Pres., AFGE Local 1061, Los Angeles, Ca.
William Danny Givens, Bus. Rep., IAM Dist. 75, Pensacola, Fla.
Samuel Stevens, Pres., UAW Local 882, Atlanta, Ga.
Rich Downs, Vice Pres., Local 18, Heat and Frost Pipe, Insulators, Indianapolis, In.
John Jeffries, Pres., and entire Exec. Bd; IAM Local 830, Louisville, Ky.
Bill Londrigan, Pres., Kentucky State AFL–CIO, Frankfort
Ken Koch, Pres., State Council of Machinists; Vice Pres., Kentucky AFL–CIO, Louisville, Ky.
John Clark, Pres., UAW Local 2031, Adrian, Mi.
Joe Joseph, Pres., UAW Local 1970, Dearborn, Mi.
Val Nevels, Exec. Bd., Region 1–C, UAW CAP Ctte.; Flint, Mi.
Bert Atkins, Leg. Chair, IAM District Lodge 837, Florissant, Mo.
John Smirk, Bus. Mgr., Painters Dist. Council 15, Las Vegas, Nv.
Gerald J. Hay, Jr., Sec.-Treas., Teamsters Local 375, Buffalo, N.Y.
Mark Sweazy, Pres., UAW Local 969, Columbus, Oh.
Chuck Morton, Exec. Dir., Building Trades, Dayton, Oh.
Gary Barnette, UAW CAP Chair, Franklin County, Columbus, Oh.
Larry Oberding, Pres., Ironworkers Local 44, Cincinnati, Oh.
Tom Knox, Chair, GM UAW Local 969, Columbus, Oh.
Lynn Lehrbach, State Political Dir., Oregon Conference of Teamsters, Portland, Or.
Ken Washington, Dir., Governmental Affairs, Laborers Dist. Council, Philadelphia, Pa.

Claretta Allen, Sec., Smith Co. Central Labor Council, Tyler, Tx.
Bruce Price, Sr., Fin'l Sec., UAW Local 919, Norfolk, Va.
Bob Francis, Exec. Bd., Pierce Co. Central Labor Council, former Pres., Teamsters Local 599, Takoma, Wa.
Dan Aude, Chair, UAW CAP Fox Valley; Green Bay, Wi.
Denal Crawford, Pres., AFSCME Local 1654, Milwaukee, Wi.