S. HRG. 108–283

REVENUE PROPOSALS IN THE PRESIDENT'S FY 2004 BUDGET

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

FEBRUARY 5, 2003

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

91–252—PDF WASHINGTON : 2004

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
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REVENUE PROPOSALS IN THE PRESIDENT'S FY 2004 BUDGET

WEDNESDAY, FEBRUARY 5, 2003

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

The hearing was convened, pursuant to notice, at 2:47 p.m., in room 215, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the committee) presiding.

Also present: Senators Nickles, Snowe, Thomas, Smith, Baucus, Breaux, Conrad, Bingaman, and Lincoln.

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

The CHAIRMAN. Good afternoon, everybody. Today we are going to hear testimony on the revenue proposals that President Bush has put forth in his third budget. That budget covers, obviously, fiscal year 2004.

Our witness this morning is Secretary John Snow, in his first appearance now as being sworn in as Secretary. We obviously welcome the 73rd U.S. Treasury Secretary to our committee, and we are glad to say congratulations, Mr. Secretary.

Secretary SNOW. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, Senator Baucus, and members of this committee, we find ourselves with a great many challenges. The American people expect us to take these challenges very seriously. I am confident that we can respond constructively. In the U.S. Senate, that means responding in a bipartisan way.

The Finance Committee faces three major challenges this year. Under the President's leadership, we will need to address the sluggish economy, a prescription drug benefit for Medicare beneficiaries, and a resolution of the World Trade Organization ruling against the Foreign Sales Corporation replacement regime known as ETI. In addition, we hope to address welfare reform and additional trade agreements.

Two of the major challenges, the sluggish economy and the FSC/ETI issues, are dealt with in the proposals that Secretary Snow presents us today.

I would like to address the sluggish economy. It seems to me that both sides of the aisle agree with President Bush's concern about the unemployed. That is, we need to help unemployed Americans get back to work. In order to meet that objective, obviously we have to have economic growth.

So, Mr. Secretary, the good news is that a bipartisan majority believe that we should aim for faster growth. There are some differences, however, in achieving that objective.

Instead of getting into those differences right off the bat, I would like to take a different track. I would like for us to consider the economic picture in light of where we can find growth. I will ask a series of questions as I move through this discussion.

As we look across the landscape of America, we can start with Wall Street and major service economies of the East Coast. There we find the stock market significantly lower than the bubble years of the late 1990's. Stock values have been depressed by the events of 9/11, the corporate scandals, and other global factors.

The dampened market has restricted the blood supply of our business, and that happens to be capital. The question is what we can do on the Finance Committee about that, but there is general agreement that things should be done.

Moving down the East Coast to here in Washington, DC, there are great discussions of deficits. These deficits arise from higher war-time spending and reduced tax collections, which are attributable to the economic slow-down.

Keep in mind that these deficits are modest in historical terms when considered as share of GDP. The question is what we can do to keep these deficits in line, and hopefully in the near term, or whenever, but the sooner, the better, return to balances.

As we venture across the country to the heartland that Senator Baucus and I know about, we find the backbone of the American economy. That backbone is small business, agriculture, manufacturing. In these areas, including my home State of Iowa, my fellow constituents are feeling the ripple effect of world events and Wall Street scandals.

Small business creates about 80 percent of the new jobs in the United States. The question I ask for this part of the country, is what can we do to help these folks in this rebound?

When we talk about the heartland, obviously that includes the South, the Southwest, and the Rocky Mountains. The West Coast is somewhat different. In these States, innovation and high-tech have been instrumental in the growth and prosperity of that region.

The weakness of those economic sectors is now a part of the reason for the high unemployment experience in the West. The question is, what can we do to energize the tech sector once again?

So in the coming weeks, the Finance Committee will be pursuing these questions: what can we do to reinvigorate the stock market and generate more investment capital? For example, will the President's tax free dividend plan boost the market and generate more capital?

How do we maintain fiscal discipline, is the next question. For example, is it fair to look at long-term effects of temporary spending increases if they are certain to become permanent fixtures in the budget?

What can we do to help small business and manufacturing rebound, is my third question. As an example, does it make sense to tax a successful small business at a 38.6 percent rate, while we are taxing Fortune 500 corporations at 35 percent? Should we have a robust expensing policy, would be another part of that approach.

What can we do, number four, to bring high-tech and other innovative sectors back? For example, would it be more bonus depreciation for the tech sector? These questions obviously are asked very cautiously.

The reality is that, as much as we in Washington think that we affect the economy, it is the businesses and workers across America that really matter. Businesses create jobs, adding value and paying taxes. Workers produce goods and services and pay taxes. Our focus ought to be on incentives for private sector behavior and not on expanding government.

While we are exploring these questions, I think it is important to explore them in the matter of unity. In recent days, many seem to have the impulse to divide workers from business owners, and consumers from investors. But these are complementary activities, that you cannot have one without the other.

We cannot ignore consumers and workers who have kept the economy going. In the same manner, we cannot ignore business owners, particularly small ones, and the investors involved who create jobs and provide the capital for higher economic growth.

So we will examine the relative merits of incentives for investment on the one hand, incentives for consumption on the other. The Finance Committee will keep an eye on using the tax dollar wisely. We will have to operate within the confines of the budget resolution that Chairman Nickles has the responsibility for producing.

The Finance Committee will keep an eye on a proposal's ability to respond quickly to our economic problems. However, at the same time a policy that produces economic growth in the short-term and over the long haul should outweigh temporary fixes.

I have wondered why a good, long-term economic policy that provides a short-term boost is not desirable. Yet, some seem to arbitrarily divide long term and short term. When does one end, then, and the other begin?

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

So, Secretary Snow, in addition to the growth package, I look forward to the administration's continued assistance on the FSC/ETI problem. The time to produce is fast approaching and there is much at stake. I look forward to your testimony.

Senator Baucus?

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

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, congratulations on your confirmation.

Secretary SNOW. Thank you very much.

Senator BAUCUS. We appreciate you here with us today so you can begin early in forming policy and helping to implement the administration's policy and being our Treasury Secretary worldwide. I appreciate that.

Last year, the President said in his State of the Union Address, "We must win a war, protection our homeland, and revive our economy." One year later, I believe that we still have these same challenges. Unfortunately, we now have another one, and that is the deficit.

Two years ago, the projected 10-year surplus was $5.6 trillion. One year ago, we had a $1.6 trillion surplus. Today, before we even consider the President's plan, the surplus is down to $20 billion.

We are going the wrong direction. I know my colleague from North Dakota will have all of his charts out and explain in greater detail how far we are going in that wrong direction.

As Treasury Secretary, you, of course, have primary responsibility for the President's economic policy. At your confirmation hearing last week, in support of the President's economic plan, you stated that you would "like to see more 'Help Wanted' signs all across America." I appreciate that.

That same evening, the President said in his State of the Union Address that, "With unemployment rising, our Nation needs more small businesses to open, more companies to invest and expand, more employers to put out the sign that says 'Help Wanted.'" I could not agree more.

But, Mr. Secretary, we already have "Help Wanted" signs all across our Nation. Unemployment continues to rise. They need help. The 1.7 million Americans who have lost their jobs since March of 2001 have their "Help Wanted" signs up, loud and clear.

Industry is operating at 75 percent of capacity. Businesses have stopped investing in new equipment and facilities. Consumer confidence has fallen from 1.6 in December of 2000, to 87.7 just this last month of December.

Businesses have their "Help Wanted" signs out. States have theirs out, too. States are facing their worst budget crisis in 50 years. In fiscal year 2002 through 2004, the States have been, and will, face deficits totaling at least $171 billion, some say as much as $200 billion.

My State of Montana is facing a budget deficit of $184 million, small by some States' standards, but very large by our Montana standards. States have their "Help Wanted" signs up.

Health care costs continue to rise astronomically. Forty-one million Americans are uninsured. Those who cannot afford health insurance, but do not quality for any assistance, have their "Help Wanted" signs up.

Seniors, who do not have prescription drug coverage, who have inadequate coverage—and there are many of them—pay the highest drug prices in the Nation. Strike that. They pay the highest drug prices in the world. Many seniors in our country pay the highest drug prices in the world. Seniors have their "Help Wanted" signs up.

So what do we do? Just as a family in Montana comes together to discuss their income, their expenses, and priorities, we need to sit down—often we use this over-worked phrase in Washington—together, but really we need to do it in the real sense of the term to discuss our national budget. How do we work together to help so many Americans who have so many "Help Wanted" signs out?

The President's budget, of course, is a good starting point. In a time of war, national security must come first. We must also take steps to revive our fragile economy here at home. We must reduce unemployment. We must work together to balance the budget, yet still meet our other national priorities, such as health care and education. We must take care of the "Help Wanted" signs that are already up.

I believe there are five critical ways in which we should improve upon the President's budget. I will be fairly brief.

First, we must address the deficit. Deficits do matter a lot. Higher deficits mean mortgages and car loans will be more expensive, if not now, certainly in the future. The only question, is how near that future is.

Businesses cut back on investments when interest rates rise. The future standard of living for our children and our grandchildren will be lower, lower the more we have higher deficits and higher national debt.

Mr. Secretary, you have written about how important it is for the Federal Government to have a balanced budget. Yet, the President's budget does not even come close.

With this fiscal year, the President proposes a deficit of $304 billion. That is the highest deficit we have ever faced. For the next fiscal year, the President proposes an even larger deficit of $3.7 billion.

Over the next 10 years, the President's budget would add—would add—deficits of more than $2 trillion. That is not the end of the story. The $2 trillion deficit comes with an additional $600 billion additional costs, the interest costs which you must pay, the cost to fix the Alternative Minimum Tax, which the administration does not mention, but which we all know must be addressed, certainly within that timeframe, which costs about $500 billion itself.

That puts the total cost of the President's budget at at least $6.2 trillion, an enormous amount even by Washington standards. The publicly-held debt—and that is the debt that counts, that affects the market interest rates—would increase by the same amount. This does not include the financial cost of war, ranging from between $50 to $200 billion.

Now, this looks, I must say, Mr. Secretary, a lot like the scheme out of the 1980's play book, but worse. These enormous additions to the debt would be enough of a problem during better fiscal times. But this increase in debt would hit just when the baby boom begins to retire. This adds even more stress on the Federal budget.

Our country, in my judgment, was able to work out the deficit problems in the 1980's, because in the 1990's we did not have the baby boomers. Now we do. That is, we will at the end of this decade. You know as well as I the astronomical, exponential costs that they present to us in terms of retirement and health care. We clearly must do better. We must address the deficits.

Second, we must do more for States. In the current economic downturn, States will have to cut spending, lay off workers, increase taxes or some combination. In turn, businesses and households will have to cut spending. These actions make the economy worse.

We need to stop this economic downward spiral with one-time grants to States. I support Federal tax cuts. I think they are needed. But, with our current economy, these cuts alone, without State relief, are less effective.

The President has also proposed to help States by turning Medicaid into a block grant program. The plan is billed as State fiscal relief, reform, and flexibility all in one.

But if you read the fine print—and I would urge all of my colleagues to do that, read the fine print—the proposal is actually budget-neutral. After the period proposed, it proposes to spend less money to States, less Medicaid dollars to States. The real goal here is to eliminate health benefits for low income and disabled Americans. That is the goal, it seems, of that program.

The third improvement, is to provide a tax cut that benefits all taxpayers. Fifty percent of all individual Federal tax revenue is from the income tax. Fifty percent. Forty-one percent is from payroll taxes.

Simply put, it is unfair to play favorites. Taxes are taxes. Taxes on the American people are taxes the American people have to pay. Whether someone pays income tax or payroll tax, it is still a burden, and particularly a burden for those whose tax primarily is a payroll tax, because it is a disproportionate burden upon them.

The President's plan accelerates many of the tax cuts that were enacted in 2001. Some of these tax cuts, I think, should be accelerated. But we should not leave out acceleration of marriage penalty relief for the Earned Income Tax Credit recipients, and the refundable portion of the Child Tax Credit. That is not in the President's budget, and I think it should be. Those dollars will be spent, clearly.

We should also add the elimination of income tax on the first $3,000 of wages for all wage earners. That tax cut, added to the $75 billion one-time grant to States, and other stimulus proposals, provides $160 billion of stimulus this year, 2003.

The President's economic plan provides either $39 billion or $30 billion, depending upon how you calculate it, at least for fiscal year 2003. I believe these ideas provide an immediate stimulus so we can start to bring down those "Help Wanted" signs.

My last two improvements to the plan focus on Medicare and on international trade. During last week's confirmation hearing, I expressed concern about the President's Medicare prescription drug proposal. The President has proposed a drug benefit, but only for those beneficiaries who choose a private plan.

The President and his advisors have likened their plan to the Federal Employees Health Benefit Program, where enrollees have a choice of private health plans. A handful of them are available on a national basis.

Mr. Secretary, I find this analogy overly simplistic and, in fact, disingenuous. The administration is comparing apples to oranges. Federal employees and their retirees in FEHBP are much different than Medicare beneficiaries. Seniors have higher health care costs. They are older. They have more chronic disease. It is not the same.

I do not share the administration's optimism that Medicare beneficiaries, especially our most vulnerable, would be well served by private insurance plans. I hope the Presidents significantly modifies his prescription drug proposal so that all Medicare beneficiaries are treated fairly, all seniors.

My final improvement deals with international trade. Normally, trade is one area of the Finance Committee's jurisdiction that does not figure prominently in the budget battle, but this year, I must say, it is different.

To my surprise, the administration has included a recommendation to repeal the Continued Dumping and Subsidy Offset Act. Well, what is that? It is also known as the Byrd Amendment, for my distinguished colleague from West Virginia.

The Byrd Amendment is good. It is common-sense trade policy. It simply says that the duties collected on unfairly traded imports should be redistributed to the companies and workers injured by those imports. My State of Montana has helped softwood lumber companies who have been devastated by unfair Canadian subsidies.

The authors of the Byrd Amendment, Senators Byrd and DeWine, are right to oppose this provision in the budget. I stand with them, and so does the majority of the Senate. In fact, more than two-thirds of this Senate sent a letter to the administration in support of the Byrd amendment. The effort to repeal that amendment is bad policy and it certainly does not belong in the budget.

Mr. Chairman, I ask consent to include a copy of that letter in the record.

The CHAIRMAN. Without objection, it will be included.

[The letter appears in the appendix.]

Senator BAUCUS. Mr. Secretary, there are many challenges ahead. Tackling them certainly will not be easy. There is much uncertainty and anxiety across our Nation. The prospect of war, lack of affordable health care, high unemployment rates, the state of our economy. I know I have raised a lot of concerns, and I think the Senators for their indulgence. But these are real concerns.

Senator Grassley and I worked together—we have for years—and will continue, and with you, Mr. Secretary, and the administration, to solve these problems. But we must listen to each other. It cannot be my way or the highway, your way or my way.

We have got to work together, and I mean really work together. I, too often around here, hear people say, let us work together, but it is only on their terms. It is not really, we are going to work together, terms. I urge you very, very strongly to sit down with the President and figure out a way we really, truly can work together, because the people we represent are certainly counting on it.

Thank you, Mr. Secretary.

The CHAIRMAN. I think, Mr. Snow will want to work with us. But remember, the process of the Senate dictates that we work together in the Senate or nothing is going to get done. So, at least for our part of it, we will have an institutionalized process that will bring about what you want, at least as a process to get to someplace.

Mr. Snow, our tradition here is to generally let you talk as long as you want to. But I hope that you will be able to summarize your statement so we can get to questions. I will just let you proceed accordingly. But any summarization you can do of your statement, I would appreciate it.

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

Secretary SNOW. Thank you very much, Mr. Chairman. I will do that.

Chairman Grassley, Ranking Member Baucus, members of the Finance Committee, before I offer those brief comments I would like to express my thanks to you, and gratitude to you, for the trust you expressed in me last week by reporting out my nomination.

I intend to do my very best to live up to those high expectations I know you have for me. I have been in office now, I think this is the second full day. I have not yet, Mr. Chairman, been infused with all of the wisdom that I am told comes the way of Secretaries of the Treasury.

But I am going to be working hard to get up to speed on these issues and be in a position to work with all of you to advance the important national agenda. Of course, I welcome the opportunity to appear before you today to discuss the President's budget for 2004.

Let me begin, if I may, by offering my views on the essential background for the budget. That, of course, starts with the state of the U.S. economy. Then I will review the President's growth program, which I am confident promises to create jobs to accelerate America's recovery, and to increase our growth for years to come.

In response to a confluence of very negative events, the Congress and the President responded, and responded, I thought, in a very appropriate way in 2001. As every American knows by now, whether from having lost a job or knowing someone who has lost a job, or worrying about losing their job, our economy took a turn for the worse beginning in the summer of 2000.

I think I mentioned to you that, as a transportation company executive, in the summer of 2000 I saw a dramatic drop-off in demand for the things we do, move containers, move truckloads, move carloads. The industrial economy went into a dive and it has not fully come out of that decline yet.

By the time President Bush took office, a strong undercurrent was running against the economy. Then we saw the unprovoked and unprecedented terrorist attack of September the 11th, which compounded the recession that was, by then, already well under way.

At the same time, we had that series of corporate scandals and the disclosures of corporate abuses by some in the corporate community, which slowed the recovery further and did a lot of damage, undermining confidence in our capital markets.

In response to this confluence of adverse events, the President led, acting in concert with the Congress in a bipartisan fashion, and took the steps necessary to protect a shaken Nation and a fragile economy.

In 2001, relief that was needed was provided, with the most sweeping tax relief in a generation. That was good legislation, in my view. As evidence of the damage became clearer in March of 2002, further steps were taken to bolster the economy.

These were precisely, Mr. Chairman, in my view, the right medicine at the right time. These actions made the recession much shorter and much shallower than it otherwise would have been.

By most measures, I think the recession was the mildest since World War II. Without any doubt, it would have been much more severe if those measures had not been enacted.

In the face of extreme adversity, our economy, like our Nation, remains resilient. Despite the economic slow-down, the attack on our homeland, the war in Afghanistan, the weakened investor confidence, and the uncertainty about the Iraq situation, the economy is recovering, but not recovering with the fullness and the strength we would like to see.

As the President has stated, we can do better, and we must do better. Relative success here is not enough. It is not sufficient. Too many Americans are out of work today, and too many Americans are insecure about their tomorrows.

As long as there are Americans who want a job and cannot find one, the economy is not growing sufficiently. That is why the President's jobs and growth package is so important. Under that proposal, 92 million American taxpayers and their families would receive a tax cut.

A typical family of four earning about $39,000 to $40,000 a year would receive a tax cut of $1,100, and not just this year, but year, after year, after year. His plan will create hundreds of thousands of additional jobs by the end of this year, and well over a million more by the end of next year.

It is important to note that the package will not only help America return to its economic potential, I think it will increase that potential. It will give us the path to higher long-term growth rates, creating a more abundant future with more good jobs and rising real wages.

Before I turn to the budget, let me offer a word on deficits. I agree with the observations that have been made. Deficits matter. They count. They are never welcome. But there are times such as these where they are unavoidable, particularly when we are addressing compelling national needs of the sort we face today.

Are they welcome, Senator Baucus? Absolutely not. They are not welcome. They are not at all welcome. Are they understandable? I think they are. I am sure the questions will give me a chance to offer my views on that.

The surpluses we enjoyed, at least the prospect of surpluses we enjoyed, were the product of a strong economy, not a weak one. We will not return to economic strength by taxing the economy when it is struggling any more than we would increase our Nation's defenses by failing to fund the Nation when it is threatened.

The prescription for returning to balanced budgets, I think, is clear: on the one hand, as much economic growth as we can get, on the other, spending restraint. That is the direction the President has chosen. It is a course to create real jobs, and real jobs that will last.

With that, I look forward to responding to your questions.

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

The CHAIRMAN. Thank you very much.

For the benefit of everybody, you know we do the first-come, first-served for questions. So it will be the Chairman, the Ranking

Member, Senator Nickles, Senator Conrad, Senator Thomas, Senator Bingaman, Senator Smith, Senator Breaux, Senator Snowe.

Senator LINCOLN. Do not forget me.

The CHAIRMAN. You will be on the next list. [Laughter.] By the way, if I announce this and if anybody has been mistreated, let me know, because sometimes staff might miss. [Laughter.]

See, I should know enough to keep my mouth shut, should I not?

Secretary Snow, if I could, I would like to put the current question of tax relief for growth packages in kind of an historical context. Today, you will hear some who oppose more tax relief, claiming that most of the Federal fiscal problems arise from an erosion of Federal tax base.

I would like to quote CBO's latest data. The Federal taxes, as a share of GDP, will dip to an historical average of just under 18 percent this year, but then would trend back up towards 19 percent through this decade, and then would reach record levels of GDP of 20.6 after the bipartisan tax relief is sunsetted, if we let that happen.

Looking at post-World War II data and the projections over the next 10 years, is it necessary to maintain Federal revenues at above-average levels or record levels to maintain fiscal discipline? Let me quickly follow on, are there macroeconomic considerations in pushing up Federal taxes as a share of GDP?

Secretary SNOW. Yes, there is clearly a point where you push Federal taxes up and it is counterproductive. It hurts the incentives to grow and invest and save, and hurts the long-term prospects for the country.

The surge in revenues we got at the end of the 1990's was as unexpected, I think, and surprising as the rapid disappearance of those revenues. They were all related one way or another to that market exuberance, that buoyant stock market, which generated lots and lots of capital gains, which generated lots of income for businesses, and which generated lots and lots of returns for high-end business people and entrepreneurs through their options and incentive compensation programs.

With the decline of the market, there has been, of course, the loss of that surge in revenues, and revenues, I think, will return more to their historic pattern over the next year or two. But, no, I do not think it is something we should aspire to to have government revenues at the high end of the historic patterns.

The CHAIRMAN. All right. That answers my second question. I kind of wanted to have you address whether or not maintaining above-average levels or record levels of taxation would bring about fiscal discipline.

Secretary SNOW. No, quite the contrary. I think if you increase taxes you may have a short-term bulge in revenues that are received, but you would do long-term damage to the economy.

Any suggestion that, in the state that the economy is in today, taxes ought to be raised, I think, is at the very least counter-intuitive and takes the economy in absolutely the wrong direction. The Nation would pay a huge price for that.

The CHAIRMAN. Yes. Now, probably a little more difficult question because it deals with the realities of the Senate being divided 50/50.

Senator BAUCUS. Do you know something we do not know?

The CHAIRMAN. Or 51/49. [Laughter.]

Senator NICKLES. Do not scare me like that. I would have a heart attack.

The CHAIRMAN. I would be the first to have the heart attack. [Laughter.] Somehow, I remember a couple of years ago.

Well, first of all, kind of three things that I publicly stated about a growth package and a stimulus package. First, I would want it to be economically efficient, meaning producing jobs, and hopefully good jobs, and hopefully long-lasting jobs.

Second, we are all looking for something that is going to have an immediate impact, so it should be a minimal delay in stimulating the economy. Then, with the reality of a 51/49 Senate, we have to be bipartisan.

So I would like to have you look at my criteria and explain how the President's proposal would satisfy those three criteria.

Secretary SNOW. On the first, efficiency in creating jobs, I think it gets an A+. The President's program would create, by the end of this year, approximately 500,000 new jobs in the fourth quarter. By the fourth quarter of next year, 2004, approximately 1.5 million, and for 2005, over 2 million.

They will be the sort of jobs that remain in the system, because the tax proposals are to make the reductions of the 2001 legislation permanent so people can, today, begin to plan their futures, with the understanding that they will have those lower taxes, that higher after-tax income in their pocket. That will mean a lot to people. I think it will help deal with this issue of confident that has been mentioned.

Second, on the notion of immediate, it will have both short-term and long-term benefits. That is one of the advantages. It will create more good jobs in the short term, but beyond that it will put us, I am confident, Senator, on a higher growth path for the future because it removes clear inefficiencies in the system that are the product of the Tax Code.

One of those, of course, is the double taxation of dividends, which, from my days as an economist we used to say that anything that you subsidized you got more of, and anything you taxed you got less of. As a consequence of the double tax on dividends, we have less equity capital. Firms are not expanding their equity capital base at the same rate they would, and they are taking on more debt.

We are creating a tax-induced incentive to use debt. We are creating a tax-induced incentive not to use equity and grow the equity base of the country. And, we have created a tax-induced incentive not to pay out the earnings of companies in dividends, but rather to do other things like acquisitions, or find tax shelters.

The CHAIRMAN. What about the bipartisanship?

Secretary SNOW. Mr. Chairman, I am going to yield on that one, because I am way beyond getting into politics. That is beyond any area of expertise I have.

The CHAIRMAN. All right.

Senator Baucus?

Senator BAUCUS. Thank you, Mr. Chairman.

I appreciate the answer, Mr. Secretary. But, clearly, as the administration's chief spokesman, under Article 2 of part of our government, you are going to have to get into how to make things work. As you know, someone once said, "what is possible is the definition of politics."

So, you have got to work and see what is possible in working on things together. I think you know that. I would just urge you to begin to talk candidly earlier rather than later on how we put that together.

Mr. Secretary, I would just like to ask you more about stimulus. Without getting into the merits of the President's program, do you not think we need a plan, whoever proposes it, that provides substantially more stimulus than what is provided so far by the President for fiscal 2003?

As I mentioned in my opening remarks, it is only about $30 to $39 billion. That is not very much stimulus with a $10 trillion economy. Do we not need more?

Secretary SNOW. Well, we are looking at different numbers. The numbers I look at indicate that this creates a stimulus the first year—and maybe these are annualized numbers—of roughly $98 or $100 billion, I think, is the number I have been working with.

Senator BAUCUS. Well, to be candid, these are OMB figures. Actually, in the President's budget it comes out to $30 billion in fiscal 2003. Those provisions you are talking about go into effect later. They may be enacted in 2003, but the actual effect will not be until later.

Secretary SNOW. I will grant you that. But some of the effects will be felt immediately. Because, as I suggested earlier, as people get a sense that their out-year take-home pay is going to be higher, as small businesses get a sense that their out-year returns—of course, an awful lot of small businesses flow their income through the normal tax tables—is they get a sense that their income, realized income, take-home income, in the out years is going to be higher, it will affect their current behavior.

Senator BAUCUS. Mr. Secretary, on that point, I do not mean to be argumentative. But I have heard that argument often. Also, I have asked CEOs of major companies, how do they plan? Do they have a 5-year plan? Do they have a 10-year plan?

The answer I got from some major companies, is, yes, we have a 5-year plan, but that is all it really is, is a plan, because we have to adjust to changes constantly, all the time.

In these times, with the world so integrated and with things happening so fast worldwide, my guess is that a lot of companies will not bank everything they have got in the company on what the law is going to be, or what the situation facing their company is going to be six, seven, 8 years from now. They do the best they can with what they have got. So, I am not quite sure that that argument is as valid today as it might have been in years past.

The next point I want to make, is deficits as a percent of GDP. You mentioned that——oh, my time is up.

The CHAIRMAN. It seems like your time went faster than mine.

Senator BAUCUS. That is why I raised my hand to answer the question if we are all being treated fairly.

The CHAIRMAN. Yes. I do not want to discuss it now, but we ought to check to make sure that the lights are the same.

Senator BAUCUS. I thought it was a pretty fast light, too.

The CHAIRMAN. Go ahead and ask one more question.

Senator BAUCUS. All right. Thank you.

The CHAIRMAN. Is that all right?

Senator BAUCUS. That is fine.

The CHAIRMAN. One more question. Well, each member should have 5 minutes, with the rule that, when the red light goes on, you quickly finish your question and the witness can still answer. I think he was short-changed.

Senator BAUCUS. My real question is, as you pointed out, deficit, as a percent of GDP, is probably fairly important. In the President's budget, basically it starts out, I think, at 2.8 percent, projected to fall to about 1.4 something.

The problem is, we have got baby boomers coming along. Baby boomers. The actuarial estimates I have seen, if we are going to address the problem when baby boomers start to retire, we are going to have to spend about seven-tenths of a percent of GDP on those retirees.

You add that to the 1.4, as projected—and we know OMB is almost always overly optimistic—it is probably going to be worse than 1.4. Let us say it is maybe closer to 2, or 1.75, or something. We are back in the soup again.

Now, it seems to me, you and I both have to be somewhat consistent. That is, you are saying that you need certainty in the future, and I say times are so uncertain now, you never really know. Now I am saying, do we not need a little more certainty for the baby boomers?

Now, you can come back and say, well, who knows what the situation is going to be 10 years from now? But I do think we have an obligation to start planning for the boomers. How do we start planning?

Secretary SNOW. Well, I think you are absolutely right, that we need to start planning for that. Demographics, in some ways, is everything. That is the reality of Social Security, and to a lesser extent Medicare, which is also driven by rising health care and health care costs.

You talked earlier, or mentioned earlier, how we came out of the deficit problems of the 1980's. When I think about how we came out of the deficit problem of the 1980's, it was really the rising productivity we found about 1994, 1995.

Without much pre-announcement, productivity, which had been low, around 1.4 percent from 1972 all through those two decades, took a surprising pick-up. The economists had not foreseen it coming. The business people had not foreseen it coming.

But something had happened in the fundamental nature of the economy that had allowed the economy to make a big burst forward, to make a major step forward. We still have that working for us. Despite the recession, despite the stock market problems, despite all the things I chronicled, we still have that productivity working for us. That is what we have to keep working.

If we can keep that working for us and get productivity and sustain it at these higher levels we have enjoyed, then we will be in the best possible situation to deal with these twin deficits, these unfunded responsibilities for the future.

Senator BAUCUS. Just very briefly, Mr. Chairman. I think productivity did have something to do with it, there is no doubt about it. I also think that the budget plan that the President proposed and Congress enacted also had something to do with it.

What I think, is that showed the American people that, hey, those guys back there in Washington have got their heads screwed on straight. Maybe they are finally doing something right. They are kind of getting their house in order. Just subliminally, at least, I think it gave people kind of a good feeling about the future.

I fear that, subliminally, people see these big deficits and they are not getting too good of a sense about the future. I just think we have to work harder to get this more under control.

Secretary SNOW. As I mentioned to you last time I appeared in the nomination hearing, I think it is only appropriate that we keep this issue of the deficit well before us as we talk about the future.

But these deficits, while it is important to keep focused on them, are still relatively modest and they will be shrinking. As a share of GDP, both the debt and the deficits are manageable. Let me say, if I ever think they are not manageable, I will be the first to tell you.

The CHAIRMAN. Senator Nickles?

Senator NICKLES. Mr. Chairman, thank you very much.

Secretary Snow, welcome. We are delighted to have you before the committee. Let me just make a couple of comments on the deficit. Actually, you are coming in at a difficult time.

Is my time almost over? [Laughter.] I raised my hand. Are you trying to tell me something, Mr. Chairman?

Senator NICKLES. I would just mention, you are coming in as Secretary and the total revenues of the Federal Government were over $2 trillion in the year 2000, and they were $1.85 trillion last year.

So, revenues have fallen by about 9 percent in the last 2 years, and that is the reason why we have a deficit. People can speculate on lots of other things, but if you would have had anywhere close to any growth, we would be in balance. So, that is the dilemma.

We have to figure out a way, in my opinion. You did not cause that, but now you are the Secretary. Now we have to figure out a way to grow the economy. You mentioned you are representing the President, and he has a growth package. I compliment you.

Several provisions. Senator Grassley said, we should not be taxing entrepreneurs and individuals that have their own businesses at rates higher than corporations.

I happen to agree with that. Let us fix that. There are several other provisions, savings packages, and so on. So I hope we can work together to pass a growth package, and there are lots of ways of doing it.

One way, I would think, would be to take those areas where we find excessive taxation getting in the way of growing and fixing it. I mentioned higher rates for individuals than you have for corporations. Hopefully, we will fix that.

One of the highest rates—and correct me if I am wrong—is we tax dividends, or corporate earnings that are distributed to owners, at a higher rate than almost any country in the world, which I think is a real disincentive for investment, and distribution of profits of those investments, to owners.

We ought to fix it. You have a proposal to fix it. It is way too high. Correct me if I am wrong, but I saw something that had the effective rate of corporate taxation dividend at 60, 70 percent. Is that correct?

Secretary SNOW. That is the range, yes.

Senator NICKLES. Well, that is absurdly high. That is a real disincentive. That is the government getting in the way of investment and, therefore, jobs.

So maybe there are other ways of doing it. I am open to that. I have suggested maybe we should allow corporations to deduct dividends, or you could have dividends taxed at capital gains rates. There are lots of other ways of doing it. But you have a proposal, and I compliment you for it.

Let me just make a couple of other comments about growing jobs. You mentioned in your confirmation hearing the need for free trade and open trade. I would just make one comment.

There is a group called The Consuming Industry's Trade Action Coalition Foundation. They requested an examination of the impact of higher steel costs on American steel-consuming industries, in particular, a quantification of employment losses in these companies due to the tariffs that were imposed by the administration in March of 2002.

Their conclusion is—and I will make a copy of this available for you, or I would at least like for you to review it—that 200,000 Americans lost their jobs due to higher steel prices during 2002.

These jobs represent approximately $4 billion in lost wages from February to November. These tariffs range anywhere from 30 percent to plates and hot-rolled sheets and cold-rolled sheets, and down to 15 percent for stainless steel rods, and so on.

I just come to you as a manufacturer. I disagreed with the administration. I thought this was going to increase jobs. The amount of money per job is astronomical, and I would like to recoup these jobs.

So, I'd just mention this. Senator Baucus, I believe, mentioned that he agreed with the administration on the lumber restrictions from Canada. I disagree. I think that has increased the price of lumber for a house by about $1,000 for consumers in the country.

So I would just mention, some of us are very serious about free trade. That is under your plate right now, and I hope that you will be mindful of some of the challenges that you have.

The cost to consumers of protectionism, the cost of building a house, the cost of building a plant, or the cost of building products has a direct impact of what is decided in your shop.

Secretary SNOW. I agree with you.

Senator NICKLES. I am not asking you to. I am wanting you to be cognizant. Every time there is a recession, there are always attempts for greater protectionism, and we have not seen the last.

Let me bring to your attention one other program that is under your control, under this committee's control, which we have done a crummy job of implementing. That is a program called the

Earned Income Tax Credit. It is one of the programs with the highest error rate in government. It is a $32 billion program.

According to the budget submitted, the error rate in that program is 27 to 32 percent. That means that more than $1 in $4 paid under EITC should not have been paid. That is about a $10 billion miss.

I know the administration requested some more money, but I would just mention this to you. You have a lot of programs, and a lot of programs are under the guise of taxes, but really they are spending programs and we do not do them very well.

EITC is one example where we give annual lump sum payments, theoretically, to help low-income people. But you do it in one lump sum, I am not sure that is the best way. Some have proposed that we do it over a monthly basis.

It might be more frugal, and it might be more advantageous for low-income people that really need help on a month-to-month basis, instead of giving them a $4,000 lump sum for individuals that have a couple of kids, or something.

So, I would mention that to you. It is a program that warrants Treasury review and scrutiny with those kind of error rates. We have had these error rates, but we have not fixed them. So, I wanted to bring that to your attention as well.

Secretary SNOW. Senator, I think there is an initiative in the Treasury budget this year to do precisely that and to put in place a much more effective program to deal with the issue you cite, and to do it in an even-handed enforcement way and actually make it, since it is a preauthorization program, streamline the preauthorization in a way that creates less hassle for the EITC recipients.

Senator NICKLES. Well, I appreciate that. Those kind of error rates are not acceptable in any program.

Secretary SNOW. They are absolutely not.

Senator NICKLES. I appreciate that, and look forward to working with you.

Thank you, Mr. Chairman.

The CHAIRMAN. All right.

Senator Conrad would be the next one. Since he is not here, on the Democrat side I would call on Senator Bingaman. But if Senator Conrad would come back, then I would call on him before I call on another Democrat. Senator Bingaman, then it would be Senator Thomas.

Senator BINGAMAN. Thank you, Mr. Chairman.

Mr. Secretary, good to see you. The hearing has been advertised as a hearing on the revenue proposals in the President's 2004 budget. What we are really talking about, are revenue reduction proposals primarily. Am I accurate in that?

Secretary SNOW. Well, you are talking about a set of proposals in the President's budget. If your reference is the growth package, it is an investment in the future. As all investments, there is an outlay before you get the returns. But that is the nature of an investment.

Senator BINGAMAN. But it does reduce revenues over the next 10 years, according to the way the OMB projects it.

Secretary SNOW. The OMB numbers show that government revenues will be negatively impacted as a result of the tax plan. That is an accounting matter, yes.

Senator BINGAMAN. Let me just put up these few charts here. This one tries to sort of summarize the various tax reductions that we have experienced, and are being urged to experience here. The 2001 tax cut was $1.35 trillion. That is over a 10-year period, as I understand it.

In the 2002 statement, $42 billion is the figure I have been given there. Then this current one is $1.46 trillion. Is that about right? That is the figure I was given. When you add in the interest and the various items that are contained in it.

Secretary SNOW. You have got a whole bunch of other things in here, maybe.

Senator BINGAMAN. Well, the committee passed out something here called "Fiscal Year 2004 President's Budget."

Secretary SNOW. Now I see it.

Senator BINGAMAN. It says "The President's Budget Tax Initiatives," and it has got $1.43 billion. So it adds up to $2.85 billion, or something in that range of tax reductions.

Now, your statement—I think maybe the nub of the disagreement that we may have here, is that you say in your statement to us that current deficits begin a pronounced improvement after next year. I think that is right out of your testimony.

Secretary SNOW. 2005. That is right.

Senator BINGAMAN. Right. So you project a $304 billion deficit in 2003, $307 billion in 2004, and then it gets better.

Secretary SNOW. It comes down. Right.

Senator BINGAMAN. I guess I have real questions about that projection. The concern I've got, is there is no real accounting in there for what we are going to have to do on the Alternative Minimum Tax, as I see it, going forward.

I mean, in your estimate about deficits getting better, there is nothing really in there—assuming any kind of military action in Iraq, which we are on the verge of, or on the brink of, whatever phrase you want to use. You are assuming we get back to good levels of growth, which we have not seen in a couple of years now.

As far as I can tell, you are assuming that we can do a prescription drug benefit for Medicare at $350 billion a year. Most people I have talked to say that is not in the realm of feasibility.

So, I have real doubts that we will see those deficits improve 2 years from now. What confidence can you give us, or what assurance can you give us, that you are not going to be sitting there a year or 18 months from now telling us, no, no, the deficit is going to keep going until the end of the decade?

Secretary SNOW. Senator, the confidence I have that these numbers are workable numbers, and in fact may actually understate the revenue side, is that I believe tax policy matters.

I believe people respond to tax policy. I think if you give people the incentive to use more of their own money in ways they choose to use it and to invest it, and stimulate small business, you are going to create jobs and growth. I believe that by removing some of these inefficiencies in the Code, we are going to lay the foundation for growth.

I think the growth numbers probably are somewhat low, and I think Mitch Daniels has acknowledged that. They went on the low side of the growth numbers in the budget.

Senator BINGAMAN. There is an ad that the Concord Coalition ran in the New York Times on Sunday. You probably saw it, or you might have seen it. It talks about a $25 trillion millstone of unfunded obligations, and that is made up of civil service and military retirement they put down at $1.8 trillion, Social Security, the obligation there at $10.5 trillion, and Medicare at $12.5 trillion.

Have you looked at that, and do you think that is a legitimate concern? I mean, we have got a bunch of people like Paul Volker, Pete Peterson, Bob Reuben, and Sam Nunn signing that. They seem to be confused about this issue, if you could straighten us out.

Secretary SNOW. No, I do not think they are confused at all. I think they are focusing on these unfunded promises of the future that will have to be funded. Funding those promises is going to require a bigger and stronger economy.

There is no doubt about the fact, and probably modifications in both of those programs of some kind, to facilitate more savings within Social Security and to facilitate real improvements in the efficiency with which health care services get delivered in this country.

So, I think that the Concord Coalition, and many others, are signaling, as were the opening comments of the Chairman and Senator Baucus, and are pointing to an issue that we really have to get serious about.

Now, how do you get serious about that? One, is growing the economy. Two, going back to the question you asked me, Mr. Chairman, about how we get things done. It has to be bipartisan. Those issues have to have a bipartisan approach.

I think the sooner we can get into that sort of bipartisan dialogue on these subjects, the better. I do not know the numbers they are using, but I know that those unfunded liabilities are huge.

Senator BINGAMAN. Mr. Chairman, if I could, just to say that one of the things they recommend, is they do recommend reforming entitlements, which you referred to there. They also recommend avoiding provisions that cause growing revenue loss over time. That may be where they have some disagreement.

Secretary SNOW. Well, they might. I know those people fairly well, and have worked with them. I have a high regard for all of them. But I do not think there can be much disagreement with the proposition that meeting our obligations in the future requires the strongest and largest economy we can produce.

The question that you are raising with me is, is this a prudent way to get us there? I am saying, I think it is a prudent way. I think it keeps the deficits at relatively—larger than I would want to see, Senator, but relatively—modest levels. I look at this tax program as an investment in the future.

When I was in business and boards of companies, as well as the company I ran, it is not uncommon for a company to take on more debt. The question is, does it get a return on that debt that amortizes that debt and puts the company in a stronger position for the long term.

So the debt, in and of itself, is not so troublesome. It is the size of the debt relative to two things: the size of the debt relative to the earning power of the enterprise, and the return you get on the investment you make in that debt. Those would be the two things I would hold out foremost.

The CHAIRMAN. Senator Thomas?

Senator THOMAS. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. We are all, of course, focusing on the economy and how we can help with the stimulus. It is interesting that the experts all over the country do not always agree on the best way to do that. So, that is sort of interesting. I suspect reducing spending may have something to do with it in the long run as well.

There is much the government can do, even though the government is not entirely responsible, obviously. I think I read somewhere that President Clinton said the government's role is to create opportunity, the responsibility of the people is to take advantage of it, if we can create that opportunity.

It is tough to identify. We have talked about broad issues, but not some of the smaller ones. I would like to focus on a smaller one and get your reaction. I am talking about AML, abandoned mine lands, which is in the President's budget, to extend that fee.

Title V of the Surface Mining Control, SMCRA, establishes this reclamation fund and financed 35 cents—and your railroad, I think, has carried a bunch of that, coal—on surface mines, and so on. It was set to expire in 1992, but has been extended twice.

Fifty percent of the money goes into the fund for the Federal Government to distribute to Mine Reclamation, 50 percent, by law, is supposed to be paid back to the States. That has not happened.

This fund is Treasury's AML fund. Several States have been paying into the fund and not getting their money back. Wyoming, for example, has paid in nearly $1.5 billion. We are now owed $355 million. As a matter of fact, all of the States together are owed $944 million out of this account that has not been paid.

I guess my question is, this budget specifically extends the AML fee. That means almost $3 billion worth of revenues paid in by the States, and they are not getting back the share that they are authorized to get back.

It is supposed to be reauthorized by the Congress this year. Some say we should not reauthorize it. The reclamation has generally been completed. So, I would like to ask what your reaction is to that, and why it is in the budget as it is.

Secretary SNOW. Senator, I will admit to something. You have taken me way beyond my knowledge. But I will certainly look into that and get back to you. I just do not know what, offhand, the funding status of the fund is. But I will commit to get back to you on that.

Senator THOMAS. We just went through some of it last week. Part of the interest has been siphoned off to pay retirement funds for companies that have gone out of business, in West Virginia, particularly. So, that has a lot of emphasis on West Virginia.

I would like to have you look into it. As I said, it is a specific fund, but to us it is a substantial thing in terms of our economy. I think we can talk generally about all these things, but each of us have a few things that have an impact on us. I would appreciate it if you would look into it.

Secretary SNOW. I will be sure to get back to you soon.

Senator THOMAS. I appreciate that.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Thomas.

Now, Senator Breaux.

Senator BREAUX. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for being back with us once again. We appreciate your testimony.

We just heard, today, an eloquent speak by Secretary of State Colin Powell down at the United Nations about the potential for a war with Iraq.

We have an incredibly dangerous situation in the country of North Korea that could explode at any time. We have a real serious fear of rising oil prices in the world, with Venezuela in chaos and the Middle East uncertain as never before.

We have a minimum of a half a billion dollar problem to fix Medicare. We have about a trillion dollar problem if we are going to fix Social Security correctly. Yet, we are looking at a $1.46 trillion tax cut, which would produce a $300 billion deficit and a $1.2 trillion deficit over the next 10 years.

My question to you is, under what conditions would this administration ever think that a tax cut would be reckless?

Secretary SNOW. In 1986, as I remember the debates here in this committee, the Senate concluded—one of your colleagues, Senator Bradley, led the efforts on that, as I recall—that a 28 percent tax rate was about right, in exchange for giving up preferences and some deductions, and so on.

I do not know whether that is precisely the right number or not, but the President has said that nobody should pay more than a third. I think the top rate was 31 in 1992. I do not have a crystal ball to tell you what is the precisely right tax rate.

But I think that, whatever the outer limits are, we are well within it right now. That is, whatever the boundaries are on rates that are too high and rates that are too low, we are within the range.

The rates here are simply accelerating, as you know better than I, with what the Congress has always approved. The dividend side to this is, it seems to me, just good economics. I do not know any economists who think you ought to tax equity income twice.

Senator BREAUX. From your background, though, as a leader, and an outstanding leader in the private sector, would you have said to your company that we are going to have untold expenses in the next coming years, and we do not know how much it is going to cost? We have no idea how much the revenues that my company is going to need in order to cover expenditures that are out there on the horizon.

o what we are going to do now, is decrease the revenues that we are going to be receiving in order to sell more products, and hope that somehow that will produce the ability to cover unexpected costs in the future. That would not really be a good thing to do in your business, would it?

Secretary SNOW. Well, the government keeps the books differently than we do in business.

Senator BREAUX. Oh, deficit.

Secretary SNOW. In business, you undertake an investment and then amortize it over some period of time and do not reflect the full amount in year one. I would think at some point it would be useful to think about using accrual type accounting to give a better picture of the true impacts of government tax policy and expenditure policy, because it would affect both.

But certainly I agree with your proposition that you, in business, expect returns on the investments you make. If the returns are not going to be there, you do not undertake the investment and you do not take on debt levels that threaten the enterprise. Certainly, I agree with you there.

Senator BREAUX. The largest portion of the proposal on the tax plan is the dividend tax elimination, which eliminates the double taxation on dividends. I think it is the right thing to do in terms of long-term tax planning.

However, I think that most of the economists that I have talked to, including the public statements of Alan Greenspan, indicate that, from a short-term perspective, that dividend tax elimination is not likely to do very much in the short term to stimulate the economic growth in this country.

The question I have, is I cannot go back to Louisiana and tell the 92 percent people that are not affected by dividend tax that we are going to spend $375 billion that could be spent on Medicare, Social Security, war in Iraq, everything else that we have demanding attention in this country, so that the 8 percent of the people in my State that really are affected by this will get some type of tax relief.

Now, I guess the argument I have heard is that the trickle down may eventually help them by allowing somebody to hire more people. But, I mean, I know this is part of the package. Would the administration consider something that would restrict the size of this dividend tax proposal?

I have heard suggestions that said, well, let us limit it to, say, $500 of dividends that a person would receive. Everybody would get it, the wealthiest as well as the lowest income out there, to try and move in that direction as opposed to biting off the whole enchilada at a cost of $375 billion. Is there any flexibility in this proposal?

Secretary SNOW. Senator, I would suggest that, while in Louisiana and elsewhere it may be a smaller fraction of the population who gets dividend relief directly, although on a nationwide basis I think it is half of the households that own equities so it is fairly widespread, but everybody benefits in an economic system when the system grows and expands.

I think that the proposal here really is calculated to grow the economy, and grow it in a very significant way. I have seen estimates of $40 to $60 billion a year growth in the economy resulting from the dividend proposal.

I guess I reject the idea of trickle down, because I do not see that as the way the economy functions. I think the economy functions in a circular flow, so you make somebody better off here, and they then spend the money and that helps somebody else, and it goes around in a circle rather than operating in some linear way.

Senator BREAUX. Is there room for compromise?

Secretary SNOW. Senator, I am here to advocate the full proposal.

The CHAIRMAN. Senator Snowe?

Senator SNOWE. Thank you, Mr. Chairman.

Welcome, Mr. Secretary.

Secretary SNOW. Thank you.

Senator SNOWE. I would like to follow up on some of the issues that have been raised, particularly with respect to the impact of the long-term deficits regarding the President's economic growth plan.

Last week, I was talking about the context in which we are operating. Two years ago, as I said, we had a $5.6 trillion surplus that essentially evaporated, and we all know the reasons why. Seventy-five percent of it evaporated due to the economic downturn, and obviously the events on September 11th.

The President's plan, in looking over his budget, apparently we are talking about total tax cuts of $1.4 trillion over 10 years. Now, I know the President has a 5-year budget, and we are looking at the short term.

But at what point does it become dangerous to drive up the long-term interest rates, when you are talking about adding another $1.4 trillion over the next 10 years that is in addition to the tax cut we enacted in 2001 of $1.3 trillion?

In looking at the CBO report, it said, "The actual surplus or deficit could be expanded in one direction in the other from the corresponding projections by roughly $55 billion in 2003, $135 billion in 2004, and $450 billion in 2008, aside from the effects of legislative changes."

I mean, the variations in the swings can be dramatic. What concerns me about the tax cut proposal, is that, as I said last week, 50 percent of it is devoted to one provision that has now gone from $364 billion up to $388 billion. It is very difficult to calculate the precise impact of all of these proposals in addition to what is occurring internationally.

I mean, we have exigencies, we have emergencies. It is hard to predict. When I look at the long term, and if you project 10 years out to 2011, essentially the President's proposals will extend the deficit to 2011.

Now, in 2013, Medicare essentially doubles from what we are spending today. So I would like to see deficits temporary. We understand the unusual circumstances that we find ourselves in today.

We understand that we have to stimulate the economy, we have to address certain emergencies, and obviously we may have military conflict. But, nevertheless, we have to strive for making this situation temporary, not permanent.

When you begin to project beyond the 5 years of the President's budget, we continue to be in a pattern of deficits through 2011. Now, whether it is OMB's or CBO's, there are big variations just in the President's tax cut proposal alone of what would take effect this year.

The President has $103 billion, OMB and CBO are saying $36 billion. There are huge variations. CBO has generally been, traditionally, consistently right.

So my concern is that we have to look at the long term, as well as at the short term. I would prefer to have a short-term stimulus than adding to the long-term deficits that have the potential of driving up the long-term interest rates.

Now, I know that the chairman of the Council of Economic Advisors, Chairman Hubbard, is saying that he would like to calculate a 40 percent revenue feedback effect from the tax cut on the short term. Then why are we not also assessing what the long-term effect is of these tax cuts when it comes to the deficits?

Secretary SNOW. I have not talked to Chairman Hubbard about that, but I think he said that it could be in the range of 40 percent revenue feedback, not that it necessarily will be.

But I agree with your broad point, which needs to be underscored. Deficits can reach a level where they affect financial markets. Once they do that, there is a real price to be paid, a price in terms of higher interest rates which affects everybody, including the Federal debt, a price in terms of future growth rates, a price in terms of capital formation, and on, and on, and on.

My only point here, is that I do not think we are reaching those levels. If we were, I would be testifying differently. These levels in my chart up here—maybe you can see it—shows that the Federal debt held by the public as a percent of GDP, going back to 1952, and shows that we are in the mid-30's range for this period out through 2008, or 2009, some period like that, and is well within the ranges we have had in the past and that have been consistent with good interest rate stability, not high interest rates.

The market, which is digesting all of this information about deficits, budgets, growth prospects, and so on, is registering the lowest interest rates we have had in, what, 40 years or so, which is helping to hold down the Federal debt.

I think the interest on the Federal debt is at the lowest level it has been in a long time because of the power of lower interest rates, even on a larger debt base. But, Senator Snowe, I agree with you. I agree with the basic thrust of your comments.

Senator SNOWE. Thank you.

Thank you, Mr. Chairman.

Senator BAUCUS. Thank you.

Senator Lincoln?

Senator LINCOLN. Thank you, Mr. Chairman.

Welcome to the committee, Secretary Snow. When you came for your nomination hearing, for the sake of time, since we only had 5 minutes, I had several questions for you, and you indicated in that confirmation hearing that your understanding of some of those intricacies was limited at the time.

So I submitted questions for you to answer, which you in turn answered, and I appreciate that very much. I would like to ask unanimous consent of the committee that I could go ahead and submit those for the record.

Senator BAUCUS. Without objection.

Senator LINCOLN. Thank you very much.

[The questions and answers appear in the appendix.]

Senator LINCOLN. Mr. Secretary, does the administration today believe that people who are paying Social Security and Medicare taxes are taxpayers?

Secretary SNOW. Well, that is a linguistic question. A share of their income is not being retained. It is going, though, to pay premiums, really. I would view those payments as in the nature of premiums for insurance programs, which are Medicare and Social Security.

Senator LINCOLN. So you do not see them as taxpayers.

Secretary SNOW. Well, I think if you analyze those payments in a strictly logical way, you would say those are payments for big insurance programs that provide income security and health security to people in the future.

I mean, I do not mind calling them taxpayers if you prefer to call them taxpayers. But from an analytical point of view, if you just look straight and analyzed it and said what are these payments going for, these payments are effectively to buy health and income insurance policies for the future.

Senator LINCOLN. But going to some of what Senator Snowe mentioned, which is what we hit when the mass majority of baby boomers hit 65, if we borrow from the people that are paying into Social Security now and then make those same people pay back the debt to Social Security with the benefit cuts that would ultimately have to happen, is that not a double tax?

Secretary SNOW. Well, I certainly hope we are not.

Senator LINCOLN. I guess if you do not think it is a tax to begin with.

Secretary SNOW. We are not going to be in the position to erode the benefits that people have.

Senator LINCOLN. Now. I am talking about in the future.

Secretary SNOW. No, that is what I am saying. I am saying, I trust we will find ways to sustain this set of inter-generational promises that have been made without reducing or modifying those commitments.

Senator LINCOLN. But that is certainly something important to answer today, as opposed to 30 years ago when we talked about tax initiatives and we had a lot more time to really think about that question. At this point, we really do not have a whole lot of time to initiate or fix that problem that the President's budget directs us in.

Secretary SNOW. No. I think the President has called attention to that issue by the comments he has made on the subject, by putting a spotlight on it, and by establishing the National Commission on Social Security.

Senator LINCOLN. But considering interest as interest is, and I am not the economist you are, I am just a regular person who pays and collects interest, is a tax cut that is enacted while we are in a deficit situation not tantamount to a tax increase, since it is borrowed?

Secretary SNOW. No. I think that would be an erroneous interpretation of it. A tax cut, whatever the deficit situation is, is a way to put more money in the hands of people.

Senator LINCOLN. But you cannot discount there is interest involved.

Secretary SNOW. Well, there is only interest involved if financial markets react in a way they have not reacted yet. We do have the lowest interest rates in 40 years, I think. But at some point, clearly, if financial markets get a sense that the deficits are out of control, they will exact a price. The suppliers of loanable funds will demand a premium.

Senator LINCOLN. I think the concern that many of us have, and I guess I, especially, since not only am I paying into Social Security, but I happen to be one of the ones on the committee that more than likely is going to go without it at whatever juncture that may happen. But if benefits do stay the same, as they are today, it seems to me that it is a mathematical certainty that taxes will have to increase.

Secretary SNOW. Or something like the IRAs will have to be put in place to help fund the system in the future.

Senator LINCOLN. As opposed to funding individuals. You are saying an IRA would have to fund the system, not the individual.

Secretary SNOW. Well, it would deflect costs from the system that would be borne by individuals, yes.

Senator LINCOLN. If I could just touch quickly on something that Senator Nickles brought up on the EITC. There is this intentional error rate, or faultiness that is found in the system.

I am just wondering if you have a comparison with the error rate there in comparison to the corporate error rate, or sophisticated shelters that might be out there for corporations.

Just looking at what the administration has in their budget, it is a proposed 72 percent increase for EIT enforcement, which I am assuming is true. You might want to correct me. I think so. I think that is what was in there. But that goes mostly to pre-certification.

Secretary SNOW. Right.

Senator LINCOLN. Is it not also true that they are proposing only a 3 percent increase for other tax law enforcement? So the majority of that increase in law enforcement for taxes is going to the EITC for pre-certification.

Is there any comparison to what is being done in terms of corporate fraud and the amount of money that is being spent on precertifying poor people compared to the money we are losing in corporate fraud, and what we are doing about that in law enforcement?

Secretary SNOW. Well, there is. In fact, there is a program, I think it is $100 million, dedicated to enforcement of really high-end people who use questionable tax avoidance or shelter sorts of arrangements.

I do not pretend to be an authority on the EITC question, but I am told that if this is done right, this pre-certification is done right, it will avoid an annual hassle that the EITC recipients go through, as every year they have got to get recertified.

If they can get certified once, then the preauthorization checks come and their life is made simpler. There is just an astonishing amount of errors, apparently, in this. Why, I do not know, but reforming this set of processes should make life better for recipients.

Senator LINCOLN. I think a lot of the problem for those individuals is they are much more transient, and so some of that pre-certification does not last because they are transient, which means they have to recertify.

But I would be interested, if you could provide us the numbers of the comparison between the error in the EITC and the error rate in the corporate fraud and the sophisticated shelters there, as well as the money that the law enforcement is dedicating to both of those.

Secretary SNOW. We would be happy to do that.

The CHAIRMAN. Thank you, Senator Lincoln.

We are going to have another round of questioning. We will do it, still, in the 5 minutes that we previously had done so that we can go back and forth and cover as much ground with as many different members as possible.

Mr. Secretary, most small businesses, as you know, operate as sole proprietorships, partnerships, limited liability corporations, or S corporations. The income of these entities are reported directly on individual tax returns of the owners.

Therefore, individual rate cuts reduces the taxes for that category of small businesses. Right now—at least this is the way I see it—I think there is a bias against those people in the Tax Code as related to big corporations, or any corporation that has a high marginal tax rate of 35 compared to the others of 38.6. So, it is kind of a rate penalty on small business.

Would you comment on the effect of this small business rate penalty? Or if you do not use those words, just how the higher marginal tax rate for individuals versus corporations affects job formation and economic growth?

Secretary SNOW. Yes. Yes, I would be happy to. I think that small business should not be paying higher tax rates than big business. An awful lot of the small business people are doing so today, and I am sympathetic to that point very much.

One effect of the acceleration, is that, of course, the highest rate would be 35 percent, so the highest rate of small business that pays, on this flow-through basis, would be the 35 percent, which would end that inequity. Many other small businesses would pay at still lower rates.

So, I would think that small business would be a major beneficiary of this legislation, and the economy would be a beneficiary because, as small business' profitability goes up, as it would with lower taxes, then small business would be more inclined to invest, and grow, and expand and put out those "Help Wanted" signs we talked about earlier.

The CHAIRMAN. Yes. Well, thank you very much for that response. I know that the President's program addresses that issue. I think it is very important that we see that as an effort to help small business.

I would like to ask a question now about business expensing. You and I discussed last week, in addition to the acceleration of the marginal tax rates, that the President has proposed increasing this from $25,000 to $75,000.

I would ask you to provide your views on how this proposal would affect the economy, and particularly ask that you concentrate your response on small business. Knowing that, since you most immediately came from a very large corporation, I would like to hear how you feel.

You noted that small business would like to grow into big businesses. That is what you said last week. But the reality is, 80 percent of American businesses have fewer than 20 employees.

Those small businesses are frequently credited by the media with creating 80 percent of the new jobs. So, elaborate on your views on the small business expensing proposal, and how small business incentives would provide economic growth for the economy at large.

Secretary SNOW. I am happy to do that. I am a fan of small business. While I was with a big business, we used the services of an awful lot of small businesses and really out-sourced a lot of activities, as big businesses do, to smaller businesses who, in many ways, are more efficient and more specialized.

So the small business sector of the American economy is absolutely vital, not just to job creation, but to the efficiency with which the whole economy operates, because small businesses can do so many things better than anybody else can.

The expensing provision will be a real boon to small business. It will immediately increase the amount that they can expense, and it will increase the size applicable to that expensable amount so that small business will be given an incentive to grow.

It will mean more free cash flow in the hands of small business. As businesses have more free cash flow, they feel better about their future, and they hire people, and they undertake growth plans. So, I think this is a very important feature of the plan.

The CHAIRMAN. I have a question that deals with pensions. This will have to be my last question, then we will go to Senator Baucus.

The administration has proposed a new plan for savings and retirement programs. There would be what the administration calls a lifetime savings account. There would be a new plan that would substitute for IRAs. Third, all types of employer-based defined contribution retirement accounts would be rolled into one.

Now, the Congressional Research Service has reported that coverage has declined slightly from historic levels of around 50 percent. Coverage is particularly weak among small business.

So, how likely is it that the administration's proposal will increase coverage among small businesses? Would the President's proposal accomplish this, particularly in this area that we call small business?

Secretary SNOW. Mr. Chairman, I definitely think it would. If my statistics are right, something only like 25 percent of all small businesses provide retirement plans of any kind.

One reason for that, is the current savings vehicles are too complex and they are too restrictive. By making them less complex and less restrictive, I am confident that small businesses will be more inclined to want to make them available.

After all, why do employers want to make available retirement plans? They want to make available retirement plans because it is a terrific way to attract, retain, and motivate workers.

The low participation rate in these plans, I think, does not reflect an absence of interest on the part of small business in making these plans available, but rather the current complexity and restrictiveness of these plans.

So the person most responsible for developing these plans is with us, Assistant Secretary Olsen here, and I commend her for the effort that she and the people in the Treasury have put into developing these plans.

It seems to me inevitable that it is going to lead to more use of these retirement plans in small business, and it is inevitable that it is going to lead to more savings, both on the individual side and on the business side. That is good for retirement security.

The CHAIRMAN. I do not want you to answer this, but either with you or with Secretary Olsen, we need to look at the alternative. I know we have got anxiety on savings and people having enough pension coverage. We made very substantial changes in the tax bill 2 years ago on pensions.

I would just wonder if we would not relieve some of this anxiety and accomplish some that the administration wants to cover by just making the provisions of the 2001 tax bill permanent as opposed to, now, it would sunset in 10 years.

Secretary SNOW. Right.

The CHAIRMAN. Well, we will discuss that at another time. But I think that there has been a lot of questions raised about the administration's proposal. I am not going to throw cold water on it, because I have not studied it enough at this point. But I think there have been a lot of questions raised about it.

Senator Baucus?

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, as you well know, the Congress passed, in the Trade Promotion Authority Act, a trade adjustment assistance provision which provides, for workers who are laid off and therefore do not have health insurance, a 65 percent advanceable, refundable tax credit that could be used to pay for their COBRA coverage, or a variety of other State-based coverage options.

This health insurance credit, as you know, is available to TAA workers for the length of time that the worker is eligible for trade adjustment assistance and could not be used to purchase health insurance coverage in the individual market, with just one exception, and that is for the individual that had previously purchased health insurance in the individual market. That is the only exception.

The real question is this. How is the administration doing on coming up with regulations and implementing this? That is, how is work progressing? What is your timeframe for implementing the advanceable, refundable features of that tax credit, and the difficulties, if any, that the Department is facing in implementing?

I ask all this, because the President has proposed creating a tax credit for individuals and families to help them purchase health insurance in the individual market. Putting aside the pros and cons of that, I have some concerns about that, questions like adverse selection and so forth.

It makes sense to me, frankly, to go a step at a time and see how the administration is doing in this one sector, this one segment, that is, TAA benefits, and work on the experience that we have developed, what has worked, what has not worked with that, before proceeding much further. So could you give us an update or a sense, or if you do not know right now because this may have caught you a little off guard, what you can tell me?

Secretary SNOW. Yes. I certainly will do my best, Senator. I do not have a full answer for you. But I understand that this issue is under very close review in the Department and that people on the staff of the Department are talking to people on your staff, and staff of the committee, about it. I will look forward to getting more on top of this and communicating with you directly on it.

Senator BAUCUS. But, generally, do you think it is wise to consider expanding before we have even begun to realize the effects of the TAA population?

Secretary SNOW. Senator, I really would ask you to give me a chance to think about those questions a little bit before I respond, because I do not feel I have a sufficient understanding of the issues to give you an informed opinion.

Senator BAUCUS. I appreciate that.

I just want to get the facts out there. The worst thing we can do is mislead people, the people we represent. Whatever the facts are, I think the people we work for should know what the facts are and not be misled.

The administration is fond of saying that the average tax cut that an average taxpayer will receive in 2003 is $1,083. That is what they say. They say it is an average. The average taxpayers would receive, on average, a tax cut of $1,000.

Now, let us just think about that a minute. As you well know, there are about 130 million persons who file taxes, and about 92 million of those will receive a tax cut. The rest, about 30 million, will not, but 92 will.

The Department cites this 92 million for the basis of their average, although, as I mentioned, 32 million filers will not receive any benefit. I think it is important for people to know that.

But the real question is the difference between average and median. While it is technically true that the average tax cut would be the amount indicated, I think that is misleading.

For example, you know the old story. Let us say, I do not know what the net worth is—excluding you—of everybody in this room. Say it is a certain amount, an average. If Bill Gates were to walk in this room, suddenly the average goes way up. Way up. It does not help us at all, but that is the statistical average.

Would it not be more useful for the administration to use median data rather than "average" data? I say that, because the taxpayer in the middle, kind of the loose average that we are talking about, would actually receive a tax cut, not of $1,000, but about $250.

Do you not think it is more honest and less deceiving to the American taxpayers to say what is really going on here? It is the tyranny of the law of averages at work here. It is really what we are talking about. If you want to use the figure of $1,000, that is true, that is the average. But if we are really talking about the taxpayer in the middle, it is much less.

Secretary SNOW. Senator, we anticipated your question.

Senator BAUCUS. I am glad you have, because my staff just now tells me that they have got a chart, which I did not know about. Please put that up.

Secretary SNOW. We will have the battle of the charts here.

Senator BAUCUS. The dueling charts here.

Secretary SNOW. Dueling charts.

I mean, there are lots of ways to display this. This is a chart that takes that family of two children, married couple, $40,000 in income. Their income tax under the current law is about $1,200, and the income under the President's proposal will go to $4,600. That is a net change for them of $1,133, or a 96 percent improvement in their status. Now, that is one block of America that fits in that chart.

We have got another grouping of America that is reflected in this other chart. You can see this one as well. This is the married couple with two children and an income of $30,000. Their income under the current tax law, because the EITCs, I guess, and credits, and so on, is a negative $1,200.

With the tax law changes, they get a tax advantage of $955, so that their negative tax payment becomes $2,158. That is nearly an 80 percent improvement.

Finally, just to show you, we got some smaller ones, too. These are all, I think, median and below median. This is the head of household with one child, income of $20,000.

Currently, they have a negative income tax of $1,455. They get a gain here, the child credit acceleration, of $400. So their income tax under the proposal, they pick up another $400 and get a 27 percent reduction in their tax. So, I agree with your point, though. Mean and median are different.

Senator BAUCUS. Than average.

Secretary SNOW. Than average.

Senator BAUCUS. Let us go back to your first two charts. Could you put the first chart back up again? That is accurate, but it is misleading. It is accurate that married couples with two children, with an income of $40,000, will receive those benefits. That is only 12 percent of American filers. Twelve percent.

There are so many others, singles, for example, who do not get benefits, or with fewer children, et cetera. In the second chart you raised, it also has only 12 percent of American filers.

If you look at this chart here, 80 percent of taxpayers do not receive the "average" that the administration is fond of talking about. Eighty percent do not receive the average.

Now, when people think of average, they should think, that should really be 49 percent that do not receive. But it is not, it is 80 percent. I know I am making a difficult argument to understand, but it is an accurate argument.

Secretary SNOW. No. I understand your argument.

Senator BAUCUS. The point is, only 20 percent or more of American taxpayers receive that so-called average. I just wish the administration would be a little more accurate with its proposals.

Secretary SNOW. Senator, I think the bottom line on all this is that, after the President's proposal is put in place, assuming Congress were to enact it as proposed, the lowest income people, the zero to $30,000 group, would have a 17 percent improvement in their tax situation, or relief, whereas the 200 plus would be 11 percent. So there is an equity in all of this that I think is important to observe.

Senator BAUCUS. Well, let us look at this. This is also accurate. Your charts are accurate, but this is also accurate. Namely, if your income is under $10,000, your cut is going to be $3. If your income is $21,000, your tax reduction is only $69. If your income is $38,000 or less, your tax cut is $256. That is all.

If your income is $68,000, and most taxpayers are that or less in America—they are not wealthy, they are really struggling—their tax cut is only $500. Not a lot, spread out over a year. This is for the year 2003. It is $574, and that is all right. Further up the income level, if your income is $317,000 or above, gross, then your tax cut is $24,000.

So the main point is, 80 percent of taxpayers do not receive the so-called average. They receive much less under the President's proposal.

Secretary SNOW. Senator, but at the end of all of that—we have each got accurate sets of numbers here, and subject to different interpretations—the highest income tax payers end up paying a larger share of the total revenue obligation to the Federal Government, and the lowest income tax payers pay a lower share than would be the case without the President's proposal.

Senator BAUCUS. Is that accurate? Is that accurate? I ask for this reason. I was fascinated with an article a week or two ago. Maybe some of you saw it. It was in one of the major papers. If you look at the effective tax cuts, total Federal tax—income, payroll, all Federal tax—in each of the five quintiles, the effective rate in each of the five quintiles is about the same. It is about 18 percent. So we, in effect, have a Federal flat tax in America today. Did you see that article?

Secretary SNOW. I missed that one, Senator.

Senator BAUCUS. It was a big one. It even had the charts there.

Secretary SNOW. I missed that one.

Senator BAUCUS. It might have been the Wall Street Journal within the last couple, 3 weeks. Fascinating. And I read it very closely because my eyes just jumped out. The total Federal tax in each of the five quintiles is about 17 to 18 percent, total.

And tax is tax. It is lower income people who pay much more in payroll tax, and all that. So if we have a flat tax effectively today, proportionately, it is hurting middle income people a heck of a lot more than it is hurting wealthier people.

I have taken way too much time.

Senator Conrad?

Senator CONRAD. Thank you, Senator Baucus.

Again, welcome, Mr. Secretary.

Secretary SNOW. Thank you, Senator.

Senator CONRAD. We keep meeting at these distances. We will have a chance to meet one-on-one soon, and I look forward to that.

I want to say to you, as directly and forthrightly as I can, that I believe the President's proposal is dangerous, I believe it is reckless, I believe it will hurt long-term growth rather than help it.

I must say, I have never been more concerned about the fiscal direction of our country. I am in my 16th year. I guess maybe not I am in my 17th year. I came here, in part, because I was so alarmed at the growth of Federal budget deficits 17 years ago. I have a financial background. I was absolutely convinced that these deficits were threatening our long-term economic security.

At least in the 1980's, we had time to get well. Now there is no time to get well because the baby boom generation is about to retire.

Let me just put up the things that I find most alarming. The first, is this dramatic change in our fiscal fortunes. Two years ago, we were told almost $6 trillion of surpluses over the next decade.

We now know, if we enact the President's budget proposals, his tax proposals, his spending proposals, according to the President's recent budget submission, instead of $5.6 trillion of surplus, we are $2.1 trillion in the hole.

Let us go to the next. That is in that decade of 2002 to 2011. This chart comes out of the President's analytical perspectives. This is out of his document. It shows, if you extend the 2004 budget policy, we are never out of deficit.

We are headed, in the future, to deficits to GDP that are totally unsustainable in the out years, way out in 2040, 2050. We are talking about 12, 13 percent of GDP as deficits.

But the thing that is alarming to me, is we are in the sweet spot now. We are in the sweet spot because the trust funds of Social Security and Medicare are throwing off hundreds of billions of dollars of surpluses. Instead of using that money to pay down debt or to prepay liability, the President is using it for tax cuts.

Now, I want to make clear, I would not quarrel with that at a time of economic weakness. The place I agree with you, is the first priority is economic growth. The thing we have got to do is get this economy growing again.

But the President's tax cuts, the vast majority of them, are not this year. The vast majority of them, even in the growth package, 95 percent of them, are in the future at a time the President is projecting strong economic growth.

On this question of economic growth, this is from Macroeconomic Advisors. I do not know if you are familiar with them. But Macroeconomic Advisors are under control to the Congressional Budget Office, they are under contract to the White House to do econometric modeling.

This is what they said about the President's policy. Initially, the plan would stimulate aggregate demand by raising disposable income, boosting equity values, and reducing the cost of capital.

However, the tax cut also reduces national savings, while offering little new permanent incentive for either private saving or labor supply. Therefore, unless it is paid for with a reduction in Federal outlays, namely Federal spending, the plan will raise equilibrium real interest rates, crowd out private sector investment, and eventually undermine potential GDP.

In the chart that accompanies that, they show economic growth after the year 2005 under the President's plan to be negative compared to doing nothing. Let me repeat that. They say economic growth will be lower than if we did nothing as a result of the President's plan after 2005.

They show the cost of capital under the President's plan going up, that the cost of capital will be increased by about 6 percent as a result of the President's plan.

What say you?

Secretary SNOW. Well, they must be looking at different economics than I am. I do not see how that could possibly be the case, Senator, with all due respect to the people at the Macroeconomic Advisors, LLC.

It seems inconceivable to me that taking the steps that are proposed by the President, which I think virtually all economists would agree, make the economy more efficient. We make the economy more efficient when we reduce marginal tax rates.

I think that is generally accepted. We make the economy more efficient when we eliminate the economic distortions that are associated with taxing corporate income twice.

Those are just raw, wasteful inefficiencies in the economic system. Taking them out always releases more productivity, more energy, and more creativity in the economy.

Senator CONRAD. Except when they are financed by debt. That is the point of not just Macroeconomic Advisors, which I can tell you, these are the folks hired by CBO, hired by the White House themselves to analyze these things.

Not just them. I mean, we have got a long list of economists who are telling us the same thing. They are saying, yes, it improves efficiency, just as you have asserted, but only if they are offset by spending reductions. The President is not proposing spending reductions to offset these tax cuts. He is financing it with debt.

The point they are making, is that that increased debt is a dead weight on the economy. It reduces the pool of societal savings, reduces the money available for investment, increases the cost of capital, and so reduces economic growth.

Secretary SNOW. I think we and they have a different point of view on this, Senator. If I thought these deficits were going to rise as a percentage of GDP, if I thought this would necessitate debt levels which were high relative to historic levels to GDP, then I would give real credence to their arguments. I do not think that is going to be the case.

Senator CONRAD. I would just say that, in the President's own budget submission, it shows us going to extraordinarily high levels of deficit and debt to GDP, because if you think about it, we are in the sweet spot now.

We are running massive deficits at a time we should be paying down debt or accumulating debt, and the trust funds are going to turn negative on us, and then it really moves away from us.

But the thing I am most troubled by in your testimony, is John Snow before he was Secretary of the Treasury, and the John Snow now. This is what you said then. "A credible sustained reduction in Federal deficits leading to a balanced budget will bring major economic benefits.

As the government spends less and borrows less from investors to cover declining deficits, more capital will be available for investment in the private sector of the economy. Inflationary pressure will ease and interest rates will respond by declining as much as 2 percentage points."

I agreed with that John Snow. I just hope that the new John Snow has an epiphany and will return to those old John Snow values, because the argument he was making then, I think, is correct. Those were very good statements, by the way. I endorse them heartily.

Secretary SNOW. Senator, if you give a moment, we were in a different situation back then in some major respects. In the early 1990's, as you know, the projections were for rising deficits. It think in 1994, 1995, 1996, 1997, 1998, the projections of the budget were all over $200 billion at a time when the economy was a third smaller than it is today. So, the burden on the economy was greater than it is today.

I was alarmed by what I saw as this string of large deficits getting larger, going out into the future. I worked with a number of members of Congress on both sides of the aisle, and with the Clinton administration, people in the private sector, Pete Peterson and The Concord Coalition. I thought what we did then was good. I mean, all of us, collectively. I do not disagree with the observation I made there, the need for fiscal discipline.

I think where you and I maybe differ, is our reading of the circumstances we are in today. I do not believe in magic, and I do not believe you can turn on a dime, but I do think we are putting the economy on a better growth path and that will be helpful.

The CHAIRMAN. Senator Lincoln?

Senator LINCOLN. Thank you, Mr. Chairman.

So you are saying that the projections for the debt ahead of us now is less awesome than the projections of the debt ahead of us back then?

Secretary SNOW. Yes. As a percentage of GDP and national debt, I think they are, Senator. I think they are.

Senator LINCOLN. Well, I am curious because when people speak about the 1993 Budget Act, which I was here for—I was in the House at the time—and so many people have characterized as the largest tax increase in the history of our country, why did that not stifle the growth of the 1990's? I mean, what is the projection there? Are you saying that it was the looming debt that did not materialize?

Secretary SNOW. No. Senator, I think the 1990's, mid-1990's and on, were a magical period in American economic history that reflected a lot of changes in the economy that had been put in place in the years before. The deregulation of so many of our industries. It took time to feel the effects, but those effects were powerful and they made the economy more resilient.

Senator LINCOLN. That was in the 1990's.

Secretary SNOW. Yes. Well, I know.

Senator LINCOLN. I voted for that.

Secretary SNOW. But we have been expanding. I mean, trade liberalization has been going on for some time, and the predecessors to NAFTA, the restructuring of American industry in the 1980's, the down-sizing, and the right-sizing, and the reengineering.

And, of course—in many ways most importantly—we finally began to get the dividend on the investment in technology. That did not really come until the mid-1990's. In the mid-1990's, something magical happened. All of a sudden, productivity rates went up significantly, and they have been up significantly ever since.

That is the new power of this economy, the increasing productivity, rising productivity. It is that rising productivity that raised real wage rates, that improved profitability of corporate America, that helped to lead to the strong stock market, that helped to lead to the explosion in governmental receipts.

Senator LINCOLN. So that is why the 1993 Budget Act did not stifle the economy.

Secretary SNOW. Well, I think the 1993 Budget Act was part and parcel of a lot of good things that were going on, yes.

Senator LINCOLN. Well, if deregulation prior to that was the magic that made all that happen, what about——

Secretary SNOW. Deregulation helped create.

Senator LINCOLN. Well, what about deregulation in telecom? What about deregulation in airlines?

Secretary SNOW. I think airline deregulation—I know there are some dissenters on this—has been a large net plus for the economy. Trucking deregulation has been a large net plus for the economy.

Railroad deregulation has been a large net plus for the economy in terms of the real welfare of America. The transportation industries today are operating, in real terms, at 40 percent less cost than they had in the beginning of the 1980's. That is reflected somewhere in the economy, that huge reduction in costs. So, the 1990's saw the blossoming of the benefits of a lot of things that were done earlier.

Senator LINCOLN. Well, I did not bring my own charts. I do not have my own charts like the rest of these guys, so I would like to use one of yours, if I may.

Secretary SNOW. Sure.

Senator LINCOLN. The one that had the $30,000 income, if you do not mind. I am just drawing from this from my own perspective, particularly from those that I represent. In your testimony, you have got a typical family of four with two earners making a combined $39,000. I would like to make sure under this——

Secretary SNOW. Do you want the $30,000 or the $39,000?

Senator LINCOLN. No, this is fine.

Secretary SNOW. All right.

Senator LINCOLN. I just want to make sure that, under this, are you assuming that the child credit is refundable here, and the EITC is refundable? Because if that is correct, that is not in the President's proposal, is it?

Secretary SNOW. Yes, I think it is in the President's proposal.

Senator BAUCUS. No. No, it is not.

Senator LINCOLN. Well, in the budget, but not in the growth plan.

Secretary SNOW. Here is what we have, the background on this.

Senator LINCOLN. It is accelerated, but not refundable.

Secretary SNOW. This reflects acceleration of the increase in the child tax credit that is worth $800, and acceleration of the reduction in the marriage penalty, increasing the standard deduction, and that is worth $155, which produces that $955.

Senator LINCOLN. All right. It seemed to me that you were assuming the refundability of those.

Secretary SNOW. Apparently it is refundable under current law.

Senator LINCOLN. It is under current law, yes, under what we did. I am a little bit confused on those numbers. I might like to ask you some more about that.

But in the testimony where you do use the typical family of four, I would just like to give you a snapshot of where I am coming from. You are saying that the combined two earners at $39,000 would receive $1,100 in tax relief, compared to the taxes that they paid in 2002.

Secretary SNOW. Right.

Senator LINCOLN. Well, approximately 25 percent of the tax returns that are filed by my constituents have no taxable income at all. Sixty-two percent of the tax returns that are filed in Arkansas have $30,000 or less income to report. Eighty percent of the tax returns that are filed in Arkansas have $50,000 or less income to report. Forty-four percent of the returns that are filed are joint returns, so approximately 56 percent of the taxpayers filing are single or widowed.

Eighty-two percent of the people who file tax returns—these are the income tax payers, not the ones that we are not sure about in terms of whether they are taxpayers or not, or if they are paying on premiums, or what have you—have no dividend income. Eighty-two percent that file tax returns have no dividend income.

Even the children in Arkansas, I am concerned about, as we did the last tax provision and we worked to make those child credits refundable immediately. Most of them phased them in or worked to try to get them immediate.

Most of the children in Arkansas are living in low-income families and do not benefit from the President's growth package, because refundability of the child credit has not been accelerated along with the increase. You have accelerated it but not made it refundable immediately.

So what I am trying to explain, is that the typical family that you are describing is not necessarily a typical Arkansas family, or a typical family, as Senator Baucus has mentioned, from some of our rural States.

I guess, considering all those facts, and as a person that is here to fight for those people, for something that is fair and equitable, help me better understand what it is that you want to sell to me in the President's tax cut plan.

Secretary SNOW. Well, Senator, what I want to sell to you is what I think you want to see occur in Arkansas, and that is more good jobs for citizens. I think that is what this package is fundamentally all about. It is about more good jobs, about a bigger economy, about opportunities for people. The best thing you can do for somebody is give them a good job.

Senator LINCOLN. Yes. I do not disagree with that at all.

Secretary SNOW. And that is what this is fundamentally all about, more good jobs, more "Help Wanted" signs out.

Senator LINCOLN. And the propensity for that dividend deduction is going to be a job creation?

Secretary SNOW. Senator, the dividend deduction, along with the other provisions, will result, without any doubt, in economic growth. The recipients of the dividend exclusion will do something with that money. They will use it. They will not put it in a knapsack, they will spend it, they will save it, they will invest it, and that will help create jobs.

The CHAIRMAN. Thank you, Senator Lincoln.

Here is what I am going to do. I have about three questions. I am going to ask those. Then I am going to leave you in the hands of Senator Baucus. I have done this before, and I do not find any problems with that. He will adjourn the meeting, unless other people come along and want to ask questions, because I have a 5:15 meeting I have to go to.

Secretary SNOW. Fine.

The CHAIRMAN. The Earned Income Credit has provided great benefits to millions of working Americans. I do not think there is any doubt about it helping low-income families, giving them an incentive to get out and work.

While we focus on that, we have focused on wasted dollars. I do not think we can forget that the $10 billion in improper EITC payments translates into thousands of low-income families being subject then to an IRS audit.

These are families that cannot afford to hire an accountant or lawyer to defend them when the IRS comes calling. These families cannot afford to pay a big tax bill, so it is important that they and the government do all they can to get it right the first time.

So I would appreciate, Mr. Secretary, your providing a review of this new program, and could you comment on whether this new program in the long run would mean fewer audits and collection against EIC families.

Secretary SNOW. Senator, I am confident that it would if we get this structured right up front. The people are put in a bad situation today. They have to continuously certify in a process that is awkward and far from seamless. The effort here is to put in place a certification process that will avoid the need for that periodic and regular review.

I think the recipients in the program will be important beneficiaries of this and they will avoid that IRS hassle and the other issues that you talked about. They are not people who are familiar with accountants, and hiring accountants, and dealing with IRS agents effectively. I think we owe it to them to do this, as well as to all of the taxpayers.

The CHAIRMAN. I would like to now turn to my last question, which deals with private debt collection for unpaid taxes. The administration has proposed a program that involves the private sector assisting in collecting tax debt that otherwise would not be worked by the IRS.

I have two concerns about the proposal. First, we must make sure that taxpayers' rights are protected. Second, I want to make sure that we have learned the lessons of the 1996 debt collection effort that did not meet our expectations.

I would like to take each concern at one time. With respect to my first concern, ensuring taxpayers' rights, I would like to make this observation. The preliminary information I have received in this matter is promising.

Private collection agency employees will be held not only to the standards governing their industry, which would be the Fair Debt Collection Practices Act, but also to the fullest extent possible to the code restrictions faced by IRS employees.

This brings me then to my second concern, which is avoiding errors of the past. I understand that a large part of the problem in the 1996 program was getting test participants the right cases and the right data, and in the right format.

In order for this new effort to succeed, IRS must be able to provide private collection agencies with appropriate cases, financial receivables, that fall within appropriate parameters in some sort of usable format. My understanding is that IRS could not do that this very day.

Can you assure me that the Information System staff at IRS will be able to complete the programming necessary to provide this data in a timely and complete fashion, in other words, doing it in a way that is going to protect rights and get the job done?

Secretary SNOW. Senator, absolutely. This program should not be undertaken unless the concerns that you have raised are fully and effectively addressed. I will commit to you to review the procedures myself and make sure that taxpayer rights are fully observed, and that the personnel of these private collection agencies, if we move forward with that proposal, will be held to the very highest standards.

The CHAIRMAN. Without objection, I would put in the record a couple of items. One is a statement from Senator Bunning, and the second one is a copy of a letter from Senator Lincoln to me which was dated January 28, 2003.

[The information appears in the appendix.]

Thank you very much for your kind attention in meeting with us after yesterday's meeting had to be canceled, changing your schedule and everything associated with it, and being here a late hour.

Thank you to Senator Baucus for accommodating me.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, my trusty crack staff found that article I was referring to. That is, with all apologies to the Wall Street Journal, it was in the New York Times. It is dated January 21, 2003, New York Times, Section C, page 1, column 5.

Secretary SNOW. I will want to get it and read it.

Senator BAUCUS. It is interesting. I will just kind of summarize the import of it.

Essentially, it is pointing out a couple of things. That is, it is not just dividend income that is doubly taxed to taxpayers—in fact, some taxpayers have their taxes doubly or triply taxed—but it points out that there is lots of other double taxation.

For example, many Americans have to pay a second tax, sales tax, or they have to pay a second tax on Social Security. That is an extra tax. That is after income. All these are after-income taxes that they pay in addition to their income tax.

So it raises two questions. The first question is, essentially, if we are going to phase out or eliminate double taxation of dividends, what about other taxes? Again, sales taxes, import taxes, payroll taxes. There are a bunch of them where people are doubly taxed. What is sauce for the goose is sauce for the gander.

In fact, the point is, only about—I forgot the number here. Maybe it has it here. Relatively proportionately fewer people are subject to the double taxation of dividends today than to the double taxation of all the other taxes that they pay. I think it is 34 million that are affected by the double taxation of dividends, but 200-some million Americans are affected by the other double taxation.

So, again, the question is, basically rhetorically, and I want to have you answer in great detail, is why not eliminate those other double taxations? Those people get hit pretty hard, frankly.

The other point is, as I said, I was not totally accurate, but I was basically accurate. This chart here—and you have the reference so you can get the information yourself—basically says, taking all types of government taxes into consideration, the tax burden as a percentage of pre-tax income is roughly the same for all income groups.

For the bottom income group, the average pre-tax income is roughly $8,000. Total government tax receipts is roughly $1,500. As a percentage of income, that is 18 percent. It is basically the same for the other quintiles, 20 percent, 20 percent, 20 percent, and 20 percent.

Now, government receipts here include—I misspoke, but I will tell you what it said here—Federal and State income taxes, an employee's share of Social Security contributions, not the employer's, property taxes, utility taxes, Federal and State tobacco taxes, Federal and State alcohol taxes, Federal and State gasoline taxes, and State sales taxes.

There are a couple that it does not include. They do not include Medicaid. I think there are other provisions they do not include. But basically I think the point is well taken. If we are honest with ourselves, Americans pay about the same amount of taxes regardless of their income, total taxes. Would you agree?

Secretary SNOW. Senator, I will read the article and look forward to trying to understand the implications of it. What you seem to be saying, is that Jack Kemp and the flat tax group have already triumphed.

Senator BAUCUS. I am saying, they do not need to go any further, there will be a negative. They do not need to go any further, or then it will be negative.

Secretary SNOW. Let me read the article.

Senator BAUCUS. I would appreciate your reading it so we can have a discussion on it.

Secretary SNOW. I will. I will. And we will take a look at that, analyze it, and get back to you.

Senator BAUCUS. Also, you have great charts. I think you made history today. You are the first Treasury Secretary, on his opening day, to have charts, as I recall, anyway. My memory sometimes is a little poor.

The CHAIRMAN. Senator Baucus, it is kind of nice to see a Republican willing to challenge Senator Conrad. [Laughter.]

Senator BAUCUS. That is right. In fact, they are so good, can we have a copy of them?

Secretary SNOW. Sure. Absolutely. Absolutely.

Senator BAUCUS. You can have a copy of ours, too, if you want.

Secretary SNOW. Good. I would very much like to get that one that shows the difference between——

Senator BAUCUS. In the spirit of trying to find the truth, somewhere in the middle, probably.

Secretary SNOW. Right. Right. Exactly. I would very much like your charts, and we will make ours available to you.

Senator BAUCUS. All right.

I have no further questions, Mr. Chairman. Let me just page through my book. I might find something here.

The CHAIRMAN. I need to get out of here.

Senator BAUCUS. All right. I will get you out of here. I think we have kind of made our basic points. Tomorrow is another day. You have got things you have got to do.

Secretary SNOW. Right. Senator, thank you very much. I think I came out of the hearing understanding the concerns of the committee much better, and we will try to respond to those concerns as we can.

Senator BAUCUS. Thank you.

The CHAIRMAN. The meeting is adjourned. Thank you, Mr. Secretary.

[Whereupon, at 5:10 p.m. the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Prepared Statement of Hon. Max Baucus

I am pleased to welcome our new Treasury Secretary, Mr. John Snow. Although today is your second appearance before the Committee, it is your first appearance as Treasury Secretary. Congratulations on your confirmation.

Mr. Secretary, last year the President said in his State of the Union address that we must win a war, protect our homeland, and revive our economy. One year later, I believe that we still have these same challenges. Unfortunately, we have another one. The deficit.

Two years ago, the projected ten-year surplus was $5.6 trillion. One year ago, we had a $1.6 trillion surplus. Today, before we even consider the President's plan, the surplus is down to $20 billion. We are going in the wrong direction.

As Treasury Secretary, you have primary responsibility for the President's economic policy. In your confirmation hearing last week, in support of the President's economic plan, you stated that you "would like to see more 'Help Wanted' signs all across America." That same evening, the President said in his State of the Union address that, "with unemployment rising, our Nation needs more small businesses to open, more companies to invest and expand, more employers to put up the sign that says, 'Help Wanted.'

I could not agree more. But, Mr. Secretary, we already have "Help Wanted" signs up all across our nation. Unemployment continues to rise. The 1.7 million Americans who have lost their jobs since March of 2001 have their "Help Wanted" signs up.

Industry is operating at 75 percent of capacity. Businesses have stopped investing in new equipment and facilities. Consumer confidence has fallen from 107.6 in December 2000 to 86.7 in December 2002. Businesses have their "Help Wanted" signs up.

States are facing their worst budget crisis in 50 years. In fiscal years 2002 through 2004, the states have been—and will—face deficits totaling $171 billion. My state of Montana is facing a budget of $184 million. States have their "Help Wanted" signs up.

Healthcare costs continue to rise. Forty-one million Americans are uninsured. Those who cannot afford health insurance but do not qualify for any assistance have their "Help Wanted" signs up.

Seniors who do not have prescription drug coverage—or have inadequate coverage—pay the highest drug prices in the world. Seniors have their "Help Wanted" signs up.

So, what can we do? Just as the family in Montana comes together to discuss their income, expenses, and priorities, we need to sit down together to discuss our national budget. The President's budget provides a framework. In a time of war, national security comes first. But we must take steps to revive our fragile economy now. We must reduce unemployment. And we must work together to balance the budget, yet still meet our other national priorities, such as healthcare and education.

We must take care of the "Help Wanted" signs that are already up. I believe there are five critical ways in which we should improve the President's budget.

First, we must address the deficit. Deficits matter. Higher deficits mean mortgages and car loans will be more expensive. Businesses cut back on their investments. And the future standard of living for our children and grandchildren will be lower.

Mr. Secretary, you have written about how important it is for the Federal government to have a balanced budget. Yet the President's budget does not come close to being balanced. For this fiscal year, the President proposes a deficit of $304 billion. This is the highest deficit we have ever faced. And for the next fiscal year, the President proposes an even larger deficit of $307 billion. Over the next ten years, the President's budget would add deficits of more than $2.0 trillion.

But that is not the end of the story. The $2.0 trillion deficit comes with $600 billion in additional costs. The interest costs and the cost to fix the alternative minimum tax must be added in. That puts the total cost of the President's budget at $2.6 trillion, an enormous amount. Even for Washington. The publicly-held debt would increase by the same amount. And this does not include the financial cost of war. This looks a lot like a scheme out of the 1980s play book, but worse. These enormous additions to the debt would be enough of a problem during better fiscal times. But this increase in debt would hit just when the baby boom generation begins to retire. This adds even more stress on the federal budget. We must do better. We must be fiscally responsible.

Second, we must do more for the states. In the current economic downturn, states will have to cut spending, lay-off workers, and increase taxes. In turn, businesses and households cut spending. These actions make the economy worse. We need to sop this economic downward spiral with one-time grants to the states. I support federal tax cuts. But with our current economy, these cuts alone, without state relief, are less effective.

The President has proposed to help states by turning Medicaid into a block grant program. The plan is billed as "state fiscal relief," "reform," and "flexibility" all in one. But if you read the fine print, and I would urge all of my colleagues to do so, the proposal is actually budget neutral. The real goal here is to eliminate health benefits for low-income and disabled Americans.

A third improvement is to provide a tax cut that benefits all taxpayers. Fifty percent of all individual federal tax revenue is from income taxes and forty-one percent is from payroll taxes. Simply that, it is unfair to play favorites. Taxes are taxes, whether someone pays income taxes or payroll taxes.

The President's plan accelerates many of the tax cuts that were enacted in 2001. Some of these tax cuts should be accelerated. But we should not leave out acceleration of marriage penalty relief for earned income tax credit recipients and the refundable portion of the child tax credit.

We should also add the elimination of the income tax on the first $3,000 of wages for all wage earners. That tax cut, added to a $75 billion one-time grant to the states and other stimulus proposals provides $160 billion of stimulus this year. The President's economic plan provides only $39 billion.

I believe these ideas provide an immediate stimulus so we can start to bring down those "Help Wanted" signs that are already up.

Mr. Secretary, my last two improvements to the President's plan focus on Medicare and international trade. During last week's confirmation hearing, I expressed concern about the President's Medicare prescription drug proposals. The President has proposed a drug benefit, but only for those beneficiaries who choose a private plan.

The President and his advisors have likened their plan to the Federal Employees Health Benefit program, where enrollees have a choice of private health plans and a handful of them are available on a national basis. I find this analogy overly simplistic and disingenuous. The Administration is comparing apples to oranges. Federal employees and retirees in the F-E-H-B program are much different from Medicare beneficiaries. Seniors have higher health care costs. They are older and have more chronic illnesses.

I do not share the Administration's optimism that Medicare beneficiaries, especially our most vulnerable, would be well-served by private insurance plans. I hope the President significantly modifies his prescription drug proposal so that all Medicare beneficiaries are treated fairly.

My final improvement for the President's plan deals with international trade. Normally, international trade is one area of the Finance Committee's jurisdiction that does not figure prominently in the budget battle. But this year is different.

To my surprise, the Administration has included a recommendation to repeal the Continued Dumping and Subsidy Offset Act. Also known as the Byrd Amendment, for my distinguished colleague from West Virginia. The Byrd Amendment is good, common-sense trade policy. It simply says that the duties collected on unfairly traded imports should be redistributed to the companies and workers injured by those imports. In my state of Montana, it has helped softwood lumber companies who have been devastated by Canadian subsidies.

The authors of the Byrd Amendment—Senators Byrd and DeWine—are right to oppose this provision of the budget. I stand with them. And so does a majority of the Senate. In fact, more than two-thirds of the Senate sent a letter to the Administration in support of the Byrd Amendment. The effort to repeal the Byrd Amendment is bad policy. And it certainly does not belong in the budget.

Mr. Secretary, there are many challenges ahead. And tackling them will not be easy. There is a lot of uncertainty and anxiety across our nation—about the prospect of war, the lack of affordable healthcare, the high unemployment rates, and the state of our economy. I know that I've raised a lot of concerns. But these are real concerns. Senator Grassley and I work closely together to find common approaches to our nation's problems. Members of the Finance Committee know how to pull up our shirt-sleeves to reach agreement. Now, more than ever, we must continue that tradition.

I want to work with you and the President to provide relief to the states, help all taxpayers, actually reduce the deficits after the first year, provide meaningful prescription drug coverage for our seniors and defend our nation's trade laws. I look forward to hearing from you today regarding the President's budget.

United States Senate
WASHINGTON, DC 20510

February 4, 2003

The Honorable George W. Bush
President of the United States
1600 Pennsylvania Avenue, N.W.
Washington, D.C. 20500

Dear Mr. President:

We write to express our strong interest regarding the approach that may be taken by the U.S. Government in response to the WTO Appellate Body's January 16, 2003, ruling that the United States violated its WTO obligations when it enacted the Continued Dumping and Subsidy Offset Act (CDSOA) in 2000. In our view, the WTO has acted beyond the scope of its mandate by finding violations where none exists and where no obligations were negotiated.

CDSOA is a payment program established by Congress to address policy objectives that can enable our domestic producers to continue to invest in their facilities and workers. Its continued operation is critical to preserve jobs that will otherwise be lost as the result of illegal dumping or unfair subsidies and to maintain the competitiveness of American industry.

In its November 2002 statement to the Appellate Body defending this law, the Administration stated that, "[T]he Panel in this case has created obligations that do not exist in the WTO Agreements cited. The errors committed are serious and many about a statute which, in the end, creates a payment program that is not challenged as a subsidy." We concur with this statement and consequently believe that America's trading partners must be pressed into negotiations on CDSOA prior to any attempt to change our laws.

Specifically, we urge you to: (1) seek express recognition of the existing right of WTO Members to distribute monies collected from antidumping and countervailing duties; (2) promptly integrate the Administration's response to this WTO decision into the strategy announced in the Administration's recent Report to Congress on the WTO Dispute Settlement Process; and (3) consult closely with the Congress on the particulars of any approach taken in negotiations on this issue.

We look forward to consultations with your Administration on this important matter and to obtaining a positive resolution that preserves the law for American companies and their workers.

Sincerely,

Dianne Feinstein

[illegible]

Blanche L. Lincoln

John Edwards

[illegible]

Fritz Hollings

[illegible]

Hillary Rodham Clinton

[illegible]

[illegible]

[illegible]

Saxby Chambliss

Susan Collins

[illegible]

[illegible]

[illegible]

Craig Thomas

[illegible]

[illegible]

Richard Shelby

Patrick Leahy | Carl Levin

Jim Jeffords | Barbara Boxer

Herb Kohl | Bill Nelson

Tom Carper

PREPARED STATEMENT OF HON. JIM BUNNING

Thank you, Mr. Chairman.

Welcome to the committee today Secretary Snow Today is the first of what I am sure will be many appearances before this committee representing the Treasury Department.

I look forward to a meaningful discussion of the tax provisions contained in the president's budget proposal.

I look forward to a meaningful discussion of the tax provisions contained in the president's budget proposal.

I would like to express my appreciation to the administration for taking a strong leadership role in the proposed FY03 budget with regard to this goal of getting our economy back on track. The president's proposed tax plan will result in over one million Kentucky taxpayers facing smaller tax bills in 2003—including almost one-half million married couples that will benefit from the acceleration of the scheduled reduction of the marriage penalty to this year.

I am especially interested in learning more about the savings plans that were proposed in yesterday's budget. The concept of simplification of retirement savings plans is intriguing and I look forward to discussing those proposals in more detail today.

I have a number of questions and I am looking forward to hearing your responses.

Thank you.

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United States Senate

WASHINGTON, DC 20510

COMMITTEES:
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SPECIAL COMMITTEE ON AGING

January 28, 2003

Senator Charles Grassley, Chairman
Senate Finance Committee
Dirksen Senate Office Building, Room 219
Washington, D.C. 20510

Dear Chairman Grassley,

Below please find a restatement of a question I asked in today's hearing on the nomination of John Snow to be Secretary of the Treasury. I have also included several other questions I wish to have answered before we vote on Mr. Snow's nomination.

1. Under the watchful eye of this Committee, the Treasury Department is reviewing the taxation of so-called "split-dollar" life insurance arrangements. As you know these products do provide a useful tool for business, but there are abuses.

   Have you ever owned an interest in a split-dollar life insurance arrangement and if so, do you still own an interest in the policy. Have you conducted a "SWAP" or "rollout" of the policy, taken a loan against such a policy, and have you, to date, paid taxes on any of the life insurance benefits provided by your company without being "grossed up?"

2. I have read the recent reports in the press about the administration's desire to privatize Medicare, and I am concerned. The administration has said that their goal of privatizing Medicare is to control the costs of the program by increasing efficiency. However, studies by the Inspector General of HHS, the GAO, and MedPAC have indicated that private plans have actually been less efficient than traditional Medicare. Given these findings, how much does the administration expect to save through market-based reforms? Will the real "savings" come from shifting more costs to beneficiaries?

3. There have been reports in the press that the President's Medicare reform proposal will force seniors to enroll in a private managed care program if they want to have prescription drug coverage. Consequently, seniors who remain in the traditional, fee-for-service Medicare program will not have drug coverage. Last year, there was bipartisan consensus that all Medicare beneficiaries get prescription drug coverage, including those in traditional Medicare. Why would the President prevent the seniors in traditional Medicare from getting drug coverage?

4. I am also concerned that the President's Medicare reform proposal would cause the federal government to pay much higher prices than every other federal program does for prescription drugs. Under the President's plan, HMOs and private insurance plans would be negotiating

the price the federal government pays. However, under federal law, HMOs can't negotiate prices that are lower than the Medicaid "best price." But currently, the federal government always pays a price that is much lower than the Medicaid "best price": such as 340B hospitals and the Veterans Administration.

Why would we want the federal government under Medicare to pay higher prices than every other federal program does for the exact same drugs?

5. As you know, Social Security taxes are only paid on the first $87,000 of income. This money goes into the Social Security trust fund and, if we are in a deficit situation, it is subsequently borrowed.

   In 2016 when the Social Security Trust fund runs out of money we have no assurances that cuts in the program won't be used to pay for the short fall.

   So my questions are:

   - If we borrow from people paying into Social Security now and then make those same people pay back the debt to Social Security with benefit cuts, isn't that a double tax?

   - Shouldn't people who are paying into the Social Security trust fund receive the benefit of tax cuts which are paid for by borrowing from Social Security? Isn't it their benefits that are on the line?

   - Considering interest, is a tax cut enacted while we are in a deficit situation tantamount to a tax increase?

Thank you in advance for forwarding these questions to nominee Snow. I look forward to working with you and your staff to continuing moving this process forward for Mr. Snow and our Senate colleagues.

Sincerely,

Blanche L. Lincoln

Blanche L. Lincoln

BLL/mc

SPLIT DOLLAR LIFE INSURANCE POLICY

On July 11, 2001 the Board of Directors approved, and the Company entered into, an employment agreement with John Snow. The agreement specified that the Company would provide Mr. Snow with a fully paid split-dollar life insurance policy with a death benefit of $25,000,000.

Changes in tax regulations enacted after the approval of the employment agreement eliminated favorable tax treatment that had previously been available for such policies. In addition, with the passage of Sarbanes-Oxley, the loan-type features of the product effectively prohibited its use for executive officers. As a result, CSX never purchased a split dollar life insurance policy for Mr. Snow. Instead, the company investigated providing an alternative insurance product to fulfill its obligations under the employment agreement. Ultimately, CSX decided to purchase a universal life policy of $25,000,000 for Mr. Snow in lieu of the split-dollar policy. CSX is providing Mr. Snow with a lump sum payment to cover the costs of the premiums and gross-up associated with his purchase of the universal life insurance policy.

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Responses to Senator Lincoln

Questions 2, 3, and 4

Senator Lincoln I understand your concern regarding the Medicare program and reports you have read. As I said in the hearing, while Secretary of HHS, Tommy Thompson is the Administration's point person on the Medicare issue, if confirmed, I will become a trustee of the program and will take a keen interest in fulfilling those duties.

Your concern over efficiency in the Medicare system providing, prescription drug coverage for seniors and obtaining the best price for Medicare purchases will all be important issues to focus on as we go forward in examining the Medicare program.

Obviously as a private citizen, I have not been involved in the formulation of the Administration's Medicare plans, nor am I privy to what will the President's budget will contain regarding Medicare. However, I look forward to getting involved in Medicare, to working with you regarding the important issues you raise, and to meeting with you in order to fully address your concerns.

Question #5 - Social Security

Under the assumptions in the 2002 report of the Social Security Trustees, Social Security would begin to experience annual cash deficits in 2017. At that time, the Social Security Trust Fund would show a substantial positive balance, consisting of debt instruments issued to the Social Security Trust Fund from the general fund. Under current projections, the government would be obligated to redeem debt held by the Social Security Trust Fund from 2017 through 2041. The revenue source for redeeming debt held by the Social Security Trust Fund is the revenue base for general government revenues, as opposed to Social Security's payroll tax base.

Your question specifically asks about the effects of benefit cuts employed to lessen the fiscal pressures associated with annual programmatic deficits in Social Security. While there are a variety of proposals in existence for strengthening Social Security, each of them assumes that the federal government would continue to fully honor debt issued to the Social Security Trust Fund, as has been done in the past, and would commit the revenues necessary to do so even during periods of programmatic cash deficits.

The larger policy question facing the Congress pertains to the extent to which it is practicable to fund Social Security benefits solely through the issuance of large amounts of debt to the Social Security Trust Fund that must later be redeemed. Many proposals have been offered to establish a more effective means of advance funding future benefits, such as the establishment of personal accounts, designed to lessen the degree to which future benefits are staked on the government's ability to cope with large programmatic cash deficits.

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United States Senate

WASHINGTON, DC 20510

COMMITTEES:
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FINANCE
SELECT COMMITTEE ON ETHICS
SPECIAL COMMITTEE ON AGING

January 28, 2003

Senator Charles Grassley, Chairman
Senate Finance Committee
Dirksen Senate Office Building, Room 219
Washington, D.C. 20510

Dear Chairman Grassley,

I have received responses from representatives of Treasury Secretary nominee Snow to the five questions that I submitted to you after yesterday's hearing. The answers to questions one through four, while skeletal, are adequate for the record in my opinion. The response to my fifth question, however, is unresponsive. Therefore, I am respectfully resubmitting the three parts of my question in the hope that I can receive a more complete answer before the Finance Committee votes on Mr. Snow's nomination.

1) If we borrow from people paying into Social Security now and then make those same people pay back the debt to Social Security with benefit cuts, isn't that a double tax?

2) Shouldn't people who are paying into the Social Security trust fund receive the benefit of tax cuts which are paid for by borrowing from Social Security? Isn't it their benefits that are on the line?

3) Considering interest, is a tax cut enacted while we are in a deficit situation tantamount to a tax increase?

I appreciate your help and patience, and thank you in advance for resubmitting my question to nominee Snow.

Sincerely,

Blanche L. Lincoln

Blanche L. Lincoln

BLL/mc

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Responses to Follow up Questions 1, 2, and 3 from Senator Lincoln

1. It is important to understand that every penny of every dollar of Social Security payroll tax revenues - whether surplus or not - is credited to the Social Security trust fund and invested in special Treasury securities, where it accrues interest. No funds so deposited to the Social Security trust fund are available to pay anything other than Social Security benefits. Therefore, neither income tax cuts or increases nor on-budget spending increases or decreases outside of Social Security have any impact whatsoever on the balances in the Social Security Trust Funds.

2. As mentioned above, there is no impact on Social Security trust fund balances from either tax cuts or increases or spending increases or decreases outside the program. As a result, the Trust Fund balances are in no way affected - either today or tomorrow - by other operations of the federal government outside the Social Security program. However, Social Security recipients, like all Americans, will receive the benefit of a stronger economy from the President's economic growth package than would occur in its absence. In that regard, they and the nation as a whole will benefit from the President's economic growth package, and it will put the nation on a stronger footing to meet it's long term obligations.

3. The interest expense associated with general revenue reductions in the jobs and growth package are orders of magnitude smaller than the estimated amount of the revenue lost. Because federal borrowing is not generally earmarked for any specific purpose, this allows the federal government to finance it's operation at the least cost to the taxpayer. The purpose of the jobs and growth package is to enable the U.S. economy to perform on a higher level consistent with its potential, thereby leading to higher economic growth and federal revenues. This was the stated purpose behind President Kennedy's program in 1962. As Senator Snowe noted from a recent business week article, an economy that grows at 4 percent for 30 years will grow 33 percent bigger than one that grows at 3 percent, which can amount to an $8 Trillion difference in today's dollars. With respect to the jobs and growth plan, the level of deficits and associated debt service will remain well within historical norms, and shrink over time.

PREPARED STATEMENT OF HON. JOHN W. SNOW

Chairman Grassley, Ranking Member Baucus, and distinguished members of the Finance committee, before I begin my testimony today I would like to thank you for the trust you expressed in me last week by reporting out my nomination to be Secretary of the Treasury. I intend to do my utmost to live up to the tremendous responsibility you and the President have given to me.

I welcome the opportunity to appear before you today to discuss the President's budget for fiscal year 2004. Let me begin by offering my views on the essential background for this budget: the United States economy and President Bush's economic growth plan, which promises to create jobs, accelerate America's economic recovery, and increase our growth for years to come.

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

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

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

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

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

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

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

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

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

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

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

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

(1) Fight the war against terrorist financing;

(2) Ensure that the tax system is fair for all Americans through a comprehensive compliance effort that includes high income taxpayers;

(3) Increase Treasury's efficiency and effectiveness by streamlining operations; and

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

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

RESPONSES TO QUESTIONS FROM SENATOR LINCOLN

Question: Could you provide us the numbers of the comparison between the error in the EITC and the error rate in the corporate fraud and the sophisticated shelters there, as well as the money that the law enforcement is dedicating to both of those?

Answer: Between $8.5 and $9.9 billion in EITC claims—or between 27.0 and 31.7 percent of total EITC claims—was erroneously paid to taxpayers in tax year 1999. Unfortunately, we do not have recent compliance data for other taxpayers, and this lack of information has hampered IRS's ability to appropriately target its resources in recent years. IRS's new National Research Program (NRP) will provide information needed to direct enforcement resources towards areas where noncompliance is highest. This will enhance the fairness of tax enforcement for all taxpayers. The NRP will eventually cover all types of taxpayers, including individuals, corporations, and other entities. The first phase, beginning now, covers individuals from all income classes.

During fiscal year 2003, the IRS will spend about $146 million on activities associated with the administering the EITC. Roughly two-thirds of this amount will be directed to enforcement activities, including examining returns and correcting errors detected during the processing of returns. The Administration has requested $151 million to continue these activities in 2004. But despite these efforts, EITC noncompliance is still too high. Therefore, for fiscal year 2004, the Administration has requested an additional $100 million to begin a new strategy for improving the EITC program. As part of this strategy, IRS plans to ask some taxpayers for additional information about their relationship and residency with the children claimed for purposes of the EITC. Taxpayers would be encouraged to provide reliable documentation before they file their returns, so that the need for audits after returns are filed would decline. IRS plans to use existing data to limit the number of taxpayers who might be subject to the new certification requirements. The goal of the new program is to reduce EITC errors without needlessly burdening eligible taxpayers, and without sacrificing the key goals of reducing poverty and rewarding work.

Also during fiscal year 2003, the IRS is expected to spend about $3.729 billion for tax law enforcement activities not associated with the EITC, including the examination of returns filed by higher-income taxpayers and corporations. (This amount does not include the correction of mathematical and clerical errors or certain other compliance-related activities that occur before or during returns processing.) The Administration's fiscal year 2004 budget proposal includes $110 million of new funding for these activities, largely to increase the number of examinations of high-income taxpayers and businesses in areas where the risk of noncompliance is greatest. In addition, the Administration's budget request includes $23 million for processing and other activities including resources to war taxpayers of abusive tax schemes, for a total compliance initiative of $133 million. The IRS is also working to redirect existing resources to areas of the highest noncompliance risk. With new and re-targeted resources, we expect the number of examinations of high-income taxpayers to increase substantially over the next few years.

RESPONSES TO QUESTIONS FROM SENATOR BAUCUS

Questions: Essentially, if we are going to phase out or eliminate double taxation of dividends, what about other taxes? Basically rhetorically, and I want to have you answer in great detail, is why not eliminate those other double taxations? Those people get hit pretty hard, frankly.

Answers: It is true that various sources and uses of income can be subject to more than one tax. However, dividends are double taxed under a single tax, the income tax.

More importantly, the marginal income tax rate on dividends can be extremely high, reaching as high as 60 percent under current law. It is marginal tax rates that affect incentives, so to improve long-run incentives and growth, we should reduce the highest marginal rates. By accelerating the reduction in regular income tax rates, the President's Jobs and Growth Package will further reduce marginal tax rates and improve incentives.

Social security taxes generally do not represent double taxation, but rather a contribution toward future retirement and health benefits. The retirement benefits that a current worker will receive in retirement are based on the contributions that the worker makes today. In addition, the formula for taxation of Social Security benefits takes into account the income taxation of the employee portion of social security contributions. Medicare benefits are not subject to income tax at all.

High marginal "tax" rates that arise in expenditure programs because of phase outs reduce economic incentives and should be addressed, but this has to be done through reforms of the expenditure programs, not through tax changes.

In many cases, state and local taxes are linked to benefits provided by expenditures, so the size of net burdens and "double" taxation may be quite small. Further, the federal government obviously cannot eliminate double taxation that arises from state and local taxes, and to the extent these taxes are benefit taxes or quasi-user fees, it would be undesirable to do so in any event.

Question: The other point is, as I said, I was not totally accurate, but I was basically accurate. This chart here—and you have the reference so you can get the information yourself—basically says, taking all types of government taxes into consideration, the tax burden as a percentage of pre-tax income is roughly the same for all income groups.

For the bottom income group, the average pre-tax income is roughly $8,000. Total government tax receipts is roughly $1,500. As a percentage of income, that is 18 percent. It is basically the same for the other quintiles, 20 percent, 20 percent, 20 percent, and 20 percent.

Now, government receipts here include—I misspoke, but I will tell you what it said here—federal and State income taxes, an employee's share of Social Security contributions, not the employer's, property taxes, utility taxes, federal and State tobacco taxes, federal and State alcohol taxes, federal and State gasoline taxes, and State sales taxes.

There are a couple that it does not include. They do not include Medicaid. think there are other provisions they do not include. But basically I think the point is well taken. If we are honest with ourselves, Americans pay about the same amount of taxes regardless of their income, total taxes. Would you agree?

Answer: No, the information presented in the *New York Times* article is based on questionable income data. According to the Joint Committee on Taxation, higher income families pay a much higher percentage of their income in federal taxes than lower income families. Even excluding the effects of corporate income taxes and estate and gift taxes, both of which fall heavily on higher income taxpayers, the JCT finds that returns with less than $30,000 of income pay less than 10 percent of their income in federal tax while returns with over $100,000 of income pay more than 25 percent of their income in federal tax.

The President's Jobs and Growth Package will reduce taxes for families at all income level, with the largest percentage reductions going to lower income families. Families with income of less than $30,000 would receive larger refunds under the President's proposal, and families with income over $100,000 will pay an even larger share of the tax bill under the President's proposal than they do under current law.

RESPONSE TO A QUESTION FROM SENATOR THOMAS

Question: We have talked about broad issues. Some of the smaller ones. I would like to focus on a smaller one and get your reaction. I am talking about AML, abandoned mine lands, which is in the President's budget, to extend that.

Title V of the Surface Mining Control, SMCRA, establishes this reclamation fund and financed 35 cents—and your railroad, I think, has carried a bunch of that, coal—on surface mines, and so on. It was set up in 1992. It has been expanded twice.

Fifty percent of the money goes into the fund for the Federal Government to distribute to Mine Reclamation, 50 percent, by law, is supposed to be paid back to the States. That has not happened.

This fund is Treasury's AML fund. Several States have been paying into the fund and not getting their money back. Wyoming, for example, has paid in nearly $1.5 billion. We are now owed $355 million. As a matter of fact, all of the States together is $944 million out of this account that has not been paid.

I guess my question is, this budget specifically extends that. That means almost $3 billion worth of revenues paid in by the States, and they are not getting back the share that they are authorized to get back.

It is supposed to be reauthorized by the Congress this year. Some say we should not reauthorize it. The reclamation has generally been completed. So, I would like to ask what your reaction is to that, and why it is in the budget as it is.

Answer: Section 402(a) of the Surface Mining Control and Reclamation Act (SMCRA) establishes a per tonnage fee for mined coal. These fees are placed in the

Abandoned Mine Reclamation Fund, and are used to finance reclamation of abandoned coalmine lands in the United States. Interest accrues on the unused portion of the collected fees and becomes part of the fund. A portion of the interest is transferred to the United Mine Workers of American Combined Benefit Fund to finance the federal contribution of the health benefits of retired miners and their dependents. The authority to collect the mine reclamation fee expires on September 30, 2004.

It is estimated that there are $3 billion of health and safety problems remaining to be addressed in some parts of the country. The current Abandoned Mine Reclamation Fund balance is about $1.5 billion. The Administration plans to propose an extension of the fee authority to address the remaining health and safety problems. Additionally, the Department of the Interior, the department that administers the reclamation program, will explore options for amending SMCRA to allow more receipts to be targeted to the abandoned mine problems, increasing the pace of the overall reclamation program.