United States Senate
Committee on Finance

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Statement of Senator Chuck Grassley
Finance Committee Hearing on Administration's Budget: Revenue Proposals
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Today, we focus on the revenue side of the budget. It is almost entirely in this committee's jurisdiction. There seems to be a common refrain from some on the other side that those on our side cannot criticize the future record deficits and debt that the President's budget will produce. The premise of that position is that the last Administration produced similar deficits. Moreover, the common refrain goes, the current Administration and, implicitly, the Democratic Leadership in the Congress, had no hand in creating the current fiscal situation.

It is true that President Obama inherited a big deficit. We on this side don't dispute it. But, to say it was bequeathed solely by those on our side is misleading. Here is a chart. This chart shows the relative level of deficits of the past 8 years. The chart shows the effects of the economy that the last Administration inherited here. The flat investment pattern of 2000, the tech bubble bursting in 2000-2001, the corporate scandals of 2001, and the economic shock of the terrorist attacks of 9-11 all occurred at the start of the last Administration. They contributed to the sharp downturn in the fiscal situation. When the bipartisan tax relief kicked in, the deficits came down. Here it is in the period of 2004-2007. In 2007, we entered a period of divided government. The Democratic Leadership assumed control of the Congress. Unless I'm missing something, all of the fiscal policy in the period of 2007 and 2008 was the product of a Democratic Congress and a Republican President. A Democratic Congress made that policy bequest, and resulting deficit and debt, to President Obama. And a Republican Administration joined in that bequest. So, President Obama inherited the deficit and debt, and it's large, but the bequest was bipartisan. And Mr. Secretary, as the head of the New York Branch of the Federal Reserve, you were a key player in creating the Troubled Asset Relief Program. A good chunk of the big deficit and debt is attributable to that policy. I point this out to set the record straight, so that we can constructively tackle the large fiscal problems we confront together.

Now, I'd like to turn to today's hearing topic. A little over four years ago, at this same annual hearing, I criticized the last Administration, in one important respect, for a lack of transparency in its budget. The criticism arose from the Administration's failure to include an extension of the Alternative Minimum Tax ("AMT") patch in the budget. It was toward the end of the hearing and Senator Wyden was waiting his turn for his final round of questions. That exchange with Secretary John Snow led to bipartisan efforts to repeal the AMT.

In 2007, when control of the Congress shifted to my friends on the other side, I likewise criticized them for not including an un-offset AMT patch in their budget. In addition, I pressed them to include extensions of the popular tax relief provisions this committee developed in 2001 and 2003.

Both the last Administration and the Leadership on the other side adjusted their budgets to account for AMT relief and to deal with the broad-based expiring tax provisions.

In neither case was all of the tax relief fully accounted for. In neither case was the revenue side of the budget fully transparent.

President Obama's budget breaks new ground in terms of transparency. That is a good thing. The budget reflects extension of the AMT patch, although it needs to be fixed to fully hold middle-income families harmless. President Obama's budget, like Republican Administration and Congressional budgets, includes extension of the bipartisan tax relief packages of 2001 and 2003. Unlike those budgets, however, this budget repeals that tax relief for major categories of taxpayers.

On principle, President Obama's budget agrees with the basic point many of us on this side have been making for several years. That is, failure to extend current law tax relief is a tax increase. Getting the discussion on this level, which focuses on the merits of existing tax policy, is an improvement in the debate.

For far too long, two years to be exact, we operated in an environment where the fiscal effects of extending current law tax policy and spending policy were subject to entirely different levels of scrutiny. Expiring entitlement spending was not accounted for. Increases in appropriations spending over the baseline were not accounted for. But every dollar of current law tax relief was treated as the sole cause of deficits. Common sense would tell you that, for budget purposes, a dollar of increased spending should be treated in the same way as a dollar of tax relief.

So, I want to thank my President, President Obama, for bringing more transparency to the revenue baseline. It will enable those of us on Capitol Hill to more accurately discuss the tax policy changes as policy changes.

Turning to those changes, I want to start off with the good news. I am pleased that the President recognizes the importance of some economic growth incentives. Last year, many on our side applauded then-Senator Obama's proposal for a zero capital gains rate for small business and start-up ventures. For reasons I don't understand, the Democratic Leadership resisted the proposal even though Senators Kerry and Snowe introduced it. Why, in a $787 billion bill, we couldn't err on the side of an aggressive capital formation incentive is beyond me. President Obama planted the flag for this incentive once again. He'll continue to get support from our side on it.

I mentioned the good news on the AMT patch. I'm pleased that much of the 2001 and 2003 tax relief is made permanent in the budget. The first bit of bad news is that those bipartisan packages are not extended in full. These are bad signals to send to workers, small business owners, and investors. I have to wonder if these signals were helpful in the current economic environment.

The second bit of bad news is that there is a new hidden marginal rate increase embedded in the budget. It is a proposal to place a ceiling of 28 percent on deductions for mortgage interest, charities, and state and local taxes. Let's review the bidding on the top two rates. The budget returns to the Clinton-era 36 percent and 39.6 percent brackets. In addition, the hidden marginal rate hikes, known as "PEPS" and "PEASE," return. The combination of all these changes will push the top two rates to their highest level in a generation.

These marginal rate hikes are particularly punitive to America's small businesses. Over half of the owners of small businesses that employ between 20 and 500 employees are owned and operated by taxpayers that are targeted for these heavy marginal rate increases. Over half, Mr. Secretary. Small businesses employ over half the private sector workers in America. Two-thirds of small business workers are employed by firms with between 20 and 500 employees. Those larger small businesses are also the businesses most likely to expand or contract depending on business conditions. Check the latest Small Business Administration data. It will tell you small businesses created all the net new jobs in this country in 2004, the most recent year for which firm size data are available,

A materially higher tax rate, will, whether the other side wants to admit it or not, affect the ability of those businesses to expand. It reduces after-tax cash-flow. It reduces the after-tax rate of return from the business activity. Expansion means more workers. Contraction means fewer workers.

So, I'd challenge anybody to tell me how raising the 33 percent bracket for a small business to as high as 40 percent will positively affect that business. I'd challenge anybody to tell me how raising the 35 percent bracket for a small business to as high as 42 percent will positively affect that business. Mr. Secretary, I believe the President and all of us want to grow private sector jobs. It's hard to see how this dramatic tax increase, which zeroes in on those dynamic job-creating small businesses, will grow the private sector job base. In fact, private sector job loss seems a more likely outcome.

Mr. Chairman, last year, we had a very informative hearing on the financial effects of cap and trade proposals. Then-Congressional Budget Office ("CBO") director, Peter Orszag, testified that cap and trade proposals are basically taxes. The budget reflects that view in how the cap and trade proposal is treated. We need to take a very close look at this proposal, particularly the tax burden it would place on American consumers, workers, and businesses. Furthermore, we need to know the actual amount of revenue the Administration expects to raise under this proposal. The President's budget hints that it raises more revenue than the $646 billion that is listed in the budget.

Finally, Mr. Secretary, there is a heavy business tax increase in this budget. We need to have a dialogue about all of these proposals. I'm proud of all the Finance Committee loophole-closing proposals Chairman Baucus and I have developed since 2001, some $200 billion in all. But we need to be careful to separate loophole closers from generic tax increases on business. One proposal in this budget, dealing with treatment of overseas business income, could put American companies at a competitive disadvantage. Tax increases that ultimately result in American companies shedding American jobs are not the right way to go.

Mr. Chairman, we have an even bigger fiscal crisis coming. The baby boom generation will be retiring in big numbers in the next decade. That is an entitlement problem. It is not derived from the current or future state of the Federal revenue base. Under this budget, the revenue base is set at above the historic average as a percentage of the economy.

Unless the predilection of a particular member is to solve the entitlement problem solely with record levels of Federal taxation, we need to deal with runaway entitlement spending. I don't see that 800 pound fiscal gorilla dealt with in this budget. That's a larger discussion and I'm pleased the President is opening a dialogue on it. We can have it, but we ought to be transparent about it.

Mr. Secretary, in normal times, your job is important. In these abnormal times, that importance is exponentially greater. I look forward to your testimony.

(Chart attached).

Deficit or Surplus2.pdf