HEARINGS BEFORE THE

COMMITTEE ON WAYS AND MEANS
(Volume 1 of 5)

104th Congress
1995-1996

	Tab No.
Contract With American-Overview	1
Tax Provisions in the Contract With America Designed to Strengthen the American Family	2

AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

HEARINGS BEFORE THE

COMMITTEE ON WAYS AND MEANS
(Volume 2 of 5)

104th Congress
1995-1996

	Tab No.
Contract With America-Savings and Investment	3
President's Fiscal Year 1996 Budget	4
Report of the Trustees of the Federal Hospital Insurance Trust Fund	5
Replacing the Federal Income Tax	6

HEARINGS BEFORE THE

COMMITTEE ON WAYS AND MEANS
(Volume 3 of 5)

104th Congress
1995-1996

	Tab No.
Miscellaneous Tax Reforms	7

HEARINGS BEFORE THE

COMMITTEE ON WAYS AND MEANS
(Volume 4 of 5)

104th Congress
1995-1996

	Tab No.
Saving Medicare	8
Thrift Bad Debt Recapture	9
Financial Condition of the Federal Hospital Insurance Trust Fund	10
Replacing the Federal Income Tax-Volume II	11

HEARINGS AND WRITTEN COMMENTS BEFORE THE

COMMITTEE ON WAYS AND MEANS
(Volume 5 of 5)

104th Congress
1995-1996

	Tab No.
Replacing the Federal Income Tax-Volume III	12
Examining the Impact of the 1993 Tax Increase on Transportation Fuels	13
Financial Condition of the Medicare Program	14
Replacing the Federal Income Tax-Volume IV	15
Written Comments on New Revenue Provisions in the President's Fiscal Year 1997 Budget	16

CONTRACT WITH AMERICA—OVERVIEW

HEARINGS

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JANUARY 5, 10, 11, AND 12, 1995

Serial 104–20

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

92–037 CC WASHINGTON : 1995

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-052057-6

COMMITTEE ON WAYS AND MEANS

BILL ARCHER, Texas, *Chairman*

PHILIP M. CRANE, Illinois
BILL THOMAS, California
E. CLAY SHAW, JR., Florida
NANCY L. JOHNSON, Connecticut
JIM BUNNING, Kentucky
AMO HOUGHTON, New York
WALLY HERGER, California
JIM McCRERY, Louisiana
MEL HANCOCK, Missouri
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
DICK ZIMMER, New Jersey
JIM NUSSLE, Iowa
SAM JOHNSON, Texas
JENNIFER DUNN, Washington
MAC COLLINS, Georgia
ROB PORTMAN, Ohio
PHILIP S. ENGLISH, Pennsylvania
JOHN ENSIGN, Nevada
JON CHRISTENSEN, Nebraska

SAM M. GIBBONS, Florida
CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
ANDY JACOBS, JR., Indiana
HAROLD E. FORD, Tennessee
ROBERT T. MATSUI, California
BARBARA B. KENNELLY, Connecticut
WILLIAM J. COYNE, Pennsylvania
SANDER M. LEVIN, Michigan
BENJAMIN L. CARDIN, Maryland
JIM McDERMOTT, Washington
GERALD D. KLECZKA, Wisconsin
JOHN LEWIS, Georgia
L.F. PAYNE, Virginia
RICHARD E. NEAL, Massachusetts

PHILLIP D. MOSELEY, *Chief of Staff*
JANICE MAYS, *Minority Chief Counsel*

CONTENTS

Page

Press releases announcing the hearing 2

WITNESSES

U.S. Department of Health and Human Services, Hon. Donna E. Shalala, Secretary 58
U.S. Department of the Treasury, Hon. Leslie B. Samuels, Assistant Secretary for Tax Policy 251

American Enterprise Institute, Michael Novak 360
American Federation of Labor and Congress of Industrial Organizations, Sheldon Friedman 706
Anderson, Eloise, California Department of Social Services 653
Ball, Carol L., U.S. Chamber of Commerce 686
Beckner, Paul, Citizens for a Sound Economy Foundation 442
Boskin, Hon. Michael J., Stanford University, Stanford, Calif 362
Bosworth, Barry P., Brookings Institution 383
California Department of Social Services, Eloise Anderson 653
Center on Budget and Policy Priorities, Iris Lav 463
Citizens for a Sound Economy Foundation, Paul Beckner 442
Dean, Hon. Howard, M.D., Governor, State of Vermont, and National Governors' Association 511
Filner, Hon. Bob, a Representative in Congress from the State of California 196
Foley, Hon. Mark, a Representative in Congress from the State of Florida 226
Foster, J.D., Tax Foundation 453
Franks, Hon. Bob, a Representative in Congress from the State of New Jersey 197
Friedman, Sheldon, American Federation of Labor and Congress of Industrial Organizations 706
Gephardt, Hon. Richard A., a Representative in Congress from the State of Missouri, and House Democratic Leader 34
Gingrich, Hon. Newt, a Representative in Congress from the State of Georgia, and Speaker of the House of Representatives 11
Goldsmith, Hon. Stephen, Mayor, City of Indianapolis, Ind 624
Goss, Hon. Porter J., a Representative in Congress from the State of Florida 171
Huard, Paul R., National Association of Manufacturers 702
Keating, David, National Taxpayers Union 448
Kellogg Stress Institute, Virginia Kellogg, Mitchellville, Md 325
Kennelly, Hon. Barbara B., a Representative in Congress from the State of Connecticut 125
Kettler, Dale, Chesaning, Mich 672
Klapperich, Robyn, San Anselmo, Calif 660
Largent, Hon. Steve, a Representative in Congress from the State of Oklahoma 221
Lav, Iris, Center on Budget and Policy Priorities 463
Lowey, Hon. Nita M., a Representative in Congress from the State of New York 176
McDermott, Hon. Jim, a Representative in Congress from the State of Washington 123
Meehan, Hon. Marty T., a Representative in Congress from the State of Massachusetts 198
Motley, John J., III, National Federation of Independent Business 691

Page
Moy, Perry, Plum Garden Restaurant, McHenry, Ill 659
Nadler, Hon. Jerrold, a Representative in Congress from the State of New York 170
National Association of Manufacturers, Paul R. Huard and Gil Thurm 702
National Federation of Independent Business, John J. Motley III 691
National Governors' Association, Hon. Howard Dean, M.D., Governor 511
National Taxpayers Union, David Keating 448
Norton, Hon. Eleanor Holmes, a Delegate in Congress from the District of Columbia 177
Novak, Michael, American Enterprise Institute 360
O'Beirne, Kate Walsh, Heritage Foundation 371
Pataki, Hon. George E., Governor, State of New York 499
Pelosi, Hon. Nancy, a Representative in Congress from the State of California 132
Plum Garden Restaurant, Perry Moy, McHenry, Ill 659
Rendell, Hon. Edward G., Mayor, City of Philadelphia, Pa 632
Roukema, Hon. Marge, a Representative in Congress from the State of New Jersey 205
Sanders, Hon. Bernard, a Representative in Congress from the State of Vermont 192
Semler, Barbara, Richmond, Ky 317
Semler, Philip M., Richmond, Ky 315
Smith, Hon. Nick, a Representative in Congress from the State of Michigan ... 216
Souder, Hon. Mark E., a Representative in Congress from the State of Indiana 230
Tax Foundation, J.D. Foster 453
Thurm, Gil, National Association of Manufacturers 702
Traficant, Hon. James A., Jr., a Representative in Congress from the State of Ohio 137
U.S. Chamber of Commerce, Carol L. Ball 686
Weld, Hon. William F., Governor, Commonwealth of Massachusetts 593
Willett & Associates, Craig Willett, Provo, Utah 318
Woolsey, Hon. Lynn C., a Representative in Congress from the State of California 188

SUBMISSIONS FOR THE RECORD

Shays, Hon. Christopher, a Representative in Congress from the State of Connecticut, statement 731
Slaughter, Hon. Louise M., a Representative in Congress from the State of New York, statement 736
Small Business Council of America, Inc., Al Martin, statement 738
Solomon, Hon. Gerald B.H., a Representative in Congress from the State of New York, statement 756
Stupak, Hon. Bart, a Representative in Congress from the State of Michigan, statement 758
Young, Hon. C.W. Bill, a Representative in Congress from the State of Florida, statement 762

CONTRACT WITH AMERICA—OVERVIEW

THURSDAY, JANUARY 5, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 1:15 p.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

[The press releases announcing the hearings follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE PRESS CONTACT: Ari Fleischer
December 30, 1994 (202) 225-8933
No. 1 ALL OTHERS CONTACT: (202) 225-1721

ARCHER ANNOUNCES *CONTRACT WITH AMERICA* OVERVIEW HEARINGS

Congressman Bill Archer (R-TX), Chairman Designate of the Committee on Ways and Means, today announced a series of overview hearings on the *Contract with America*, the series of 10 bills offered by the Republicans as a national legislative agenda. The first hearing will take place on Thursday, January 5, 1995, beginning at 1:00 p.m. in the main Committee hearing room, 1100 Longworth House Office Building. On that day, the Committee will hear testimony from House Speaker-Designate Newt Gingrich (R-GA). **Three additional overview hearings will be held on Tuesday, January 10, Wednesday, January 11, and Thursday, January 12, 1995, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m. each day.**

Oral testimony at these initial hearings will be heard from invited witnesses only. Witnesses will include individuals from the general public, governors, economists, scholars and other interested organizations. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing. Additional hearings on specific elements of the *Contract with America* will be announced for additional days in January at which time the interested public may testify.

BACKGROUND:

Five of the 10 bills contained in the *Contract with America* are under the jurisdiction of the Committee on Ways and Means. They include:

The American Dream Restoration Act: Families today often spend more money on taxes than they do on food, clothing and shelter combined. Just the act of becoming a family - marriage - is penalized by a tax code that makes a couple pay more in taxes than they paid as single people dating each other. To allow families to keep more of what they make, the *Contract* provides for a $500 tax credit for each child under the age of 18 for families with adjusted gross incomes under $200,000; provides relief from the marriage tax penalty, and provides new opportunities for families through a new Individual Retirement Account, called the American Dream Savings Account.

The Job Creation and Wage Enhancement Act: To create more high-paying, upward moving jobs for Americans, this bill includes capital gains relief to stimulate savings and investment; neutral cost recovery; expensing for small business; an increase in the estate tax unified credit; and restoration of the home office deduction.

The Family Reinforcement Act: To help families come together and stay together, this bill includes a maximum $5000 refundable tax credit for adoption expenses and a credit of $500 per parent or grandparent who lives at home and is unable to perform daily living activities.

The Senior Citizens Equity Act: This bill would repeal the Clinton Administration tax increase on Social Security; increase the Social Security earnings limit; provide tax incentives for private long-term care insurance; and allow accelerated benefits under life insurance policies to aid those with terminal illness.

(MORE)

The Personal Responsibility Act: Ending the cycle of welfare dependency in the next century by revolutionizing the welfare system is essential to our growth as a nation. This bill requires welfare recipients to work; forces fathers to participate in work programs if they fail to pay child support; eliminates most welfare payments to most people who are not American citizens; limits the time people can spend on the welfare rolls; and creates a powerful disincentive so children on welfare don't have children they can't afford to raise.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written statements for the printed record of the hearing should submit at least six (6) copies of their statements by the close of business, Thursday, January 26, 1995, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. An additional supply of statements may be furnished for distribution to the press and public if supplied to the Committee Office, 1102 Longworth House Office Building, before the hearing begins.

FORMATTING REQUIREMENTS:

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

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.

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

3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

*****

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

CONGRESSMAN BILL ARCHER - CHAIRMAN

FOR IMMEDIATE RELEASE
January 4, 1995

CONTACT: Ari Fleischer
(202) 225-8933

GINGRICH TO TESTIFY TOMORROW

-OVERVIEW OF CONTRACT WITH AMERICA-

WASHINGTON - Speaker of the House Newt Gingrich (R-GA) will testify on the *Contract with America* at an overview hearing of the Committee on Ways and Means tomorrow, Thursday, January 5, 1995, at 1:00PM. The hearing will be held in room 1100 of the Longworth House Office Building.

Gingrich's testimony will follow the Committee's official organizational meeting at 11:00AM, which is open to the public. The Committee will reconvene at 1:00PM to hear the testimony of the Speaker.

-30-

Chairman ARCHER. This being the first official hearing of the Ways and Means Committee, I have a couple of housekeeping comments to make before we proceed. First, I would like to welcome and introduce all of the new members of the committee participating in their first hearing in order of their seniority on the committee, Jim Ramstad of Minnesota; Dick Zimmer of New Jersey; Jim Nussle of Iowa; Sam Johnson, Texas; Jennifer Dunn, Washington; Mac Collins of Georgia; Rob Portman of Ohio; Phil English, Pennsylvania; John Ensign of Nevada; and Jon Christensen of Nebraska.

The members of the committee should also be aware that the Speaker originally committed to be with us for 1½ hours, but we now have about 1 hour and 10 or 12 minutes left. He does have other engagements. I have one last housekeeping announcement, instead of 10 a.m. next Tuesday, the full committee will commence its hearings at 9 a.m.

This meeting today is truly historic. It is profound, and I, for one, am emotionally touched by it. It is the opportunity that I have waited and prepared for for a very long time, and it is a responsibility that I will carry out with the interest of the American worker and taxpayer as my first priority.

It is also historic to commence a hearing with the leadoff witness being the Speaker of the House of Representatives. I intend to chair this committee in as bipartisan a manner as possible. I remember very fondly my days when the committee was chaired by one of the greatest legislative craftsmen in the history of the Congress, Wilbur Mills. Much has changed since then, but collegiality, respect, and simple fairness should not change.

I hope we can again make those virtues our way of doing the people's business for it is the people, working Americans, taxpayers, to whom we all, Democrats and Republicans alike, owe our allegiance. As this committee moves forward with its agenda, an agenda for the next century, we must remember that the American people are watching. They are watching this great and historic committee with very short patience.

The people have often heard promises made from Washington that were abandoned once the elections were won. Voters were promised a smaller government that spends less, but it did not happen, and voters before were promised tax cuts for which they are still waiting.

No one knows better than you, Mr. Speaker, that this year is different. Congress is different. We are different, and because of that, America will be different. Beginning today we will take action to implement the promise, no, the Contract that we made with the American people last fall, and in the next 100 days we will cut spending and we will cut taxes, and we will revolutionize welfare to put America on a better track.

Our agenda for the next century will renew the American people's faith in Congress, their government, and most importantly in the direction of our country, and we are going to do this in a new manner. We will carry out these changes with fewer staff and less money. We have already cut this committee's staff dramatically and the spending dramatically to maintain that staff. We have cut the staff by more than one-third, and we will do more with less.

As I have always done, I will continue to fill out my own tax returns. We passed as our last act last night the placing of Congress under all of the laws that we put on other people. I personally believe it would be wise if every member of this committee prepared his or her own tax return so that we will either fix it or we will suffer with it.

I will also continue my longstanding policy of not accepting PAC money. America is a very different place today than it was when the last Republican majority controlled the House of Representatives in 1954. In 1954 the Federal Government spent $71 billion. Last year the Federal Government spent $1.5 trillion.

In 1950 the Federal Government spent $282 for each American citizen. In 1990, the Federal Government spent $5,032 per capita, and it has increased since then. In 1954 the Federal Government took $30 billion from the taxpayers through the income tax. Last year we took more than $510 billion in income taxes. In 1955 there were 409,000 words in the Internal Revenue Code. Today there are over 110,000 people working for the IRS and 1.3 million words in the Tax Code.

Those 110,000 people working for the IRS compares to only 51,000 in 1955, and in 1954 the Federal deficit was $1 billion. Last year it was $203 billion. In 1954, 5 percent of American children were born out of wedlock. In 1991, the last year on which we have any statistics, that number of all children born out of wedlock was 30 percent. In 1954 the average American city of 100,000 suffered with 175 people per year victimized by violent crime. In 1991, a city of that same size had 758 people fall victim to violent crime.

Those facts are why the Republicans made our Contract With America. The Government is too big, and it spends too much. The American people question whether the high taxes that they pay for countless social programs are doing any good. We believe our Contract With America will begin to fix those problems.

Mr. Speaker and fellow members, the next century is almost upon us. These numbers and the human lives whose sufferings and joys they chronicle remind us that a big government who taxes more and spends more does not necessarily accomplish more. Over the last 30 years government in this country has spent over $5 trillion on welfare programs, and yet the Census Bureau tells us that there are more people in poverty today after all of that money than there were when it began 30 years ago.

I believe we must stop measuring compassion by the amount of money the Government spends. We must measure compassion on how much better life becomes. Our committee, the oldest in the Congress, had its first meeting in 1789, and it has a tremendous obligation to wisely rewrite the tax laws so that we may make life better for American people.

Our obligation to the people today remains the same as it was when it began. We must ask working Americans for the least possible amount of taxes so that Government will do only those things that they cannot do for themselves. The five bills in the Contract With America that are within the jurisdiction of this committee kick off our agenda for the next century, and they will do just that.

Before hearing from our witness, I would like to recognize the ranking minority member of the committee, Mr. Gibbons.

Mr. GIBBONS. Thank you, Mr. Archer, and I shall be brief, because I want to hear the witness and I want members to have an opportunity to examine the witness.

First, Mr. Gingrich, we welcome you here. We remember your appearance here and work with us on the trade legislation last year, and your constructive input.

Second, we recognize that the voters have spoken. I want to commend Mr. Archer and Mr. Moseley of the staff for their orderly transition. We worked together and worked out our differences, and we were treated fairly under the ground rules that were established. We are ready to go to work.

Mr. Chairman, your Democratic members are organized and prepared to shoulder their part of the responsibility. We deem it to be primarily our responsibility to make sure that mistakes of the past are not repeated and that we look forward to the future with as clear a vision as we can command.

One of the mistakes of the past is that in 1981, in this committee, we entered into a rather massive tax cut but found that there was no followthrough on the spending cuts. As a result, the national debt of this country ballooned from about $1 trillion to about $4 trillion. That has become the heaviest burden upon middle-class America. I think the continued reduction of this indirect tax burden, or debt burden, is the most important thing that we can do for middle-class Americans.

Our middle-class Americans live largely on borrowed money; they are not lenders. Some save and more should, but the burden that has been cast upon them by failure to follow through with the so-called revolution that began in 1981 has been the cruelest hoax to those people and we need to correct that.

Certainly in this time of relative prosperity, we should continue very vigorously to reduce the Federal budget deficit. I don't want to be partisan and I don't want to be critical, but I noticed the very first pamphlet that has been prepared for us today has all the nice beautiful pictures in it, but has nothing in it as far as cost is concerned.

We Democrats will be asking a lot of penetrating questions about the cost of all of this. We have learned our lesson on that, and we do not intend to repeat it. Finally, let me say that I realize that the rules have changed, that there will be only one opening statement from each side before we begin these committee hearings. I do not intend to monopolize my ranking position here so I will share it amongst our Democrats in a democratic manner.

Thank you, Mr. Chairman. We are ready to work.

Chairman ARCHER. I thank the gentleman from Florida. Without any objection, any opening statements that might be desired by any other single member of the committee can be submitted and put in the record.

[The opening statements follow:]

BARBARA B. KENNELLY
STATEMENT ON THE "CONTRACT WITH AMERICA"
THE WAYS AND MEANS COMMITTEE

JANUARY 5, 1994

Thank you Mr. Speaker for coming before our committee today.

I know that both Democrats and Republicans are looking forward to your explanation of the legislative provisions in the Contract with America. My first concern when I look at the Contract is - what impact will this have on the budget deficit. We have finally begun to make some progress on reducing the deficit and I would hate to see that improvement undone.

I hope you agree that the deficit is one of the most serious long-term problems facing our great nation. Every dollar of debt represents more than a dollar in future taxes and high deficits tend to drive interest rates and therefore monthly mortgage payments up. This is a double dose of bad news for the middle class.

Some have said that certain tax cuts may pay for themselves and that perhaps we should adopt a "dynamic" method of budget scoring to reflect that philosophy. With all due respect, that kind of thinking helped create the deficit we are now attempting to shrink. Advocates of the tax breaks of 1981 made the same arguments. It is no accident that our deficit began to soar shortly after those tax changes, as well as increases in defense spending, were enacted. Now it seems it's deja voodoo all over again.

I am also concerned that some of the Contract's welfare provisions seek to punish the poor, more than move welfare recipients into work. Let me first say that I support strong welfare reform legislation, including mandatory and strict time limits on benefits. However, some of the Contract's provisions seem aimed more at punishing children than demanding personal responsibility.

For example, the legislation prevents children in poverty from receiving AFDC if paternity is not established, regardless of whether the mother does <u>everything</u> possible to cooperate in identifying the child's father. This means a mother could give the exact name and address of the presumptive father but still not receive AFDC benefits for her child because the state has a large backlog of paternity establishment cases. In fact, states now take an average of six months to a year and half to establish paternity, largely because of staff shortages. For this reason, it is has been estimated that this provision alone might deny AFDC assistance to 2.8 million children. Rather than "empowering" poor families, this requirement appears as though it will hold mothers and their children hostage to government bureaucracies.

While it is not it in our committee's jurisdiction, I must also voice my strong reservations regarding the Contract's proposal to repeal funding for community policing and crime prevention. Are the authors of the contract content to merely see these crimes committed and then to punish them?

Mr Speaker, I look forward to your discussion of these and other important issues in the Contract with America.

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON THE CONTRACT WITH AMERICA
January 5, 1994

Mr. Chairman, it is a pleasure to be here this afternoon to begin consideration of the most proactive, innovative and positive legislative agenda Congress has considered in decades.

When Americans elected a Republican majority last November, they signaled their support for changing the way business is conducted in the nation's capital.

They told us they wanted Congress to comply with the laws it imposes on the rest of the nation, cut committee staff, employ intellectual honesty in the federal budget process and raise the threshold for increasing income tax rates.

Yesterday, we proved to the American people that we are committed to these procedural reforms.

Today we begin consideration of legislation that will prove to voters that we are sincere about balancing the federal budget, promoting economic growth, easing the tax burden on American families, reforming the dependency-breeding welfare system, strengthening our national defense, reducing burdensome federal regulations and implementing substantive legal reforms.

This committee alone will have the awesome responsibility of considering five of the ten bills included in the Contract.

I look forward to working with the other members of the committee on these critical legislative initiatives, and I look forward to working with the architect of our revolution -- today's witness, Speaker Newt Gingrich.

WAYS AND MEANS COMMITTEE HEARING
REP. MAC COLLINS (GA-3)
JANUARY 5, 1995

As Chairman Archer has indicated, today does mark an historic meeting of the Ways and Means Committee under a new majority and a new leadership.
The Contract with America means a new agenda for Congress, as well as for the entire nation. But more than symbolic, this combination of legislative reforms means substantive change. It is an aggressive agenda that has, at its foundation, the intent to reduce the oppressive power the federal government has accumulated in the last several years. The components of this reform package return the power to govern one's affairs to where it should be: on a local level, in the hands of American citizens.

Opponents of the Contract with America argue that the costs of the reforms outweigh the benefits provided to the American public. Detractors blindly argue that the budget deficit; the requirements of the Balanced Budget Amendment; and budgetary restrictions mandated by Congressional "pay-as-you-go" rules, will prohibit the ability of Congress to "pay" for these reforms. But a realistic look at these reform measures, and the process necessary for passage, indicate these measures will be self-financing as they are implemented in "real world" market place settings.

The annual budget process will provide the major vehicle for the passage of these reforms. Each year, the Budget Committee reports a resolution to the House that provides the necessary blueprint for all federal spending. This budget blueprint is then sent to the Appropriations Committee that divides these spending "directives" into 13 different spending, or "appropriations" bills. The Appropriations Committee and Subcommittees must spell out the details of all federal spending according to the direction given in the Budget Resolution.

By reducing spending levels set by the Budget Resolution and the appropriations process, we will offset the costs associated with tax-related reforms in the Contract with America. These savings will provide the necessary offsets needed for the aggressive tax reform measures currently before the Ways and Means Committee.

Additionally, many of the reform measures will prove to be self-financing in the "real" world of economic behavior and growth. A tax credit for children will enhance family income, savings and buying power. Correcting the marriage penalty will provide the same savings and investment power for families. Provisions to reform welfare and restore self-dependency mean fewer people will be receiving government checks; and more will be wage earners, paying taxes. Eliminating the unfair tax penalties placed on able-bodied senior citizens who choose to work, means that more seniors can return to the work force, earn wages and pay taxes on their earnings.

Tax reform affecting the private business sector means increased investment and a higher turnover of money. More ivestment means more economic growth and more job creation. Creating new jobs means a stronger workforce and a larger pool of citizens saving, investing and paying taxes.

The Contract with America offers a series of reforms encouraging economic growth through savings, investment and increased job opportunities. Through the budget and appropriations process, the new Republican leadership of Congress, will provide the financing framework for these necessary reform measures.

Chairman ARCHER. Now it is my great privilege to welcome the gentleman who has had a bigger role in inspiring and crafting the Contract With America than any other single person in this country, the new Speaker of the House, Newt Gingrich. We will be pleased to receive your comments.

STATEMENT OF HON. NEWT GINGRICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA, AND SPEAKER OF THE HOUSE OF REPRESENTATIVES

The SPEAKER. Well, let me begin by thanking you, Chairman Archer, and I want to thank the Ways and Means Committee for the way in which it has prepared for this historic day. I am not sure we have ever had a committee hearing of a committee of this importance that began on the second day of a Congress. And, I have to say, I don't know about the rest of you, I am a little bit tired.

I closed the House last night at about 2:25 a.m., and I just really appreciate the workmanlike attitude of the committee. I also want to thank Mr. Gibbons again for the courtesies you showed me last year and the great honor you showed me in allowing me to sit as sort of, I guess, an honorary member of the committee during a hearing on the GATT agreement. I think our bipartisan work on NAFTA and on GATT were good for America. They are good for job creation, and I feel in that sense that with this committee I have always had a long relationship of being able to try to find some bipartisan agreements. In 1986, for example, this committee was very bipartisan in a very difficult process. I look forward to working with you now.

It is also, as you immodestly point out, an extraordinarily important committee, both in its historic background and in its obligations to the Contract. This is a committee which, in the tradition of governments, had to be created immediately because without this committee there was no resources for the government at all, so you have a very distinguished, but also a tremendously responsible job.

I want to say that I think that we are at the edge of a potential opportunity of historic proportions. We met with the President this morning. Bipartisan leadership meeting, Congressman Gephardt and Congressman Bonior and Congressman Fazio were down there. All three of them were down along with Congressman Armey, DeLay and myself and Senator Dole and Senator Lott and Senator Ford and Senator Daschle with the President and Leon Panetta. I want to report to you that I thought it was an extraordinarily positive meeting, that there was a spirit in that room—to use the term I had picked up from Congressman Wolf yesterday in the prayer service—there was a spirit of reconciliation, of trying to work together openly, of trying to solve problems and of trying on a bipartisan or nonpartisan basis to listen to the American people. And I left that meeting feeling that we had just a remarkable opportunity to work together, to maybe put off the rhetoric of the 1996 Presidential campaign for at least 9 or 10 months and to genuinely focus on getting some things done.

So in that spirit, I would like to outline sort of my thoughts as the newly elected Speaker and give you a framework in which,

from my limited perspective, I would hope you would engage over the next 10 or 12 months.

Let me start at the larger level for a second, and then come down to the specifics of the Contract. I believe that we have reached a turning point in American history. I believe there are four primary goals that are at the heart of where we have to go, and they are fairly precisely definable, and they should shape every committee in the House, and they should shape the way in which we work with the administration, and by the way, this morning we had a very good talk with the President about the possibility of Vice President Gore coming in January to the Republican Conference and having a discussion of Reinventing Government—again, to establish this notion that a bipartisan team is going to do everything it can to reach out and work together.

The first goal, I think, has to be to take seriously the Alvin and Heidi Toffler concept of the third wave information age that follows on a first wave agricultural society and a second wave industrial society. I mention this because if it is true, and I believe it is, I think this concept then makes us rethink a lot of the Tax Code, and it makes us ask questions.

For example, why are we discouraging home offices when maybe in the information age we should be encouraging them? Why do we make it harder to be a small entrepreneur when maybe we should be making it easier to start your own business? If you look at California, which is in many ways the forerunner State of this economy, and I know that Congressmen Thomas and Matsui and Stark and Herger can cite their own experiences back home, the fact is we are entering a period of enormous change. And maybe just as there was an agricultural era economy and then Adam Smith wrote the "Wealth of Nations" to design the transition, and then there was an industrial era economy, we literally need to be thinking about the totality of change.

We are being listened to and interestingly I just came from the Library of Congress where we put the Thomas system—named for Thomas Jefferson, not Bill Thomas—online through the internet so that the U.S. House will now be accessible worldwide in 84 countries in real time by anyone who wants to access it. Now, that is an example of the direction we are going; I would suggest to you and to your staff and to the witnesses you bring in that on about every policy we should ask the question: Does it accelerate our transition into a third wave information age or does it slow it down?

Does it increase the freedom of entrepreneurs and individuals to have the resources to get there or does it weaken them? I believe you will find that you are shaped by different considerations than you might have expected.

Second, we are in the world economy. A bipartisan majority argued aggressively for being in the world economy, but I believe that means we should ask of every corporate witness the following question: Under what circumstances would you create the next thousand high-value-added jobs in the United States? If you are—rather than gripe and complain and whine and browbeat, if you are a multinational corporation, how do we have to change the American government, the American litigation system, the American regula-

tion system, and the American taxation system so that the best rational investment to create jobs in the planet is the United States of America? We need to be advised by those who are making the decisions.

I want every community in America to be the first stop for the next good job, and that is a totally different agenda than, first of all, punishing businesses until they get ready to leave and then complaining because they are not patriotic after we drive them offshore. So we need to really think about it if we are going to be in the world market; I worked with this committee to maximize that process. And I hope when Chile and Venezuela and Colombia and others are back this year, we had better make sure that while we are in this giant world market the best place to create a job is the United States.

Third, as I said yesterday, the welfare state has failed and in failing has had an extraordinarily destructive impact, but I was told and I still find this so hard to believe that maybe one of you can correct me if I am wrong, I was told that the act of marriage—under the earned income tax credit at $11,000 a year for one person and $11,000 a year for another person—the act of marriage costs you, on a $22,000 income, $4,600 in earned income tax credit.

I have had my staff check that three times with the Ways and Means staff, so it is probably the right number, but I can't believe it. I mean, how can we have a Tax Code—my younger daughter, who is fairly well off, has an MBA and is married to a CPA, called me 1 day and first got me really going on this. This goes back to Millicent Fenwick when Bill Thomas and I were freshmen working on this issue; the Tax Code punishes you if you get married. It punishes us if you stay married and in Social Security it punishes you if you decide not to get divorced.

The signal we send economically in this country is destructive. Then we designed a pattern of rising so that we punish you if you start to be successful. We punish you if you try to get off welfare. A member of Jimmy Carter's Atlanta project, a woman whose credentials are impeccable—she is African-American, she is a cultural anthropologist, she is a Ph.D. from Berkeley, she is working in Atlanta with the poor—tells me, you know, in every public housing project, there is a candy woman. A "candy lady" was the term she used. She goes down and she buys candy wholesale and she illegally sells it to the children for a markup, not having a business license, but providing a service, and we have made it legally impossible for her to take the risk of opening a candy store.

We have raised the first step to dignity and capital accumulation and profitability so high that she can't take it. Now, this is not Gingrich the suburban Republican, this is a very leftwing intellectual working in Atlanta, telling about the reality of what she encounters when she sees people. And, by the way, the most powerful statement of that is Mario Vargas Llosas' introduction to Hernando DeSoto's "The Other Path," which is a study of the poor in Lima, Peru. It shows how the Government punishes the poor and prevents them from going into business, and how in Peru they simply created an entire economy which is not legal, but it is not criminal, it is just out there.

Well, guess what, in every major city in America, you will find an economy which isn't criminal, but it is not legal, and so I would hope we would look at these, notice how these three fit together. If we are moving into an information age, don't we have to figure out how we carry the poor with us? Don't they have to have every right to have as much access as anybody else? Shouldn't the Tax Code favor them in having a chance?

I will give you a nutty idea. I am just tossing it out because I want to start by getting you to think beyond the norm. Maybe we need a tax credit for the poorest Americans to buy a laptop. Now, maybe that is wrong. Maybe that is expensive. Maybe we can't do it, but I will tell you, any signal we can send to the poorest Americans that says we are going into a 21st century third wave information age and so are you, and we want to carry you with us, begins to change the game.

Second, we want to say to every American, the world market is going to be tough, but we are at least not going to have our government punish us while we compete, and so we have got to find a way to be honest about it, and I believe it is going to be very tough to compete with China, Germany and Japan. I think anybody who thinks we are going to take on the Asian tigers, and that it is going to be a lark totally misunderstands the intensity, the competition and the aggressiveness of our competitors, so I think we better rethink that.

Third, if we do it right, we actually liberate the poor to seek prosperity while making those transitions, but that requires changing our core laws.

Last, I want to pick up on what Congressman Gibbons said, because I agree with him, and this is going to make it much harder, and I know that my dear friend, Mr. Archer, one of the most fiscally conservative Members of this Congress, agrees entirely with this. We have to make these three transitions while moving to a balanced budget by 2002.

Now, I don't believe you can honestly get there faster, at least not without a crisis mentality, but I don't see any reason why as mature adults we can't establish a glidepath this year that is honest and serious and has integrity, that gets us to a balanced budget by 2002, and that means doing things differently. I would recommend you look at the major folks who have been successful in transforming companies, starting with Peterson at Ford Motor Co., and listen to them and say, all right, what do we have to do? We are going to come right back to this again and again.

Now, let me give you one example of breaking out. Many of you know about the old consult answer gimmick of what they call the nine dot problem where you ended up trying to cover the nine dots with four lines, and you finally had to go outside the dots to do it. I am not going to spend your time as a witness trying to show you, but conceptually what the consultants were getting at is that we artificially create frameworks that stop us from thinking cleverly.

I want to talk about Medicare for 1 second, then I will talk about the Contract. What this city wants us to do is to be so stupid that we are guaranteed to fail. We just went out—Dick Armey and Tom DeLay and I went out and did a totally positive press conference about our meeting with the President, and we stood at the White

House, you will see this later on today on C–SPAN; you can watch it on videotape and measure it for yourself.

We said it was a great meeting, a terrific dialog, a positive start. We are going to cooperate on every front. We are going to set up staff task forces. We are going to try to find ways to work together.

The second question we got from a reporter was "How do you think it will break down"? Let me just say bluntly if we allow the lobbyists and the press culture of this city and the bureaucrats of this city to guarantee that we fight, we will get nothing done and we will be one more failed Congress leading to one more bitter election, and I believe there will be a third party in that campaign. I am just appalled.

Medicare is my favorite example. Medicare is a large, clunky, inefficient government system. Everywhere in Eastern Europe—we told Eastern Europeans from Poland to Hungary to Russia, large, clunky, centrally designed bureaucratic systems don't work very well; market driven systems work better. Now, I believe we can design a Medicare program which gives every senior citizen greater choice of better health care at lower cost and, as a consequence, saves a heck of a lot of money.

In some States that is starting; there are HMOs out there today which offer senior citizens prescription drugs for 95 percent of the cost of Medicare. I believe if we were creative and we were cooperative and we brought in representatives of senior citizens and we brought in doctors and hospitals and pharmaceuticals, we could explain how we can create the greatest marketplace choice. I am willing to give you, as an example, a smaller deductible if you go into a program that saves the American taxpayer rather than a larger deductible if you decide you want a program that is more expensive.

I am willing to find ways so that the average senior citizen doesn't say, "Oh, why are those politicians punishing us"! or so the interest groups can't send out mailings that say, "Let's go beat up on the politicians who don't give us what pork we want." Instead, the senior citizens will come in and say, "I like this townhall meeting. I like this proposal. I think this is actually better for me."

Now, that is such a different mindset, and I don't mind, by the way, if it is totally bipartisan. I am perfectly happy if we go in together and we sit down together and we have joint meetings and joint townhall sessions. But our goal shouldn't be to say how many groups can we punish before they rebel; yet that is the mindset of this city when you talk about balancing the budget. Who are you going to hurt? Who are you going to punish? Who are you going to cripple? It is a sick, out-of-touch culture; we have to reach beyond it to the American people and work with them.

Now, let me talk very briefly within this larger framework about the Contract With America. You have an enormous job, and I sympathize with my good friend from Florida's comment that this paper, which I frankly was sort of impressed got printed so fast, happens to have mostly the good parts. I am sure that we will find a handful of bad parts presently, but I think it is very encouraging. And I would say to the American people that to be able to contact the Ways and Means Committee and get a brandnew document called "Description of Provisions in the Contract With America

Within the Jurisdiction of the Committee on Ways and Means" is a positive first step and I would say also to those of you who are technical experts, it is a pretty overwhelming challenge to say we are going to get all this out of committee in the next 60 days or so, but let me tell you, we are going to get all of this out of committee in the next 60 days or so.

Let me make it very clear, a lot of people said to us, you can't really pass nine reforms on the opening day. We did. We are going to break on the date we announced so families can have a vacation at Easter, period. The committees are going to report and have to report in order to be able to keep that schedule. We don't want to report bad or ill thought out or hastily drawn legislation, so we are going to start hearings at the earliest date in the history of the Congress. We are going to ask our witnesses to come and be very prepared, and be very tough-minded, and they are all going to be open to improvement.

We don't think that we wrote in stone. We thought we had in September some good ideas. That was months ago. The world changes. Those ideas give us a direction. We have five very major ideas in this committee: First, the American Dream Restoration Act, which looks at the family tax credit, at the marriage penalty tax relief, at the American dream savings account. Let me say I would hope this committee would also openly look at the President's ideas.

I think his new concept of encouraging people to get better educated, to recognize that intellectual capital may be a key to the information age, I hope you will very soon have the administration come up to testify. I would like to try to find a way to accommodate it if we can. I don't think we should reject out of hand an idea just because it comes from the President. We ought to look at it.

Second, the Job Creation and Wage Enhancement Act, with things like capital gains relief, neutral cost recovery, expensing of small business, increasing the estate and gift tax, the home office deduction. I want to make two key points here. One, if you don't have a job, having a tax credit for the American dream doesn't help you much. Two, having a job, as Ronald Reagan used to say, is the most important social program there is, and if we are going to be in the world market, we had better have the best jobs in America and so this particular bill becomes a very important vehicle for redesigning the American Tax Code to create the best jobs in the world by liberating entrepreneurship.

I will say to all of you, capital gains is often an intellectual-liberal battle. Liberals say, oh, it is terrible. You are going to help the rich. Conservatives say we need it and nobody can explain why.

If you will, bring in the biotech industry, and you will let them tell you what not having access to capital has cost in jobs in America in the largest job-increasing industry in the country. Let them tell you what is happening to foreign countries buying American biological breakthroughs because we don't have the capital here to create the jobs and create the companies. Let them explain to you the factories they would like to build, the products they would like to have, the opportunities that are forgone, I think it will begin to be obvious to the American people that we are talking about the key to the 21st century when we talk about creating enough capital

to build enough factories to have enough research and development to have enough products to dominate the world market. And that, by the way, is an area where we are currently totally dominant, but the absence of capital may mean we will lose that domination by the end of this decade.

Third, the Senior Citizens' Equity Act, which looks at increasing the Social Security earnings limit, repealing the Clinton tax increase on senior citizens, instituting the tax incentives for long-term care insurance, and accelerated death benefits. Let me make a point here again. If the society sends a signal that working all your life and saving and being prudent and being frugal is stupid because we are going to take away your savings to give it to your twin brother or twin sister who did nothing and therefore throw themselves on the State, I think we send a very, very destructive signal. And when a society says to senior citizens at a time when we all know we are living longer, "We are going to punish you if you stay at work, even though we know that when you stay at work you are healthier, you are more active, you are less expensive on Medicare, and by the way, you are earning a living and paying taxes, but we are going to punish you and send the signal to quit working," I think those are exactly the wrong signals.

Fourth, the Family Reinforcement Act, refundable tax credit for adoption, refundable tax credit for home care of the elderly. There are a number of steps at strengthening and rebuilding the family that aren't speeches about Murphy Brown, they aren't arguments about orphanages. They are practical, common sense. Why are we punishing people who are doing the right thing, and why don't we want to send the economic signal to people to do the right thing?

And finally, the Personal Responsibility Act which looks at work requirements. It cuts welfare spending, it attempts to reduce illegitimacy, and it looks at restricting welfare for non-Americans. I just think we have to engage in an honest discussion, and I indicated yesterday that I hope in the next few months that virtually every Member who represents a poor district will match up with somebody who represents an economically better off district and that we will have a genuine bipartisan effort to educate each other and to really open a dialog.

I don't know what the details are. We have a bill we think a lot about. The Governors, as you all know, are very excited, and have their ideas. I think in the next few weeks—the President has already indicated a strong interest in working together on this—we should be able to craft a bold new direction on welfare reform, and we should be able to start the move from dependency to independency and back to behaviors that work in America, and I think that you play the major role in getting that done.

I appreciate your patience with me. I will just say in closing, this Contract never leaves my coat, whichever coat I have got this is with me, and I just say that to say, we are going to get this done. It is going to happen, we are going to get the votes on the floor. I believe we are going to pass almost all of it, but we are going to pass it the way we did yesterday. If you look at yesterday's votes, I am very proud of the fact that on virtually every vote we had an enormous bipartisan majority. We had from 23 Democrats—and I think that was the smallest vote for a Republican proposal—up to

unanimous on both sides of the aisle. I would hope as we go through the hearings and the markups and the rules process that we could design a procedure where, on virtually every bill in the Contract, there is a strong bipartisan majority. It would be a procedure where the President can work with us in such a way that when it gets to the White House, after, of course, going through the other body, that the President will feel comfortable signing it because we will have worked together to cooperate in doing good things for the American people. Let me now just throw it open to questions, Mr. Chairman.

Chairman ARCHER. Mr. Speaker, thank you very much for taking your time to come and launch the official discussion of the agenda before this Congress. I will waive my right to question and recognize Mr. Crane for his questions.

Mr. CRANE. Thank you, Mr. Chairman, and thank you, Mr. Speaker. I am uplifted by your presentation.

Chairman ARCHER. Would the gentleman suspend for a moment? Considering the time constraint which the Speaker has to live with, I would like to alert every member that we will attempt to limit the questioning to 2 minutes per member so that we can cover more members. That has been agreed to by the ranking minority member.

Mr. CRANE. Very good. I commend you for your recognition of the fact that as a former history professor, which I was, we are at an epochal turning point in the history of this Republic. I commend you also for your recognition that this has nothing to do with Republicans and Democrats, but all Americans.

I spoke to a college Republican convention one time a few years back in Illinois, and I told the kids in describing my district, it was the fastest growing in the State of Illinois. And they said, well, aren't you right next to Chicago, and I said, yes. And they said, well, don't you shudder, those people have to be coming from Chicago. I said, yes, but kids, I grew up in the old neighborhood in Chicago, and your typical city Democrat is, first of all, a God-fearing person. Second, he believes in family and traditional values. Third, he believes in the work ethic and finally when the country goes to war, he is trying to jump in front of you in the line to enlist. And the kids said, didn't you just define your basic Conservative there? I said, no, your basic American, but you are born with two very intense loyalties, the religion of your parents and the politics of your parents, and it is hard to in effect turn your back on the faith of your father.

I think we can join in a bipartisan effort to change the direction this country is headed, and focus on two of, to me, the most disturbing things that have been going on in my experience here. One is that escalating national debt, out of control, and two, the destruction of so many of the traditional values upon which this Republic was founded. So I salute you, look forward to working with you, Mr. Speaker, and I think we can cooperate toward guaranteeing we leave something better for our kids.

Chairman ARCHER. Mr. Gibbons will inquire.

Mr. GIBBONS. Mr. Speaker, I am sure it pays for the country to have a visionary like you, but I want to try to get us down to the nitty-gritty of what we are talking about here. Your Contract has

been scored by the Treasury Department as losing revenue of $712 billion over a 10-year period. I haven't seen any other scoring estimate on it, so I would have to accept these as being correct.

How within the 100-day period, are we going to proceed in this committee to reduce the stream of revenue by $712 billion, almost three-quarters of a trillion dollars, add it to the $4 trillion debt we have now, and make sure that the spending cuts that you talk about in gossamer terms are going to take place? I will not go down the road again, having once made the mistake of voting for tax reductions and just taking an empty promise that we are going to get the spending cuts.

The SPEAKER. Let me say, first of all, Mr. Gibbons, I agree with your premise, that I think we should, in fact, pay as we go and if anything, pay more than we need. Also, I think Mr. Kasich, the Budget Committee chairman, was very clear I think last Sunday on the Brinkley show in saying that we ought to cut spending first.

Now, I haven't seen the Treasury estimate, but I want to make several comments about Treasury estimates because I have worked with them over the last 16 years. First of all, I believe if you check, all Government estimates were explicitly wrong on the Jimmy Carter capital gains tax cut, literally wrong to such a degree that it wasn't a question of scale. They had a negative number for their estimate when it was a positive number, so they were saying it will cost us money if we cut capital gains under Jimmy Carter, and in fact we made money. Now, I would just suggest to you that that is not an unusual situation.

Second, the boat tax, I believe, was explicitly scored wrong. Both the congressional and executive branch estimators said the boat tax would raise money. In fact, the boat tax destroyed the boat industry, killed businesses, laid people off, cost us money, and was a net loser, so if you are saying to me that the same socialist mentality bureaucrats who have been consistently wrong were wrong again, that is possible, but I want to make a third point about the years you used.

One of my frustrations, and this is not partisan, I mean I was as frustrated under Reagan and Bush as we will be, I am sure, with the current gang down at the Treasury Department because they don't change. They are the same technicians. They pick whichever year you lose money. If they say let's do 5-year scoring, we say terrific. We will come in with a back-ended IRA. You will make a huge amount of money in 5 years. They say, oh, but you will lose money 20 years from now.

If they come in and say, well, let's score over 20 years, we will come in with a current IRA and you will gain money in the short run, whichever way you want to go, they will count it against you, so I just think we have to recognize there are some people in this city who have a passion for more money for Washington and less money for America.

Now, if we sit down and we can't solve that, then we may have a big problem. We will have a fight on the floor, but I will tell you flatly, I believe you can find honest estimates and not just by one or two people who for ideological reasons fudge. We can find honest estimates we can broadly agree on, and we can find a way and we

can reshape the bill to work within those honest estimates. Thank you.

Chairman ARCHER. Mr. Thomas will inquire.

Mr. THOMAS. Thank you, Mr. Chairman. I want to thank the Speaker for once again indicating that ideas are not just important, they are essential, and that what we are largely talking about in his five goals is an examination of where we are and where we need to go in terms of prioritization. There is no question I can ask in a 2-minute period or you can answer that would expand beyond your opening statement and therefore I yield back the balance of my time.

Chairman ARCHER. Mr. Shaw will inquire.

Mr. SHAW. Thank you, Mr. Chairman. I would like to congratulate you, Mr. Speaker, on a very good opening statement. I think you hit some hot buttons, particularly as to the negative effect that many of our laws have upon the goals that we would like to accomplish, both Republicans and Democrats, and I would like to dwell for just a moment on welfare.

Your figures, I believe, are quite right as far as the earned income tax credit and how we penalize marriage, but we tell young people, particularly a young girl, that you can have a child, not get married, not go to work, not live by any of the other rules, and we are going to have a package for you that is worth anywhere from $12,000 to $16,000 a year.

On the other hand, you can go to work, earn minimum wage and not quite get up to $9,000 a year. The system is totally backward. I think we have put together a very compassionate welfare reform package, and I think the President has correctly enunciated some of the basic principles that are in our package, and hopefully we can work together. Some of the details that we are going to argue about, unfortunately, are going to be the details that will be making the news, but I think the cruelest welfare system of all is the one that we already have in place—paying people to stay in their place, not to succeed, not to break out.

I think you made the point very well yesterday in looking at some of the words from the "Battle Hymn of the Republic" on what is freedom. Someone living on welfare is not free. They don't even have the basic principles that we guarantee as far as the rights of basic Americans, of basic citizens, and we are going to make that happen.

I have spoken to many of our colleagues on the other side of the aisle who are going to be on my Human Resources Subcommittee—many of whom who are on this committee aren't on that committee—who want to help and want to get involved, and I am going to be meeting with members on both sides in order to try to determine where we come down together and where we are going to agree to disagree, and move that process forward, and I will tell you that we on our side, on the Republican side, we are committed to delivering on the Contract, and we are committed to the time that you have set, and we are going to be here on Mondays and Fridays working very, very hard because the full committee is taking up Tuesdays, Wednesdays, and Thursdays, and we are going to be here next week working and starting the hearings, and we are going to deliver on that Contract, and I appreciate the leadership

that you have given in pushing this forward as one of the major planks. And I feel that it is the most major plank that we have in our Contract With America.

If we are truly going to change America as we would see it, we have got to bring everybody along, and we cannot leave people enslaved by a system that has broken down and encourages people not to succeed, and I thank you for your leadership.

The SPEAKER. Can I make two very quick observations? I know—I don't want to use up the time on this, but I want to use this as an example of how different we could be because I want to go back to Mr. Gibbons' correct point. There is no reason in a budget-neutral way that we could not redraft the earned income tax credit to simply provide that we will reduce the amount available for individuals while expanding the amount available for couples so that you at least get the same, you get two times individual, do it all on a budget-neutral basis and at a minimum have eliminated the antimarriage penalty.

That should be something that the staff could do in 1 week if you want to. You could do it with no budget consequences, so, first of all, there are ways to rethink how we do things if you are willing to do it.

Second, I would be very interested, and I am using this as an example for a whole range of bills, and I am not in any way trying to preclude the Chairman's leadership, but I want you to think about this possibility. Rather than get into our classic tax fight where somehow we produce massive bills and the minority on either side has to produce a bill and then each side's lobbyists get together, then there is a big brawl, then the President vetoes it, let me suggest if we could agree that an antifamily earned income tax is stupid. We could agree that a budget-neutral way of reforming it would be smart, and if the President and Senator Dole and Senator Daschle would agree so that they would protect the bill as written, I would entertain, if the committee came and asked me to, as Speaker, bringing a bill like that in as a very narrowly drawn bill, widely supported on both sides and pass through—not to be used in the Senate as a vehicle to send us back a bunch of stuff, but with an agreement in advance that it would go through the Senate and be protected by both parties and get to the President and be signed. We would literally early this year make the earned income tax credit no longer antifamily.

Now, I don't know if that is good or bad. I am just saying today, it is a way of thinking about trying to get to some reform and some solutions that could actually be signed into law quickly and not just degenerate into a partisan fight, and I thank you for raising your point, Mr. Shaw.

Chairman ARCHER. Mr. Rangel will inquire.

Mr. RANGEL. Thank you, Mr. Chairman. Mr. Speaker, yesterday your speech raised a lot of eyebrows in the press and throughout the country and people were shocked, surprised, some were even critical because they had never heard you express such sensitivity to the plight of poor folks in this country, and even today you pointed out that as America moves forward you would want to make certain that at least as a part of everyone's dream those that

find themselves in this city, that they are part of that. It is reachable, that it can be done.

Throughout the Contract and the rhetoric of the campaign, it seemed as though the Republicans were able and far more effective than Democrats in pointing out the frustration of American people in wrestling with these problems, and that is, the problems of children irresponsibly giving birth, children shooting each other in the street, the problems of crime, AIDS, violence in jails, and so forth. So, as we move forward in this global economy, we face now 1 million people in jail, 1 million people waiting to get in jail, 1 million people under some type of control. Yet the answers in the Contract look like, well, cut off the checks and get more cops and get more prisons and show that we won't tolerate it.

When you said we expect more from the private sector, we are getting closer to reading from the same page if what you are really saying in addition to what you have said is that the private sector has a responsibility to tell us what that work market should look like. The private sector has a responsibility to be working with our schools and educational institutions to make certain that not only will the kids be able to read this diploma, but will be employable because it is the private sector that dictated what these needs are.

It would seem to me that as we reach out in asking them what we should and should not be doing to remove regulations and tax impediments for them to succeed, that if we can agree that we can look at the poor very much the way the Army looked at me when I was a high school dropout. They did not ask me what kind of job I wanted. What they did was tell me what had to be done and once I found out that I could do it, I was excited about the job, and I succeeded.

I do hope that we can go beyond the Contract which somehow doesn't really give those incentives for people to stay in school, to know they are going to have a job, and to be working but rather deals mostly, from what I see, with those Americans, poor as they may be, minority as they may be, that are falling between the cracks. I look forward to working with you to see whether we can get a full contract for all Americans.

The SPEAKER. Let me say very briefly, first of all, I think we are very close to the same page. I don't know if that is because you have on occasion gotten the Republican nomination in your district and there is really this secret compatibility, but there is no question that in many ways in our conversations over the years we are very—we are much closer than our debates and our votes sometimes imply.

As a minor example, last night I was very pleased to be able to announce at the Republican gala which celebrated our victory that we have raised at least $10,000 for Horton's kids to use in Anacostia this year in an "earning by learning" program where we go in with volunteers and we help poor children by paying them $2 a book to read in the summer and we help second and third graders in public housing. That was done deliberately to say here is a political event that is fun, but let's turn it to the good of the community of the National Capital.

I believe if we could work together and if we could work with your mayor, who I have great respect for and I think is doing a

good job despite one minor slip-up in October, I think that we ought to be able to pick up on exactly what you just said: How do we ensure that we have the incentives to stay in school, how do we ensure that there are jobs in that neighborhood when they get out of school, and I think we would go to the people. And that goes back to my other point, for example, the biotech companies.

We have one district in your city whose largest single employer is a pharmaceutical company. Now, to adopt a Tax Code and a regulatory code which drives that pharmaceutical company to go to Germany thereby closing the largest single manufacturing facility in that congressional district is irrational if you want the people of that district to have jobs. I would like to work with you and I know Chairman Archer has a deep desire to work with you, and I can just assure you in the Speaker's office we will do all we can to shape a full contract for every neighborhood and every community in the country.

Chairman ARCHER. Mrs. Johnson will inquire.

Mrs. JOHNSON. Thank you, Mr. Chairman. I just wanted to comment on a statement that you made, Mr. Speaker, because it is something that this committee is already aware of, that some in this city want us to do stupid things and fail. There is a certain truth in that, but also our process sometimes encourages us to do stupid things that force failure, and as we go into this, your admonition to think big, to think beyond the dots and beyond the lines is the only way we can avoid the kinds of failure that our own process has forced on us in recent years. I want to thank you for that comment, but I am going to yield back the balance of my time because I would like my colleagues on the other side to get through their questions. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Stark will inquire.

Mr. STARK. Thank you, Mr. Chairman.

Mr. Speaker, I do have an area which I think we might want to talk about redrafting. In your Contract, the bill called the Senior Citizens' Fairness Act, or, as I think you said, Equity Act, helps high-income individuals by repealing the 1993 increase in the amount of Social Security benefits subject to tax.

The 1993 change applied only to the 13 percent of the wealthiest beneficiaries. That change would increase the deficit by $15 billion over 3 years. The Republican estimate was $17 billion. We think it is a little lower. And because the revenue generated from the 1993 increase was dedicated to the Medicare Trust Fund, you are in effect increasing the income of 4½ million upper-income beneficiaries and cutting Medicare for the remaining 30 million Social Security recipients with low incomes.

I hate to suggest taking from the poor and giving to the rich, but in effect you are giving $15 billion to this upper-income group and taking the $13 billion in effect away from the 87 percent with the lower income.

I think that this may have been unintended, because quite frankly, when the Contract was drafted, someone may have overlooked the fact that that money had to go into the Medicare Trust Fund.

Would you encourage us to rewrite this portion of your Contract to protect the low-income beneficiaries from this Medicare cut?

The SPEAKER. Well, let me say first of all, Mr. Stark, since I am not on the committee and I am not an expert, maybe you can help me and the country understand. When you talk about increasing taxes on upper-income retirees——

Mr. STARK. Lowering them.

The SPEAKER. What is the level at which it became upper income? Where did this tax increase go into effect?

Mr. STARK. Well, it is $44,000 for families, which, as I say, is about 13 percent of the——

The SPEAKER. $44,000 per family, and what was it for an individual?

Mr. STARK. That is where it starts. The median is probably closer to $80,000 or $90,000. The 30 million under that, the median is about $7,500 a year.

The SPEAKER. See, what we said was that in effect $44,000 for a couple, you are now rich enough that since we don't have the courage to directly means test Social Security and take it up front, we will simply steal it from you from the back door by raising your taxes.

Mr. STARK. But for the poor people, you are going to cut Medicare——

The SPEAKER. I am not necessarily going to cut Medicare. We don't agree on the initial definition. You may think $44,000 is upper income. That may explain why the——

Mr. STARK. I am happy to support any tax cut you want to make. I am just saying, do you want to do it by cutting Medicare? Is that your intention?

The SPEAKER. Not necessarily. But let me make two points. First of all, the last, I think, three Republican budgets have proposed that at the $100,000 retirement income, senior citizens do not have to be trapped into Medicare against their will, nor will we subsidize them if they decide they want to buy Medicare.

So we were prepared to say at the $100,000 income level, in budgets that I voted for, at least, that you could buy your own health insurance, you could buy Medicare, unsubsidized if you like, or if there is a better plan at a fully unsubsidized rate, you can buy it.

But we were prepared in that sense to approach the Medicare question in a way which directly affected—we thought $1,000 was closer to being a serious number than 44, but to begin to say to people at a fairly high income level, why should we tax the $20,000-a-year person with a family of three to transfer the subsidy to a multimillionaire?

So I am prepared to look at ways that change it. But second, I want to go back to my other point because maybe it wasn't clear, or maybe I didn't make myself clear.

Mr. STARK. The question was, Mr. Speaker, do you want to cut Medicare by $15 billion?

The SPEAKER. That is the second point I want to make. It is my understanding that we have a Medicare option available only in 15 States which allows people to take an HMO at 95 percent of the Medicare average for that State, which means by definition every citizen who decides to take a Medicare HMO in that State is saving the taxpayer 5 percent of the average cost of Medicare.

Now, if you were to say to me, if I found a good enough package that voluntarily enough senior citizens wanted to improve their options, and in the process they saved $13 billion, would I be willing to take the savings that they voluntarily gave back to the government because the market gave them a better option? Sure.

If you are saying to me, am I going to punish senior citizens, the answer is, of course not, that is silly, we are not going to do that. And if that is not the way we pay for it, we will find some other way.

I certainly want the committee in its hearings to explore all the options and not do something which would be dumb. I agree with you: We should not be dumb if we can afford it.

Chairman ARCHER. The gentleman's time has expired.

Mr. Bunning will inquire.

Mr. BUNNING. Thank you.

Mr. Speaker, it is good to hear from you, it is always enlightening.

On the Senior Citizens' Equity Act, there are some other provisions in the act that are in my opinion probably the best ideas that we have seen for senior citizens and for people to get back into the marketplace. After we force our senior citizens to become inactive after the age of 65 by the Tax Code, we can do away with the Tax Code and do away with the money. We would all be better off.

Do you do your own taxes or are your taxes done by a public accountant?

The SPEAKER. I want to confess up front I lack Mr. Archer's courage. I also want to confess up front that it is basically all handled by my wife who hands me a document from a CPA which I sign.

I also want to say up front, I can say this without sounding too defensive, that given my track record and my public disclosure and my media relationships, I would be an idiot if I did my own taxes because I need a CPA and a tax lawyer to stand next to me and say, Yes, it is OK.

But I agree entirely. I was going to mention earlier, I feel very badly I didn't mention it, that I would hope once you get beyond the Contract, you would have hearings both on Mr. Armey's flat tax concept, and on the Domenici tax approach. I would hope you look in an aggressive way.

I was very cheered 2 or 3 days after the election when Chairman-elect Archer said to the national press that he intended to very aggressively look to getting to a simple, direct Tax Code.

You mentioned something that is a good example of where Mr. Gibbons and we may have a debate later on, or he may decide we are right. If you do not take into account changes in behavior, lowering the tax penalty for working costs the Federal Government a lot of money in terms of Social Security.

That is, if you allow senior citizens to work and you don't punish them, but you don't take into account the fact that more of them will work, the Treasury can come up with some horrible number about what it costs us to allow people to keep their own money and work.

On the other hand, if you have any assumption, and this goes back to the boat tax example, where Treasury was totally wrong and totally destructive and killed thousands of jobs, and if you say,

"Gee, if we allow senior citizens to keep the money if they work, they may pay tax, including Social Security tax, you get a totally different number for what that costs.

There ought to be some bipartisan way to set up a panel of experts who are not trapped into a Socialist mindset and find the kind of solution that I think you would agree with that gets us there.

But I appreciate your raising it. I think the Code should be simpler. I think we should encourage people to behave in ways that are healthy. And I believe in the long run the country will actually make money from those kind of changes and not lose it.

Chairman ARCHER. Mr. Houghton will inquire.

Mr. HOUGHTON. Thank you.

This is going to be very brief, Mr. Speaker, because I would like to relinquish my time to others on the other side. I think the bind is going to come in making the arithmetic work out, because when you basically cut taxes, increase military, and then cut spending, the basic spending cuts have to come from the discretionary account, because you can't touch interest, and you are not going to touch Social Security, and you are probably not going to cut very much out of Medicare. And probably defense is going to be touched a bit. That falls on a third.

And so when you take the arithmetic of balancing the budget with all those things, and level it on that discretionary or that third of the amount of money we spend on our expense account, it is going to be a difficult task, and that is what we are going to be facing. But I wanted to share that thought and that worry with you.

The SPEAKER. I agree.

Chairman ARCHER. Mr. Jacobs will inquire.

Mr. JACOBS. Mr. Chairman, I have a gift for the Speaker and for the committee. I pass.

The SPEAKER. I accept my preemptive Christmas gift and I thank Mr. Jacobs.

Chairman ARCHER. Mr. Herger will inquire.

Mr. HERGER. Mr. Speaker, I want to join in thanking you for your leadership, for your ideas. It is the greatest breath of fresh air I have seen in my tenure here in Washington. Again, I commend you.

You have been out to my district in northeastern California which contains some 17 percent of the land area of California. It is very rich in agriculture and produces many wood products. My concern has to do with the vast majority of businesses in our district, which are small family businesses, like so many throughout the Nation. I worry about their ability to transfer these businesses from parents who have worked hard all their lives to their children who have been working with them.

Statistically, in our district and in the Nation, some 67 percent of all small businesses do not survive that first generational transfer because these businesses do not have large liquid assets, whether it be in cash or whatever, with which they can pay these large Federal inheritance taxes. Therefore they are forced to sell these farms and businesses in order to pay the taxes.

My specific question is, how will the provisions in the Contract With America that increase and index the estate tax credit help these small family businesses need to survive the transfer between these generations?

The SPEAKER. Well, I think that is one of the reasons, frankly, we put it in. We felt there were three powerful reasons for encouraging people to be able to work very hard and be successful. The first was to strengthen family ties, to say to people, We think it is a good thing if you try to help your family, we think it is a good thing if you care about your children and grandchildren.

The second was to recognize if you really want to have capital accumulation, if you look at those countries which have had very rapid growth rates, they almost all have strong extended families in which the families acquire the capital over time. It is very important to have a dynamic model where you are thinking about time, and something that 1 day is not very powerful, over 10 years, may become extraordinarily powerful.

And so we have until now adopted a very anticapital accumulation, antifamily business, antientrepreneur attitude which punishes those who have worked the hardest and tried the most in order to achieve things.

Last, I think our approach to this is to say that the government should not intervene in a way which destroys a local community. When you set up a situation where a family suddenly learns that basically in order to pay the Federal Government they ought to sell their company to a Japanese company or to a German company or to some other country where they have capital because they have more savings, they have a better Tax Code for capital.

And you are in effect disinvesting America of its own ownership because your government now punishes those families that worked so hard for their children and grandchildren. We think there is something profoundly wrong, and that is why we want to pursue those kind of changes.

Chairman ARCHER. Mr. Matsui will inquire.

Mr. MATSUI. Thank you, Mr. Chairman.

I want to congratulate you, Mr. Speaker, for your election yesterday and I appreciate the fact that you are here today. We appreciate your testimony. Two minutes certainly doesn't give us enough time to analyze the Contract With America. But just to underscore the lack of time and the inability to really delve into this, you mentioned, for example, senior citizens and the wage cap and the fact that if you lifted it they would find more opportunities for work and therefore there might be a positive dynamic impact on the economy.

One of the reasons the Joint Tax Committee never scores that as a positive revenue impact is because there is another impact, too, and that is that you may displace some others who are moving up into the job market. Getting into macroeconomic policy by making a microeconomic change is a very dangerous game. I hope all of us will be very careful when we do this.

Another example: You mentioned the marriage penalty, which obviously we would all love to change. Mrs. Kennelly attempted that last year, but it was estimated to cost $70 billion in taxpayer money in order to make that change over 5 years. Your Contract

provision only deals with $10 billion or one-seventh of that particular problem.

Let me conclude, because I don't want to take any more time. I would hope that you—and I am sure you have—would review the book written by Dave Stockman, and particularly page 98 where he talks about rosy scenarios. I recall that I was here when you were here in 1981 and we did do the Reagan economic plan. This book talks about those that were the ideological fathers of the Reagan supply side economics; Paul Craig Roberts, Norman Ture, Steve Entin, Art Laffer, Jude Wannisker, Jack Kemp, and Lou Lehrman.

Many of those same people are behind and had input to the Contract With America. I just hope that they are not as wrong this time as they were in 1981, when we had the massive deficits, as the ranking member, Mr. Gibbons, has talked about. Last year we went through a lot to get that deficit at least starting the trend line down over the next decade, with a view to continuing that trend well into the next century.

For us, now, to eliminate that budget discipline will result in more pain for the average middle-class taxpayer because their interest rates will go up. They are the ones that borrow in this country, they are the ones that will really pay for any kind of undisciplined activities we take over the next 6 months or so.

The SPEAKER. Let me commend you first of all for getting a lot into 90 seconds. I will try to match you, at least in brief comments, in about 40 seconds.

First, I agree with the need for fiscal discipline. That is why, for example, with the earned income tax credit, I suggest we find a revenue-neutral way for eliminating the penalty for getting married.

Second, we are aware of the fact that the marriage penalty replacement would be expensive. That is why we suggest gradually phasing it in. But we think by setting a pattern of phasing it in, we are at least moving gradually in the right social policy.

Third, I believe that the Reagan tax cuts, without any question, increased the size of the American economy. We doubled the revenues of the Federal budget in the eighties. When you go back and look at the numbers, the revenues went up. Now, the Congress then had no fiscal discipline, and so we managed to increase spending at a rate even faster than doubling the revenues during the decade.

But look at 17 million new jobs created; look at the capital investment which allowed Ford Motor Co. and others to be competitive in the world market; look at the explosion of the biotechnology and computer industries, look at the fact that we retook our advantage in computers back from the Japanese; it was a very powerful period of economic growth. That doesn't mean we in the Congress don't have an obligation to have fiscal discipline.

But, finally, I want to say one last thing. Mr. Stockman wrote an interesting and sadly cynical book about the fact that he couldn't dictate to the U.S. Congress. He couldn't dictate to the U.S. Congress because he wasn't prepared to start with the first premise, which is a dialog with the American people.

I was in a lot of those meetings. I watched that system break down. That is the reason I am suggesting to us here today, we have

to have a different approach. You cannot get to a balanced budget on the current structure of this government. It is impossible. You have to rethink the entire structure to get to a balanced budget.

Stockman was not prepared to do that kind of very deep thinking, and he wasn't prepared to be honest and open with the American people. And you cannot in the long run hoodwink the American people into changes they don't agree to.

Chairman ARCHER. The gentleman's time has expired.

We have time for one last questioner. Mr. McCrery will inquire.

Mr. MCCRERY. Thank you, Mr. Chairman.

Thank you, Mr. Speaker, for sharing with us today your vision for the future of this country and the change in direction that you think we must head.

Beyond the very important things that we should have gleaned from your vision, you also said something very important of a very practical nature, and that is that the Contract With America and the legislation that backs up the Contract With America is not written in stone. In fact, it is going to be a dynamic process. We can add to it, we can subtract from it, we can alter it, we can modify it, and that is good news for those of us on the committees of jurisdiction, and it is good news for the American people, I think.

One thing, for example, I think we ought to add to our welfare reform package is reform of the SSI disability for children program. It has tripled since 1990, since the Supreme Court decision. We need to correct the Supreme Court decision or correct the incentives in the system that caused it to bloom.

Also, with respect to welfare reform, I like your analysis of the consultants causing us to think outside the dots. I think we ought to start thinking outside the dots in a lot of areas of public policy, and particularly our welfare system.

For example, rather than starting with the current system and try to modify it, as President Clinton has done and as we have really done to a certain extent, why not reject the system as it exists now, start anew with the premise that welfare should only be given to people who are truly unable to care for themselves, they are disabled mentally or physically, and to people who work. Start with that premise and build a system off of that.

If you do that, then you end up with an EITC, a disability program and an unemployment compensation program. That should be our welfare system, put very simply. We can think outside the dots. We should. We should scrap a lot of what we are doing now and start anew.

With respect to the Medicare cuts: Mr. Stark, my good friend from California, knows very well that we have cut Medicare consistently through the latter part of the eighties and into the nineties. What he means by that is we have cut the growth of Medicare. We have never cut in nominal terms what we spend on Medicare, what we spend on the elderly. We have only cut the rate of growth. And the example he gave is exactly that, only cutting the rate of growth, not cutting Medicare.

And he also knows that every time we have cut the rate of growth in Medicare spending, those cuts have fallen not on the elderly, but on the providers in the health care system. And I am

sure that that will continue to be the case as we try to downsize Medicare.

I, for one, hope that we can cut Medicare some more. We are going to have to if we are ever going to get this budget into balance. Again, when I say cut Medicare, I am saying we need to cut the rate of growth and spending in the Medicare program.

The SPEAKER. Can I just say one or two quick things in closing? I want to build on what Mr. McCrery has said.

First of all, I don't know that I would ever use the term "cut Medicare." I think we need to transform Medicare into a different system. And I think it is nonsense for us to talk about a system which is highly bureaucratic, extraordinarily expensive, and in many parts of the country now is beginning to actually offer a lower quality of care as doctors begin to withdraw from it because they don't want to deal with the redtape and they don't want to deal with the Health Care Financing Administration. And so senior citizens are finding it harder to get good care because the Federal Government is making the system unworkable.

So I don't know that I want to increase or decrease what I think is a system that needs to be transformed, that needs to become different.

Let me build on that at two levels, and I will close on this, but I really commend this to all of you. First, I mentioned yesterday Marvin Olasky's "The Tragedy of American Compassion." Olasky goes back for 300 years to how we dealt with people who did not have money and people who needed care and needed help. The book is so radically different than anything I expected to read. He describes an America that was more effective at helping individuals in trouble and was constantly blocking itself from creating classes of people who were entitled to money.

When you read quote after quote for 250 years of active philanthropic reformers saying, "Don't set up a class structure where people are entitled to money or they will find a way to get the money, and they will change their behavior in ways that destroy them," it is the most staggering indictment of our current structure.

The one thing I didn't agree with my good friend Mr. Houghton about is, except for Social Security, which I think should be off the table because I think it will tear us apart to deal with it, I believe there are no other entitlements that do not deserve to be looked at and transformed. And I am not afraid. As I said yesterday, I am an FDR Republican. We have nothing to fear but fear itself. I want to have a public dialog about these things.

Mr. Archer knows full well, and I would encourage you to have both Democratic and Republican Governors come here and share with you the courage they have had: Talk to a Bill Weld who cut spending by 13 percent in 3 months; he got 71 percent of the vote getting reelected because people thought about it and decided they liked smaller, more effective government better than bigger, less effective government; I talked to a John Engler, who changed the system in Michigan and got 70 percent of the vote. And it is not just Republicans, Democrat mayors like Rendell in Philadelphia, who changed the structure of Philadelphia, or Norwest in Wisconsin, or talk to my Democrat Governor Miller, and these leaders will tell you, if you have the courage to look the American people in the

eye and tell them that it makes sense to do it better, we can dramatically change the size and shape of this government.

And that is the way I would like to approach it, not timidly, backwardly, not in the closed room, not afraid, but walking out in public and saying to the American people, "Your children and grandchildren are going to have a balanced budget, a better government that is more effective, that delivers goods and services better and that, where possible, helps every American pursue happiness by having the best paying jobs in the world."

That is our challenge. It is a hard challenge, and I simply say to my Democratic friends—and I apologize, I have got to go to another meeting—but as I said to the President this morning, and it was a great meeting, we will reach out, we will work together. I believe we can get most of this Contract, virtually all of it passed, and I believe if we work together, it will be good for America.

Thank you very much, Mr. Chairman.

Chairman ARCHER. Thank you for giving us your time out of your busy schedule, and for your vision and for your presentation.

With apologies to the members who were denied the opportunity to inquire because of the constraint of time, I do think we should be grateful to the Speaker for the time he has given.

When we adjourn, we will adjourn until 9 a.m. on Tuesday morning. Normally we would hold our hearings at 10 a.m., but a number of Members of Congress wish to testify, and in an attempt to accommodate them on Tuesday, we will begin at 9 a.m.

The committee is adjourned.

[Whereupon, at 2:35 p.m., the hearing was adjourned.]

CONTRACT WITH AMERICA—OVERVIEW

TUESDAY, JANUARY 10, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 9:05 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

Chairman ARCHER. Today we begin the second day of overview hearings on the Contract With America. Last week we heard from the Speaker, Newt Gingrich, and today we will hear, first, from the distinguished Minority Leader Richard Gephardt, followed by Secretary of Health and Human Services, Donna Shalala, other Members of Congress, and from Les Samuels, Assistant Secretary for Tax Policy with the Department of the Treasury.

In addition to items under consideration by the full committee, the subcommittees are having their hearings, and when we are finished, we will have heard from hundreds of witnesses on all of the details that are included in the Contract.

The Contract and the five related bills that are subject to the jurisdiction of this committee represent a powerful agenda to get America on a positive track. I call it an agenda for the next century. And while the Contract's main principles of less government, less spending, lower taxes, and more freedom will not be changed, we are holding these hearings so we can benefit from the very best ideas of the American people and their representatives. And we do welcome and should welcome new ideas and thoughts.

As I have stated before, I intend to carry out the taxpayers' business of this committee in a bipartisan manner. I believe the American people will benefit from the best ideas from both parties. No party has a monopoly on good ideas. Our work is important and listening carefully to each other is equally important.

Dick, I welcome you to the Ways and Means Committee and I look forward to your testimony, but if I may, prior to hearing that, I would like to recognize my friend and the leader of the minority of the committee, Mr. Gibbons, for a statement.

Mr. GIBBONS. Thank you, Mr. Chairman. I am going to yield to Mr. Rangel, who will make a statement for us.

Mr. RANGEL. Thank you, Mr. Gibbons.

Mr. Chairman, thank you for the bipartisan way in which you have started the operation of this committee under your chairmanship, and I look forward to working with you on the agenda for the next century. It is going to be exciting for all of us to see how we can dramatically reduce capital gains taxes, move forward into the

next century as the leader in trade and the global economy, and, at the same time, manage to see what we can do for the jobless and the homeless and the hopeless people in this country.

Right now we have over 1 million people in jail, 1 million people waiting to go to jail, 1 million people under some type of court supervision, and we also find millions of young children being born to irresponsible parents into poverty, destined to live in poverty, and their children to follow them. And so, when Republicans and Democrats and the American people focus on this, it is interesting to see that one of the solutions could be just to say that the Federal Government has no responsibility for this and we will pass it on to the States; another novel solution is to say that if you are 18 or younger, that the child receives no assistance at all.

An additional approach could be that if the mother cannot identify the father, then, obviously, she would not be entitled to health care or any other type of assistance. And whether she is trained for work or whether work is available, if somehow in 2 years she is not working, then certainly it is not a Federal responsibility. This is interesting because I suppose that it means that the child and the problem have disappeared, and since it bothers all of us to carry this burden into the next century, I am very anxious to see how these solutions are going to work.

So, Mr. Chairman, as we move forward together with this agenda, I do hope that when it is proven that it will not work, that some of us can come up with some constructive criticism, try to make amendments, and see whether or not for the American people we can find some solution to what everyone has identified as a real, serious problem.

Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, Mr. Rangel.

Without objection, any other opening statements may be inserted in the record at this point.

Let me say at the outset that Mr. Gephardt's testimony will be limited to 1 hour, including the questioning, and not because of him, because he is willing to stay on, but because our schedule is so full today and we need to hear from all of the other witnesses. I apologize to you, Dick, for that, but as succinct as I know you are, I think we can get a lot done in 1 hour. And having said that, we would welcome your thoughts.

STATEMENT OF HON. RICHARD A. GEPHARDT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI, AND HOUSE DEMOCRATIC LEADER

Mr. GEPHARDT. Thank you, Mr. Chairman, very much.

It is a great honor, always, to appear here, as it is today. I think it is very fortunate that much of the Contract that we are going to be considering over the next weeks is coming through this committee, which I served on at one time, as most of you know, and I say that because this committee has always had a tradition of responsibility and bipartisanship, which I think will serve us all well as we go through this very important set of issues.

I would ask that my formal testimony be made a part of the record. I would like to cut it way down and be very succinct, if I can be, so we can get to as many questions as we can.

Chairman ARCHER. Without objection.

Mr. GEPHARDT. Let me start by saying that I speak today not for the Democratic Party, although I am the leader in the House of the party, I speak as an individual and I am going to offer some ideas and suggestions that I hope will be constructive and helpful for your consideration on a number of the issues that you will be taking up in the next weeks.

We have a very new and aggressive policymaking process within our caucus in the party. It is fully engaged now and we are working to develop ideas on many of these proposals, and we will have those ideas as we go along at the proper time. But I do not pretend today to come here to speak for all the Democrats in the House. I come today as an individual and to offer some suggestions, constructive suggestions.

Let me first say that, before delving into the specifics, let me just give some of my observations about the Contract in general, and then I will get to the specifics.

First of all, I commend the Republicans for putting forward a set of ideas. I think that is a constructive way to operate. The Democratic Party in the House has always tried to do that, and I commend you for doing that. I have two worries about the Contract, and then I am going to talk about what I hope we can do with it.

The first is that even if you accept, in my view, everything in the Contract as being positive, and even if we were to enact all of it as is, I do not believe, with all humility, that it addresses directly, as we must and should, the major problems that face our society, or the core challenge that faces our society.

It is not that there is anything wrong with these areas. We do need to do welfare reform, we do need to do something about the budget, we do need to do something on taxes and on down the line. Term limits need to be considered and so on. But the core challenge that I sense in talking to my constituents is the standard of living of the American people, and especially middle-income Americans.

For a variety of reasons, some in our control, some not, in my view, the standard of living has been stuck in place or moving backward, and that has created a set of problems for families that are very serious. And it goes way beyond just the economic issues. Clearly, if people are not making enough money they have economic problems, but it creates human problems. If families are not able to be together because parents are working two jobs and on split shifts, they are not spending the time supervising children, relating to one another as a family, and doing the things that families have to do that take time.

And so this whole cluster of economic problems, which I think we are all aware of, are being compounded by becoming human problems, quality of life problems, whatever you want to call them, and I think that is the core challenge that our country faces as we move into the next century, and we have to do something about.

Some things in the Contract indirectly, some more directly, affect that cluster of issues, but, clearly, we have to do more. And I am sure everybody here would agree that once we are finished with the Contract, whatever happens with it, we have to move on to those central challenges and deal with them very directly.

Second, I have expressed since the beginning of the discussion a concern that if the totality of the Contract is enacted, that there will be very negative serious financial implications for the Federal Government's budget. We can argue about that, we can differ about that, but the way the numbers add up for me is that if we did everything as written we would wind up blowing at least a $1 trillion additional hole in the deficit, and I think that is something that this committee especially needs to be very careful about, because, obviously, that would have negative economic consequences.

Finally, I am—and I will talk in the tax section—I am worried about who gets the tax benefits and whether or not we get into a bidding war and whether we size the amount of the tax cut. I am going to talk about that more in just a moment. But I wanted to raise those concerns that I have while saying that I think any time anybody or any group in this Congress presents serious ideas to improve the country, it is a good thing, and you can be assured that the Democratic side, and I am sure the Republican side, will come forward to this debate in a constructive way and we will try to offer suggestions, as I will today, to make these ideas work better, and we ought to work in a bipartisan way as much as we can to try to approve these ideas and make them work for the American people.

Now, let me go to welfare reform and then to some of the other issues in greater specificity.

As I understand the proposal on welfare reform, as the gentleman from New York said, it has become probably a question of passing much of the responsibility for welfare to the States. I want to first submit that I do not think that anybody would try to argue that the welfare system we have is perfect or that it works the way we would all like it to work or that it could not stand improvement. Clearly, it could. The question, however, is what kind of improvement? Who do we help? Who do we hurt? How does it work? What is the outcome? What is the result?

If we make a decision that more responsibility should be pushed to the States, I think we have to be very careful about how that takes place. I think all of us believe in work and personal responsibility, but I think that we have to not just pass the buck but we have to figure out how to solve the problems.

Block grants toss the ball to the States and hope they do better, but I think we have to require them to do better. We cannot just cross our fingers and hope for the best approach.

I am not talking here about mandates. I am not suggesting that we fly in the face of another effort that we are engaged in in the Congress of getting rid of unfunded mandates. I am saying that if we are going to be contributing huge amounts of money to the betterment of the welfare system in the country, that it is not wrong for us to demand real results. Not complex bureaucratic requirements, but basic human requirements. And let me just quickly suggest four possible standards that we might think about if the decision is to give the States more responsibility.

First, we might want to say that all children and families under 90 percent of poverty should receive adequate nutrition, housing, and health care. The Speaker in his speech last week emotionally, and I think very movingly, talked about what is happening to chil-

dren in our society, to some children in our society. There is not an American, I believe, who does not want to change that situation. But if we just send money to States without some sense of what we are trying to achieve, then we have really missed the boat.

Why should we not set a goal for them to reach for that says that kids in families under 90 percent of poverty should not be left out in the cold, should not be starving, should not be in grave difficulty? That seems to me to be a place to start.

I might note that protecting children is a Democratic priority on a whole host of issues: Health care, crime, education, job training and so on. So that is the first suggestion.

A second standard or requirement might be with regard to fathers. Could we say fathers of illegitimate children should be identified and either paying child support or married and part of the family? All of us believe strongly that if there are two parents available that there is a better chance that children will get a proper start and will be dealt with properly.

Why should we not encourage a requirement or a standard that States should move toward a goal which would bind families together, push families together, rather than requirements or inducements that pull them apart? Something we have talked about in past versions of welfare reform and needs to be addressed again in this version.

Third. Should we not say that a large proportion of AFDC recipients should be placed in jobs as a goal, with child care and health care for kids? Under the Personal Responsibility Act, which was an original provision in the Contract, only 2 percent of a State's welfare recipients were required to have jobs, and by the year 2003 that commitment rose to only 50 percent.

Do we really want to leave this question with States with a goal that says we are only trying to get half of the people into jobs? Why should we not go for 100 percent? Should the goal for welfare not be, as the President said in his speech of about a year ago, to get this not to be a way of life, but a way up, a way out of a system that no one really wants to be in?

Finally, could we not suggest that States have programs serving parents living in poverty to help them be better parents? We have a program in Missouri that has now been copied in most States called Parents as First Teachers. Parents as First Teachers. It is a family-based program. It tries to help parents be not only good parents but teachers. And we all know that our parents are our most important teachers throughout our life. Should we not encourage, as a goal, States to have programs like that?

We know Head Start works. There is little disagreement that Head Start is an important way to deal with youngsters who are in tough situations, who have families that are not intact, who are having learning problems, who need help. It is a way to keep children in families, not a way to separate them from families.

In the crime bill last year, I suggested an approach of getting schools to be a major instrument in helping families stay together and helping children succeed in difficult poverty circumstances. I have been to the Comer Schools in New Haven, Conn. We have Comer Schools in St. Louis. They start earlier; they go later. They have lower pupil-teacher ratios. They bring families into the school;

they send people out to get families to bring them into the schools. Some of them require that families be present in the school for a certain amount of time a week and they show tangible results. This is the important thing, tangible results, in getting better test scores, more intact families, and in helping families succeed at what they are trying to do.

At the original Comer School in New Haven, Conn., in the toughest, poorest part of New Haven, the school that 20 years ago had the worst test scores and the worst outcomes for children, now has the second best in the New Haven system. I visited it, I talked to the children, I talked to the parents, and any of you who would go there would be deeply impressed with what they have achieved.

So those are four suggested things that we might look at if indeed we are going to give States more latitude and ask them to try to produce with the dollars that we are sending.

Again, I think simply sending money, without any sense of what we are trying to do, will not work. If we shift responsibility but we do not demand results, I think we are going to be hypocritical and we are going to fail. This is not micromanagement, this is not trying to tell everybody how to do everything, but broad basic goals.

Let me say one other thing. I think people's frustration with our political system in government has been that we do not get the results. I think a lot of the frustration in the last two elections was, you know, people look at us as plumbers or doctors. Do not tell me how you are going to fix it; fix it. If I have a broken leg, or I have a broken pipe, I want it fixed. Do not bother me with how you are going to do it.

I would hope in this welfare reform, in addition to these kind of broad requirements we could say to State governments, if you do better from wherever you are starting at these kinds of standards, whatever they wind up being, we will give you more money. We are trying to get the result. We will pay for results. If you get more people employed, if you get more kids covered and not standing out on street corners and not being malnourished, we will give you more money.

And on this point, I know there is a desire to save money in welfare reform. Well, I am not so sure that needs to be our goal. Our goal is to get people off of welfare. Our goal is to get people in jobs. Our goal is to make sure kids are not malnourished. If that is our goal, let us not start off by saying we are going to save money, necessarily. We may not be able to do that.

I would be thrilled if we could use the money we have and get better results. And if we could spend a little more money and get the result, if we could really get people off of welfare, then we ought to try to do that if we really think the results are being achieved.

Now, let me go to tax proposals in the Contract. I think all of us believe that taxes are too high. All of us want to see how taxes can be reduced. I want to say that I am very happy that Republican leaders, including the chairman of the committee and others, the Speaker, the majority leader, have said that in this tax debate we are going to not have a bidding contest, as we have sometimes in the past, and we are going to try to do the cuts and bank them and pay for the tax cuts before we do them.

I totally agree with that sentiment. And for my part, and I think for the Democrats' part, we will try our best to live under that regime. We think that is the right way to do it.

I think that if that is what we do, there is going to be a limit to the tax cuts we can produce. I know a lot of the Republicans want to do every tax cut that is in the Contract. I would hope that we will again limit ourselves to what room we are able to find in the budget.

For my part, I think we should move the tax cut to the people who need it the most, and I will not bore you with the facts that you have heard me give before. You may not agree with my facts, but I believe in the last 20 years the middle class has stood still in income while their taxes, especially at the State and local levels, have gone up. I think people at the top have had their income go up dramatically while their taxes have gone down dramatically. And, therefore, I think if there is a limit to what we can do, we should focus it at the people who need it the most.

I think that what I hope we will talk about is how to best focus this at these middle-income people. I have an idea that I presented, which is one that I hope you will consider, that simply says we give a wage credit. We do not try to get too fine, we do not try to get too worried about who exactly gets this, but go at people who earn under $75,000 a year and give them a simple credit against their wages, period. Not on how many kids they have; not on how much tuition they pay. Everybody is treated the same way.

The President has a different and a very good proposal. He says do it on tuition. Do it to help for education. I think it is another very sound and good idea. Whatever the idea is, I simply hope that you consider focusing whatever moneys we are able to produce at the middle-income taxpayers.

Finally, let me talk about the balanced budget amendment, because I know this committee is going to be involved in that discussion. What I have been trying to say in the last days is that I hope whatever the balanced budget amendment turns out to be—and I don't know whether we will agree on one—but whatever it turns out to be, that along with it, the Congress passes a balanced budget resolution for 7 years, 8 years, whatever it is, and that that be presented before the amendment, whatever amendment it is is sent out to the States.

Why do I say that? I say that because I think people, as they are considering it in the States, should not buy a pig in a poke. This has real consequences in people's lives. It is easy to say let us balance the budget; it is hard to say how to do it. And you all know that.

The American people deserve honesty. We need to lay out for them what this means in their lives so they can determine whether or not they want to do it. I will not bore you with my version of a balanced budget. I have authored one. I have been for one. I am not for a supermajority to unbalance the budget. I will not bore you with why I think that should be.

I am for exempting Social Security because I think it is in a separate category and we do not want to break that contract. But whatever the amendment turns out to be, and the Congress will work its feelings about this, I would hope that we would pass the

Honest Budgeting Act or the Right to Know Act and put the specifics out there before the States take it up.

Let me end with this, Mr. Chairman. I think this is an important time in our history, as the Speaker said it was the other day. I think we have a chance to do some very important things. I would hope that we can work hard to find the common ground together.

I have been here now for 18 years. I know how hard it is to compromise. The reason we are here is that we are here sent by people who largely disagree over most issues and we are here to resolve conflicts. And as I said the other day, it is a marvelous achievement that we can do this peacefully and with respect and dignity.

If we are to find common ground, it only comes through hard work and compromise and reaching for an agreement that we can all live with. That is very hard to do. Not because we are trying not to agree, but because we do not agree. You can go down to any street in any district, houses that all look the same, walk door to door, and you will find serious disagreements not only between the people in the different houses but sometimes between the people in the same house. So to think that we do not have disagreements in the Congress representing 240 million people is just crazy. We do. The question is can we overcome the disagreement.

And I just pledge to you that we will work as long and as hard as we possibly can to find common ground, to move these issues in the proper direction, and to give answers and results to the American people. That is what they send us here to do and that is what we must do.

Thank you very much.

Chairman ARCHER. Mr. Gephardt, thank you very much for your input and for your very strong expressions of cooperation. With it we can move ahead to try to do the right thing for all the people of this country. I appreciate that.

[The prepared statement and attachment follow:]

NEWS FROM THE HOUSE DEMOCRATIC LEADER

For Immediate Release:
Tuesday, January 10, 1994

Democratic Leader Richard A. Gephardt
H-204, U.S. Capitol

Testimony House Democratic Leader Richard A. Gephardt
On the "Contract With America"
Committee On Ways and Means

Chairman Archer and members of the Committee:

I thank you for the opportunity to testify this morning, to share my views on the package of proposals that is now before the 104th Congress -- the "Contract With America."

But let me begin by saying how pleased I am that so much of this crucial debate will take place right here, in the Committee on Ways and Means. As a former member of this Committee, I have a great deal of respect for your tradition of partnership before partisanship.

Frankly, that's the only way this Committee can meet its broad mandate, which touches on virtually every area of our nation's government. So I look forward to working with Chairman Archer, and with each and every one of you, to make sure that all Americans have a stake in this Contract -- before we sign on the dotted line.

Before delving into the specifics of the Contract, I think it's useful to take a step back, and ask ourselves two broader questions: first, what do we really hope to achieve by passing this Contract? And second, for whom do we hope to achieve it?

It is clear by now that there was no massive mandate for this Contract. Most Americans hadn't even heard of it when they cast their votes this November. Many Americans still don't know what's in it.

That doesn't mean the Contract can't be a useful vehicle for reform and progress. It can. And with a great deal of discussion and revision, I hope that it will.

But let's not fool ourselves into thinking that this Contract is the be-all, end-all of the 104th Congress. Let's not fool ourselves into believing that the Contract With America -- whether you like it or hate it -- will really bring the kind of progress we need to build a better America for ourselves, and for our children.

You see, there's one question Republican pollsters failed to ask in the countless questionnaires and phone surveys that shaped this Contract:

Even if every clause in the Contract is signed into law, do America's hard-working, middle-class families really think it will make their lives any better? Or our schools any stronger? Or good homes any more affordable?

Congressional terms would be limited. But would the fifteen-year slide in America's wages and standard of living be limited?

Capital gains taxes would be slashed for wealthy investors. But would families who can't afford to play the stock market really gain?

A balanced budget would be required by Constitutional Amendment. But would an average family have an easier time balancing their checkbook?

The President would have the line-item veto. But would a struggling young couple be able to buy the items they need to support a family?

I daresay the answer to all these questions would be a resounding "no." And

ultimately, this is my biggest concern with the Republican "Contract." At best, it is a marginal, peripheral diversion from the real task at hand: improving our standard of living, raising real incomes, and protecting America's jobs.

At worst, it's trickle-down economics all over again: huge tax breaks for the rich, massive defense increases, and only two ways to pay for it -- exploding the deficit, or carving huge chunks out of programs that benefit hard-working, middle-class families.

Ultimately, this is where the two parties diverge -- and this is where the great debates will take place in the new Congress. The Republican Party remains committed to a trickle-down approach that serves the best off, and hopes that somehow the rest of us can feed on the leftovers.

The Democratic Party thinks that government has to stand up for those who have been left out or locked out of good jobs, decent incomes, and real opportunities for the future.

While some of the issues the Contract raises are useful, even at its best it has little capacity to help the people it threatens to hurt.

When I look down the list of items -- a balanced budget, a welfare system that rewards work and responsibility, giving a break to overworked, underpaid, overtaxes families -- I find a lot of goals that I agree with.

But on just about every issue, the devil is in the details.

That may be why, in focus group after focus group -- and I know there were many -- people universally liked the Contract.

Reduced to sweeping statements of principle, the goals are unassailable. But when you read the fine print, it's a different story altogether.

Let's start with the critical issue of welfare reform. I believe very strongly in the value of work and personal responsibility. We've got to reform a system that simply doesn't do enough to emphasize those core values. I'm committed to doing that.

But the leading Republican proposals -- the Personal Responsibility Act, and the more recent effort to shift to Block Grants to the states -- amount to passing the buck, when we should be solving the problem.

The American people have a right to know that every dime they send to Washington to pay for public assistance programs is easing the transition from welfare to work. Under the Republican plan, all we're really doing is tossing the ball to the states, and hoping they do a better job.

We don't require them to do better; we don't even really ask them to do better. It's a cross-your-fingers, hope-for-the-best approach -- and an irresponsible way to spend taxpayers' dollars.

I say: as long as we're going to commit federal dollars to the states, let's focus on the notion of rewards for results. And let's demand that states meet some minimum standards -- not complex, bureaucratic standards, but basic human standards. I would suggest four:

First, let's draw a line in the sand when it comes to America's most precious and vulnerable resource -- our children. Let's say from day one that we will not design, or condone, or tolerate welfare reform that punishes children, period.

Let's tell the states that in return for a welfare block grant, they must ensure that

children in the poorest families -- say, those under 90 percent of the poverty level -- all have decent nutrition, housing, and health care.

And this is a principle of protection that must extend far beyond the narrow confines of welfare reform. On crucial challenges such as crime, and health care, and education, and job training -- we must ask ourselves at every step of the way: are we doing enough for America's children? Are their needs being served? That is one of my highest commitments as a Democrat, and as an American.

Second, it never ceases to amaze me how, when we talk about welfare reform, when we talk about personal responsibility, usually that means the mother has to take responsibility. That's only half the equation. What about the father? Why are we going after welfare moms, but tolerating deadbeat dads?

What about a system of carrots and sticks to get fathers to play a role when a child is born out of wedlock? Let's ask the states to ensure that fathers be identified, and required either to join families through marriage, or pay child support. Fathers who can't support their children because they're unemployable should receive job training and job placement.

Third, it's time to move beyond the rhetoric of replacing welfare with work, and focus on the reality. We need a real commitment to creating jobs and opportunities, and to helping welfare recipients find them and qualify for them.

Under the Personal Responsibility Act, a paltry two percent of a state's welfare recipients are required to have jobs, and by 2003 that commitment rises to only 50 percent. Do we really think half a loaf is good enough? Can we really say to struggling families on welfare: we think half of you deserve a job?

We should ask states to ensure that a much greater proportion of those receiving A.F.D.C. are placed in jobs, and offered child care and health care for their children as well. I don't see why our goal shouldn't be 100 percent, not 50 percent. That's the only way "welfare to work" becomes a solution, not just a slogan.

Fourth and finally, we've got to stop pretending that the cold authority of a welfare check -- whether it comes from Washington or from the state house, whether it comes with carrots or with sticks attached -- will solve the problems of our neediest communities.

I've spent enough time in the needy neighborhoods of St. Louis to know that without positive role models, without a way to learn the skills of successful family life, we'll never build the kind of strong families that break the cycle of dependency. Let's ask states to develop programs that teach parents living in poverty to be better parents.

These may be mentoring programs, such as an outstanding program here in the District that both Speaker Gingrich and I have supported; programs for teenage parents in our schools; or existing programs such as "Parents as Teachers" or Head Start.

But the point is this: welfare reform that simply changes the logos on the checks until they run out will get us nowhere. Welfare reform that shifts responsibility, but doesn't demand results, will be doomed to failure. Welfare reform that gives lip service to strong families and work but doesn't lift a finger to provide them isn't just bad public policy -- it's plain old hypocrisy.

That's why I'm advocating the four standards I've outlined. It's not an effort to micro-manage: let the states meet these broad standards any way they please. But let's not just throw money at the states and abdicate the true federal role in this debate, which is leadership. Setting the goals. Laying out the vision.

We need a real partnership with the states. Partners don't just mail checks to one another; they work with one another. Dollars without direction and accountability is a recipe for disaster.

If the states show real progress toward meeting these standards for a substantial proportion of welfare recipients, I believe we should pledge them greater federal funding, to serve even more people the next year. Rewards for results. It's the only way to make sure the system really works.

I'd like to raise just two further points about welfare reform. First, I think it's a mistake to slash overall funding by 15 percent to reduce the deficit, as the Republican proposals do.

Ask any Governor: assuring decent jobs, feeding hungry children, helping people to live lives of decency and dignity, is neither cheap nor easy. Channeling all of the savings from welfare reform into deficit reduction, as the G.O.P. plan does, is like starving your children to speed up your mortgage payments. It just doesn't make any sense.

At the same time, let's not pretend that we have all the answers to this crushing complex of problems we call poverty and dependence. If we move to a system of Block Grants, let's give it five years to work. At the end of those five years, let's be prepared to reassess it, and start over if it doesn't work.

In the final analysis, it's a question of the kind of America we want to build. It's a question of the kind of people we want to be.

Speaker Gingrich has spoken very eloquently about his dream of America -- about the Monday morning we can all wake up and find that no child has been killed over the weekend; that our children have decent schools in which to learn and grow; that it is easy to find a job or create a job.

That's an admirable vision. But I have some caveats to that vision.

I dream of a Monday morning when our children are safe not because they have been ripped from their families and thrown into indifferent, big-government institutions -- but because we've made their families and neighborhoods strong.

And I dream of a Monday morning when it is not just easy to find or create a job, but when every American is ready to fill those jobs.

Now let's turn to the tax proposals in the Republican Contract.

Let me say as plainly as I can that I agree that taxes are too high, and it's time to cut them. I've fought for tax reform for years -- and you won't find a stronger advocate of a simpler, less burdensome tax system.

But let's talk brass tacks for a moment. Tax cut proposals may be a dime a dozen -- but they cost billions of dollars apiece. The 104th Congress isn't going to pass ten different tax cuts; we can probably afford to pass one.

So the question becomes: who needs that tax cut the most?

The Contract's answer is clear. Seventy-two percent of the benefits of the Capital Gains Tax Cut would go to Americans earning over 100,000 dollars a year. The family tax cut would go to families earning up to 250,000 dollars a year.

Over half of the benefits of the Contract's tax provisions for individuals would go to those earning over 100,000 dollars a year -- and a third would go to those earning

over 200,000 dollars a year.

The flat tax proposal advanced by Leader Armey follows the same formula. According to the non-partisan Citizens for Tax Justice, if you earn 30,000 dollars, you'll pay 1,700 dollars more in taxes. If you earn 530,000 dollars, you'll pay 44,000 dollars less in taxes.

Even the Wall Street Journal predicted last month that the Contract's tax provisions would create, and I quote, a "new generation of tax shelters," allowing "some big and profitable companies to escape taxes altogether."

I'm not saying we should penalize the rich, or get into a big debate about who's middle-class and who's wealthy. But after years of tax giveaways to upper-income Americans -- after years of declining incomes for hard-working families -- I think it's clear what our priority should be.

We've tried trickle-down tax policies -- based on the notion that if you feed those who already have food on the table, some of the crumbs will fall to those who really need it. And according to any reputable or reasonable economist, that approach failed miserably. Isn't it time for trickle-up economics? Isn't it time for tax cuts and incentives based on the notion that if most Americans are struggling, we can hardly sustain our nation's businesses and corporations, let alone our own families?

That's why both the President and I have proposed a tax break for working people, anyone earning less than 75,000 dollars a year.

My approach is a straightforward tax cut, with no strings attached, whether or not you have children. I believe the best way to help working families is by letting them decide how to spend their own money. The less government interference, the better.

Astonishingly, the Republican approach denies all tax relief to those without children -- as if the childless haven't got a care in the world. Let's face it: the size of your family isn't always related to the size of your wallet. My tax cut proposal recognizes that reality.

Here are some of the details of my Working People's Tax Break:

25 percent of a family's wages and earned income would be exempt from taxes, up to a maximum of 5,000 dollars. In other words, if you earn 20,000 dollars, you won't have to pay taxes on the first 5,000. It's like having three months tax-free. The maximum family tax cut would be 750 dollars.

Individuals could exempt a quarter of their earned income up to 3,000 dollars, for a maximum tax cut of 450 dollars.

The plan would cost about 33 billion dollars per year for two years, and would give the average taxpayer a tax cut of 486 dollars. Overall, about 69 million Americans would benefit. Those receiving the Earned Income Tax Credit today would have to choose between the two.

I want to make it very clear that when I talk about giving a tax break to working families, instead of wealthy investors, I'm not advancing an anti-growth agenda. I'm proud of the President's programs and policies that have created more than five million jobs; cut the deficit for three years in a row; and brought unemployment down to an impressive 5.4 percent. I'll be the first to say that we have to do even better.

But the Democratic Party has a sacred commitment to help hard-working, middle-class Americans. Those are the people we've fought for -- and those are the people we're going to keep fighting for in the 104th Congress, with tax policies, and with all

policies.

For that reason, I must say that I'm deeply concerned that last week's drop in unemployment could lead to another damaging interest rate hike. The fact is, in recent weeks and months, some Federal Reserve officials have expressed the view that the economy is too strong.

I don't criticize the Fed lightly. But I wish some of the Fed officials who think the economy is too strong would come back to my district in St. Louis, and meet some of the families and workers who are barely making ends meet.

Our people are working longer hours, for less pay, with fewer benefits -- in jobs they're not even sure they can keep. If you ask them if the economy is too strong, I daresay they'd give you a very different answer than the average Fed official.

The Fed has already done a lot to tighten the economy. To take another drastic measure before fully gauging the results of these recent rate hikes could cause needless economic distress for millions of workers.

At the same time, the traditional view of inflation -- that strong growth leads immediately to higher prices -- simply doesn't hold true in a super-competitive global economy. If our manufacturers raised prices, they'd suffer serious setbacks in world markets. So while we must be careful, we need not be overzealous about this risk.

Unemployment may be down, but the fact remains that underemployment is rampant. Many of the jobs created in the past two years are not good jobs, and lack the kinds of benefits and security that ensure true, long-term economic strength and stability. Unemployment among young people and minorities is far higher than the national average.

If many of America's families are condemned to joblessness and hopelessness, what kind of recovery is it anyway? So I urge the Fed to move very carefully in this matter.

Let me raise one final issue today -- one which is not strictly within the jurisdiction of this committee, but raises questions that are of grave concern to this committee. I'm talking about the Balanced Budget Amendment -- and unfortunately, there's not much I can say about it, because it's a proposal wholly devoid of detail.

Let me be very clear about this: I believe in a balanced budget. But the question isn't whether you do it -- it's how you do it, and on whose backs. That's where this committee ought to be concerned.

Will Social Security or Medicare be on the chopping block? Will veterans' pensions be submarined? Will farm assistance be put out to pasture? Will major tax changes be required to balance the budget?

We simply don't know the answers. And it seems that some don't want us to know.

House Republican Leader Dick Armey says that if the people know what a Balanced Budget really means, they won't like it, Congress's "knees will buckle" -- and it'll be doomed to failure.

But we say: we're not signing this contract until you show us the fine print. We don't believe in cloak-and-dagger public policy.

The people have a right to ask: Is there some hidden agenda here? Is this a veiled attack on Social Security or Medicare? We need to know. And if the plan can't

withstand the bright light of scrutiny, maybe they'd better go back to the drawing board.

That's why Senator Daschle and I have introduced the Honest Budget bill in both the House and the Senate. It's a bill that requires us to be honest with the American people -- to tell them exactly how they would balance the budget.

Under our proposal, before a Balanced Budget Amendment can be sent to the states for debate, Congress must present an actual balanced budget plan with reconciliation instructions -- a clear, line-by-line accounting of how they would achieve a balanced budget over the proposed seven-year period.

We won't delay a vote on the Amendment. But neither will we allow this Congress to balance the budget on the backs of working people and senior citizens. If we're serious about balancing the budget -- let's lay our cards on the table, and let the people be the judge.

I believe this same principle of open, honest debate should be applied to the way that this Congress calculates its budget estimates.

As you are all aware, some of our colleagues want to use something known as "dynamic scoring." It means that when we consider a proposal, if its authors believe it will create economic growth, they can subtract that growth from the cost of the proposal -- even if no respected economist or budget expert in the nation agrees.

Dynamic scoring isn't about objective fiscal analysis -- it's about blind ideology. It's about cooking the books when we don't like the real recipe. Supply-side economics has always been far outside the mainstream of economic opinion in this country. And its critics have been proven correct.

The American people demand that the numbers we use to measure a bill's impact on their lives be real, not rhetorical. Based on policy -- not politics.

That's the way this committee has always worked -- and I trust that tradition will continue. Quite frankly, there have been a lot of times when Democrats didn't like the numbers. But we never dared to corrupt the system to serve our own agenda. The truth isn't always easy. But it's always necessary.

And this isn't about partisan politics, as some have charged.

I think the new Republican majority will be surprised by Democrats' willingness to work with them, as partners, if we can have a frank and honest debate about the costs and consequences of the Contract.

That's where the Ways and Means Committee has a crucial role to play.

I served on this committee for 12 years -- and I'm very proud of the work I did with this committee, under presidents of both parties. This committee has always had an abiding commitment to the public interest -- to reasoned analysis, and serious scrutiny of each and every proposal.

Many party leaders have wished this committee would simply steamroller their agendas -- but the work that is performed here is too important, the stakes too high, for politicized public policy to reign supreme.

I urge you, in the days and weeks ahead, to hold fast to that commitment. To think not of the focus groups, but of the families where the husband works during the day, the wife works at night, and they barely ever see each other.

The families that have given up every minute of family time working two, three,

even four jobs -- working in plants and factories where they're treated like robots, devoid of all meaning and fulfillment.

The families that want government reformed, and improved -- but don't want to see our safety net shredded, and our decency denied.

I think a lot of good can come of this Contract if it is redrafted with those families in mind. In its present form, its impact on their lives will be marginal at best, and devastating at worst.

Let's move through these first hundred days diligently and prudently -- and then let's get down to the real business of working America.

Thank you. Now I'm happy to take your questions.

# # #

Working People's Tax Break

* 25 percent of a family's wages and earned income would be tax-free up to a maximum exclusion of $5,000.
* In other words, an average working family making $20,000 would not have to pay taxes on the first $5,000 they earn.
* That works out to a family making $20,000 not having to pay federal income taxes for the first 3 months of the year under this proposal.
* The maximum credit for working families would be $750.
* 100 percent of the benefits of this tax proposal would go to taxpayers with adjusted gross income of less than $75,000.
* Individuals would be able to exempt 25 percent of wages and earned income up to a maximum of $3,000, for a maximum credit of $450.
* The cost of this plan would be roughly $33 billion per year. The tax break would be available for two years.
* An average taxpayer would get a tax cut of $486.
* 69 million taxpayers would benefit.
* Individuals eligible for the Earned Income Tax Credit could elect to continue to get either the EITC or the Working People's Tax Break. They could not receive both.

Preliminary Distributional Analysis

Income Class (AGI)	Distribution of Benefit	Average Tax Cut
Less than $10,000	1.6%	$149
10-20,000	12.3%	325
20-30,000	20.4%	475
30-40,000	23.6%	590
40-50,000	18.7%	634
50-75,000	23.3%	523
75-100,000	0.0%	0
100-200,000	0.0%	0
200,000 and over	0.0%	0

Chairman ARCHER. Let me say to the members that I would hope we do not get into the balanced budget amendment because that is not within the jurisdiction of this committee. I am pleased to receive your views on it, but I was part of the debate in the Judiciary Committee yesterday, and I think we are going to have to leave the details to them to work out. We have plenty on our plate here that we can discuss with you.

Second, I am pleased that you support the concept of putting in place spending cuts and that we will then know how much revenue we can lose, in effect, in this committee without exacerbating the deficits. I can assure you that this committee will not exceed whatever the limits are of spending cuts when we pass any tax cuts. That is the procedure, I understand, that we will follow, and I support it very strongly.

It is my intention, because we have a limited period of time for questioning, to begin to recognize members at the cutoff point when Speaker Gingrich is here so that each member will have an opportunity to question. Without objection, I would ask the committee to accommodate me in that regard in fairness to the members.

In addition, I would ask the members to attempt to limit their questioning time to 2 minutes so that more members will have an opportunity to have a colloquy with you. Prior to starting that procedure, however, I will recognize the minority leader of the committee for inquiry.

Mr. GIBBONS. I am not going to take my time. I would rather yield my time to some other member junior to me, Mr. Chairman.

Chairman ARCHER. I thank the gentleman.

I will also recognize the ranking Republican who was here at the time the gavel went down for inquiry, and then I will proceed down the list beginning where we left off with Speaker Gingrich.

The gentleman from California, Mr. Thomas, is recognized.

Mr. THOMAS. Thank you, Mr. Chairman. Being a junior member to the gentleman from Florida, do I get his 2 minutes?

Chairman ARCHER. I don't think so.

Mr. THOMAS. OK. Then mindful of the 2 minutes, I am going to ask you some questions and I would appreciate succinct answers so we can move forward. But, first of all, welcome back to the committee. It is good to see you.

You talked at the opening of your statement about children, and all of us are concerned about children. You made the comment about Speaker Gingrich's statements about children in his opening speech. The President, in his presentation of his tax plan the other night on television, talked about children as well. My understanding is the President's tax break is denied to parents of teenage children over 13 years of age. Do you agree with that aspect of the President's program?

Mr. GEPHARDT. As I said in my testimony, I guess I would prefer in the tax area we not get too fine and get into all those kinds of questions. I support what the President has presented in concept. I would urge the committee to look over the details and to filling out exactly how you want to do it.

I guess I am most comfortable, although I could live with what the President has or something like it, with a tax cut that does not

decide it on the basis of children or nonchildren and simply be a wage credit.

Mr. THOMAS. On page 2 of your testimony, Dick, you say at the bottom, "Let's tell the States that in return for a welfare block grant, they must ensure that children in the poorest families, say those under 90 percent of the poverty level, all have decent nutrition, housing, and health care." In your mind, is that an unfunded mandate?

Mr. GEPHARDT. No, I think it is a goal or a standard that you are reaching for. I think we should shoot high, and I think all of us want children to not be out in the cold and not be starving to death, and so I think we ought to set a very high goal and then—look, the Governors have come here and said, in a bipartisan way, they can do this. They can do well. They want to be freed up so they can see what they can achieve. I am not unwilling to think about doing that, but I do not want to just turn the money over with no admonition of what we hope can happen.

Mr. THOMAS. But you do not see it as an unfunded mandate?

Mr. GEPHARDT. I do not. I think if you set a standard—this is not micromanagement.

Mr. THOMAS. Last question. On page 7, where you say you "will not delay a vote on the amendment"—that was the balanced budget amendment—"but neither will we allow this Congress to balance the budget on the backs of working people."

Just let me say that those kinds of phrases—because, frankly, there are not enough people in this society who clip coupons or who do not work. Folks may want to define work one way or another, but when you use the phrase to balance the budget on the backs of working people, that really is the kind of statement that does not move us forward in trying to solve the common problem I think that both of us are looking for.

There are an awful lot of people in this society who work for differing amounts of wages and what we have to do is solve a real problem. And saying that you will not allow the Congress to balance the budget on the backs of working people really does not advance the debate very far. But I thank the gentleman for his testimony.

Mr. GEPHARDT. I thank you.

Chairman ARCHER. The gentleman's time has expired and the Chair recognizes the gentlelady from Connecticut, Mrs. Kennelly, to inquire.

Mrs. KENNELLY. Thank you, Mr. Chairman; and thank you, Mr. Gephardt.

We talk about children—and I would like this to be highlighted once again—we talk about children, all of us, because when we are talking about welfare, 10 million of the 15 million concerned are children.

I want to go further with something you mentioned at the beginning, Mr. Gephardt, and something that is important to many of us and that is child support enforcement. The Contract has child support enforcement included in the block grant back to the State, and yet we know over the past years, as we have wrestled with this very difficult question, any real progress that has been made has

been through the Federal level, through the IRS, or through really increasing grants and increasing paternity establishment.

Could you expand further how you would address child support enforcement? Does it go back to the block grant and compete with jobs programs, or are we to try to keep it on track with the Contract going quickly, because we know we try to get teenage mothers to be responsible. We should make fathers be responsible also. How would you handle child support enforcement at this time on this schedule?

Mr. GEPHARDT. Well, what I was suggesting is that one of the four standards or requirements, general requirements, that I would want to set is that we identify parents, that we have an active child support enforcement program in the States. And if we need, as we have thought we have needed in the past, a Federal partnership with that to make it work effectively, so people do not move around and escape their responsibility, we should do that.

All I am saying is to have welfare reform without an important element of identifying fathers and getting fathers to live up to their responsibilities, I think, is a terrible mistake. We would send a terrible message if we go through this and do not make that a big part of what we are doing.

Mrs. KENNELLY. Thank you, Mr. Gephardt.

Chairman ARCHER. Mr. Hancock will inquire.

Mr. HANCOCK. Thank you, and welcome, Dick.

Last Wednesday, at the opening of this Congress, you made the comment, let the great debate begin. And I think that is exactly where we are now. We do need to let the great debate begin and see if, in fact, we can make some major reforms in the direction that this country is heading, has been heading for quite some years.

You mentioned, and I just want a real brief statement here, in your opening statement that you are not impressed very much with dynamic scoring when it comes to economic activity. Our whole system is based on dynamic scoring. If it was not for dynamic scoring, there would not be any risk takers, nobody would do anything, because if they operated on a static model everybody would say, well, it is hopeless; you cannot change anything. Every businessman operates on dynamic scoring. He invests his money for the future. Every person going to school operates on dynamic scoring. Even when you get married you operate on dynamic scoring because you are looking for future benefits.

So I would like to point out, Mr. Gephardt, that dynamic scoring is what has made this country great for almost 200 years, and I wish you would really take a real good look at that aspect of everything that we do should be judged on the basis of how that is going to impact in the future instead of in the immediate, just based on the exact past history. Anyway, thank you very much.

Mr. GEPHARDT. I thank the gentleman for his suggestion.

This is an area where, I would hope, we could have a bipartisan, serious, open, honest discussion. It is one of those areas where we are not flying completely blind. We have past projections and past results, and I talked to Majority Leader Armey some about this, and I would hope that we could maybe engage in a real inquiry together on history to see what has worked and what has not. Be-

cause we are talking about something very important here, and that is what happens to the Federal budget, the deficit.

We do not want to go off with a bad projection that winds us up further in the hole, which is sometimes what we have done in the past. But it is one of the areas where it is not all theory and ideology. It really gets down to some hard facts and we should be able to look at those and make some judgments.

Chairman ARCHER. Mr. Ramstad will inquire.

Mr. RAMSTAD. Thank you, Mr. Chairman, Mr. Gephardt.

As I understand—you can tell I am a new member of the committee, I don't know how to turn on the microphone—Mr. Gephardt, as I understand your tax cut proposal, it is a credit for all taxpayers with an adjusted gross income of less than $75,000; is that correct?

Mr. GEPHARDT. That is correct.

Mr. RAMSTAD. Wouldn't your proposal, if it applies to single individuals, really exacerbate the already onerous marrying penalty?

Mr. GEPHARDT. I am more than willing to look at solutions to the marrying penalty problem. We have done that in the past, and you could do that in this proposal as well. I was trying to deal with a concept, what this tax cut might look like, who would get the major benefit from it. But I am not against trying to figure out how to undo the marrying penalty.

Mr. RAMSTAD. I appreciate that recognition of that penalty. I was struck by the contrast to the provision in the Contract, expressly proposing to reduce that penalty, and I appreciate your willingness to work with us toward that end.

The second area I would like to examine, in the 2 minutes allotted, concerns another real problem facing our economy. I am alarmed when I read and hear about the low net national savings rate. One economist at Harvard concluded recently that even if all the net savings went into machinery and equipment, the level of such investment in this country would still be too low to sustain long-term economic growth.

My question is, what tax policy do you believe would best encourage Americans to put more of their income into long-term savings to address this problem? As I am sure you know, Mr. Gephardt, we rank number seven in the G–7 nations in terms of our savings rate.

Mr. GEPHARDT. Representative, I have, through the years, been increasingly unimpressed with our ability to induce the actions we want in a lot of areas by what we do with the Tax Code. I do not agree with Dick Armey's flat tax, because I think it is very unfair, and we will have more on that later. But the general concept of what he is doing is something I am interested in, and a number of Democrats will be working on an alternative, so-called flatter tax proposal, and that is the way I think we ought to move.

I do not think we can micromanage the society in the Tax Code. I think we have overcomplicated it. I think we wind up confusing ourselves and our constituents, and I think if we could get most Americans on a 10, 10½, 11 percent rate, without any complications, then people would save and invest according to what makes sense, and that is what they should do.

Chairman ARCHER. Gentleman's time has expired. Mr. Coyne will inquire.

Mr. COYNE. Thank you, Mr. Chairman, and welcome, Mr. Leader, and thank you for your statement.

My question is, is it realistic to think that we can do meaningful health care reform without first doing welfare reform? I raise the question to see what your thoughts are on whether or not single parents would be able to get off of welfare without health insurance with two or three children.

Along with that, what should our priority as a party be regarding health care reform in this session of Congress?

Mr. GEPHARDT. Well, first, I believe and I think most people believe, if you could get everybody included in a health care policy, and that is a big statement, a lot of people would leave welfare. We induce people to be on welfare to get Medicaid. That is exactly what we are doing today. And if we could solve the health care problem, which is easier said than done, as we all know, we would make probably the most important step toward welfare reform in getting people off welfare.

I do think that as we do welfare reform, we ought to, as a Congress, address health care reform. And, again, I offer my hand to the other side to figure out what we can do. And I am now of the opinion that we could not do a big reform, so let us do smaller sensible reforms. And I am willing to start small. I would say tiny steps for tiny tots, and I think we should do something that we can agree on and then let us make it work. Let's show the American people that we know we have some sense of what we are doing; that what we did made intelligent sense and then demonstrate to them, again results, that it works. And then we can take the next step.

Maybe the first step is insurance reform. And maybe a few other minor things with it. Let's do that and figure that out together and let's walk before we run. And I am fully prepared to do that and it would be a very important step, along with welfare reform.

Mr. COYNE. Thank you.

Chairman ARCHER. Mr. Zimmer will inquire.

Mr. ZIMMER. Mr. Gephardt, in recent weeks you have spoken eloquently and movingly about the plight of many middle-class families whose income has stagnated over the last 20 years and we Republicans share that concern. I appreciate your expressed willingness here to work on a bipartisan approach to this problem.

Would you agree that a major element behind that stagnation in living standards for many Americans is the fact that our rate of investment and savings has been extraordinarily low, as Mr. Ramstad has referred to?

Mr. GEPHARDT. I think it is part of the answer. I think there are building blocks we can all agree on: Economic success, infrastructure, education, research, and certainly savings and investment, along with labor management relations and motivated workers together make a high standard of living and high productivity.

I just guess I have come to the conclusion, and I may be wrong and others may be right, that we can easily use the Tax Code to induce the result that we want on savings. I do not think it works very well. I think it winds up substituting the way money is saved rather than actually increasing the savings pool. And I just think if we could work to lower tax rates as low as we can get them for

all Americans, that we would get more savings and the right kind of savings that we should have, and that is what I would like to work to do.

But I understand the opposite point of view. People love IRAs, capital gains and other methods of making this happen. I just am not impressed with the results.

Mr. ZIMMER. Let me put a hypothetical question to you, then. If there was a tax rate cut which would substantially increase savings and investment in this country, which would create more good paying jobs for middle America, and if that tax rate cut would not reduce Federal revenues, would you support it, even though the direct beneficiaries initially would be disproportionately people who earn higher incomes?

Mr. GEPHARDT. I guess the problem is the if.

Mr. ZIMMER. Well, it is a hypothetical question. We can argue about the details later. Now we do not have time.

Mr. GEPHARDT. I cannot say I agree with the if. Obviously, you can assert that and you may be right and I may be wrong. I cannot agree with the assertion. I think the best way to go about this is to simply get income tax rates down as low as we can get them for everybody, and I think that alone will allow people to spend more time and more effort either earning money or investing money than they are doing today.

I think we have been so cued, not in a negative sense, we are all trying to do the right thing, but we have been so fine and so sophisticated in what we are trying to get people to do that we have frustrated our intent.

You know, we set up a tax break and then people all run to that, and then we worry somebody is going to abuse it and then we refine it and write more regulations and make it more complicated. People are driven crazy by this Tax Code. It is a disaster. It just does not work anymore. We are not smart enough. We are winding up trying to write a boutique Tax Code for everybody in the country. It does not work. We have to make it simple. Throw it all out and just say, this is what you pay.

Now, I want it to be progressive, as it is today. I do not want to go backward on that. But you could get four out of five Americans at a 10 percent rate and that, to me, would be real progress.

Mr. ZIMMER. Well, I would just point out your proposal would make the Tax Code even less simple than the one you are criticizing. I look forward to working with you on this issue. Thank you.

Mr. GEPHARDT. Thank you.

Chairman ARCHER. The gentleman's time has expired.

I want to thank the minority leader for his embracing that we need to perhaps replace the income tax with a better form of taxation.

At this point, Mr. Levin will inquire.

Mr. LEVIN. Thank you, Mr. Chairman. I am tempted to ask more on the tax proposal because, Mr. Zimmer, I think your question really is not hypothetical in the sense we tried that in the early eighties, and I think there is some history we at least need to look at.

Let me ask you, Mr. Leader, and welcome, a question about welfare reform. You have urged results-oriented welfare reform. I

speak as someone who has been, over the recent years, in favor of much more State flexibility, but let me ask you a question about the potential tension between some of the block grant proposals and the results-oriented approach.

Some of the block grant proposals say give the State the same amount of money for 5 years in a block grant and let them do as they see fit. You are suggesting a results-oriented approach.

What happens if there is a recession during those 5 years? In the States, having a set level for AFDC or for food stamps, unlike the present, where the Federal portion goes up, how do you put those two things together?

Mr. GEPHARDT. Well, I think we can think about a capped entitlement for States as opposed for individuals, and we could make it sensitive. You could write it so that it was sensitive to a number of outside factors if you wanted to do that, such as recession and so on. That would be possible to write.

But I also think that whatever amount of money we put into that capped entitlement, the theory of what we are doing is that States, if given more flexibility, can get more coverage, more results, more good things out of the money they get. And, in effect, that is why I like reward for results. I would like to put a little bit of reward on top of it, so that if they are really showing more progress from wherever they start toward those results, you even help them some more.

So you induce almost a national competition to see who can do this the best; who can get the result. But you have to have something to judge people against in terms of a result or you are just cutting a check and hoping for the best, crossing your fingers. And I do not think that works. But I think you can write a formula for a capped entitlement for States that is somewhat sensitive to exogenous factors.

Mr. LEVIN. Thank you.

Chairman ARCHER. Mr. Johnson will inquire.

Mr. JOHNSON OF TEXAS. Thank you, Mr. Chairman, and good morning.

Chairman ARCHER. If the gentleman will suspend. We are going to reach the hour here in about 3 or 4 minutes and I intend to recognize Mr. Collins and then we will release Mr. Gephardt and Secretary of HHS, Donna Shalala, will then appear as a witness.

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

Mr. Gephardt, you talk about us not identifying the family and the children as a problem, and yet you are the one that says we do not need to give a deduction for children; that it should be for the individual. Can you explain the dichotomy of those viewpoints?

Mr. GEPHARDT. I guess it goes back to my basic philosophy about taxation. I really believe we have confounded ourselves in the last 40 years by trying to write a Tax Code that is adjusted for everybody's personal situation. I think it is too hard, I think it is too complicated, and I think it is self-defeating. I think the American people are fed up with a tax system that drives them crazy.

I think we should let people make their own decisions about how they spend their money. We ought to get tax rates as low as we can get them and we should turn people loose to do what they want. If they have 10 children, then they have to deal with 10 chil-

dren. If they want to invest, they have to figure out what to invest in that will make them the most money. But we cannot micromanage it and figure it out for everybody from here. I think we have to leave those decisions about their money to them, take as little of it as we can to run this government, and we will have a raging debate over what the government should and should not do, and then turn them loose with their creative powers to do what they want to do. And I want it to be progressive. We may have a fight about that.

Mr. JOHNSON OF TEXAS. I think that is exactly what Mr. Archer has in mind, but we need to put money back into the people's pockets right now, and I think those credits do that for the people who have kids. You keep talking about being aware of the children and a welfare program and we are talking about tax reductions which would put money in people's pockets today.

Mr. GEPHARDT. I understand. I understand. And I am not unwilling to be for something for kids and tuition and so on. But you get into all kinds of complications. What about a couple that has kids that have just gotten out of college and they are still sitting there with loans they have to pay off? Are they included?

The world and families are complicated. Everybody is in a different situation. And you start trying to write something that takes care of everybody's deal and reality is tough.

Mr. JOHNSON OF TEXAS. I will draw one more conclusion. You made a point earlier, as Ross Perot says, just stop the car and fix it. Well, that is what we are trying to do, is fix it, right now. Then we go on from there with Mr. Archer's idea of possibly no income tax at all.

Thank you for your comments, sir. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Collins will inquire.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. Gephardt, I find it of interest that you mention you would be willing to go with a lower tax rate that would apply to all, because, to me, all would mean those with the higher incomes who would then reap a greater benefit from a lower tax rate than the families that you have put an emphasis on.

But my question to you deals with an area of the tax laws that I think is one of the biggest disincentives for capital investment and also has resulted, I think, in the loss of many jobs around this country, especially in the area of manufacturing and assembly lines, and that is the alternative minimum tax. And I would like to have your views on the alternative minimum tax as to how to change it, repeal it, or what you think we should do with it.

Mr. GEPHARDT. Again, if you went to what I am talking about, or Dick Armey's talking about, although I do not agree with his total approach, you would not need an alternative minimum tax because everybody would pay tax. You would not have deductions and exemptions and all the other things we use to get our tax rate down.

I think it is wrong for anybody in the country to get themselves in a position, even though they are doing all these wonderful things that we have said in the Tax Code we want them to do to pay no tax, it is hard for somebody to swallow out there working for $30,000 or $40,000 a year somebody making $2 million a year pays

no taxes. They may be doing a lot of wonderful things we ask them to do in the Tax Code but it grates on people that that is the case.

So again, if we could simplify the code, get out of the business of micromanagement, trying to figure out for everybody what they should do, we would not have to worry about a minimum tax. Everybody would pay a minimum tax at the lowest possible rates.

Mr. COLLINS. I take it then that you would be very interested in doing away with or repealing the alternative minimum tax?

Mr. GEPHARDT. I am for changing this Tax Code, and I will be offering ideas; and then, as was said, let the debate begin.

Mr. COLLINS. Good. Thank you, Mr. Gephardt.

Mr. GEPHARDT. Thanks.

Chairman ARCHER. Dick, thank you very much for your excellent testimony.

Mr. GEPHARDT. Thank you, Mr. Chairman. I always enjoy being in this great committee. You all serve on—and I hope you won't repeat this—but the best committee in the House, maybe in the Congress, probably, certainly in the Congress.

Chairman ARCHER. I think there are people here who will repeat it, but of course we won't argue with it, as members of this committee. Thank you very much.

Mr. GIBBONS. Of course, we remember your distinguished service here for so many years, too, Mr. Gephardt.

Mr. GEPHARDT. I enjoyed every moment of it. It was the best time I spent in the Congress, believe me.

Chairman ARCHER. The committee will stand in recess momentarily for the arrival of the Secretary of HHS, Donna Shalala.

[Recess.]

Chairman ARCHER. If our guests will please take their seats so we can proceed. We have a lot of witnesses today to hear from.

The Chair now welcomes our next witness, the Honorable Secretary of Health and Human Services, Donna Shalala. We welcome you to our committee, the committee that Minority Leader Gephardt just said is the most important, influential and powerful committee in the Congress, and we are pleased to hear your testimony. Immediately prior to that I will recognize Sam Gibbons for any comments that he would like to make.

Mr. GIBBONS. The only thing Mr. Gephardt could have said that he didn't say, was that it was filled with the most charming guys and gals that we have around here. And perhaps I think it better, though, that I yield my time to the next ranking Democrat who hasn't had a chance to inquire.

Chairman ARCHER. Madam Secretary, we welcome your testimony.

STATEMENT OF HON. DONNA E. SHALALA, SECRETARY, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Secretary SHALALA. Thank you very much, Mr. Chairman.

I should add my comments to Mr. Gephardt's about my admiration for this committee and for the work that you have before you.

I would like to thank the members of the committee for the invitation to appear before you today. I am pleased to be with you to talk about the Contract With America and to begin with what I be-

lieve is an important dialog with each other and with the American people.

I also have been asked to announce that the President will host a bipartisan working session on welfare which will include State, Federal and local elected officials on January 28, and the White House will extend the invitations today.

I would like to begin today by talking about our vision for welfare reform and the President's view of the Personal Responsibility Act found in the Contract With America. I have submitted more detailed testimony for the record.

I think it is fair to say, after consulting with Members of Congress, with people on welfare, with business leaders, with welfare experts, with religious leaders, with Governors, with State legislatures and county officials all across this country, the President honored his promise to the American people by submitting the Work and Responsibility Act to Congress last year. This was a bold, historic piece of legislation which would fundamentally change our approach to helping young parents move from dependence to independence, and it grew out of the President's longstanding commitment to welfare reform.

As Governor of Arkansas he worked closely with national and State officials from both parties to pass the Family Support Act of 1988. That act served as the impetus for States to begin changing the welfare system to one that encourages work, not dependency.

In the last 2 years we have worked with Governors and other elected officials to grant 24 waivers that give 23 States the flexibility to design welfare reform strategies that meet their specific needs. We have approved more welfare waivers than all the previous administrations combined.

The President's bold approach to welfare reform is based on a simple compact—job training, child care and child support enforcement will be provided to help people who are willing to work, make the move to independence. Time limits will ensure that welfare is seen as a hand up, not a handout.

Our approach emphasizes three American values: Work, responsibility, and reaching the next generation. But today welfare does not emphasize work, responsibility, and reaching the next generation. We agree on this, and both Republicans and Democrats have sought to change this with welfare reform. Yet from our perspective some elements of the Contract With America seem inconsistent with these values.

Let's talk about the value of work first. We are committed, first and foremost, to ensuring that everybody who can work does work and that current welfare recipients become taxpayers. That is what this great national debate on welfare reform must be about.

More something for nothing is not the answer. We believe that work is the answer. Our innovative approach to welfare reform puts work first, and in doing so it differs from the Contract's proposal in some important ways.

First, we send a critical message to people from the very first day they apply for welfare. You must work, we expect you to work, and we will help you prepare for work so you can stay off welfare for good.

We require those who are employable to move into work as quickly as possible by engaging in an up-front job search in education and in training, and we expect States to hold up their end of the bargain. And for those who refuse to train for work, for those who refuse to look for work or accept work once it is offered, the consequences are clear—cash assistance will first be reduced and then eliminated.

We also believe that people who can work should be treated differently from those who can't. Here I draw a sharp distinction between our approach and the Contract With America. We propose that everybody who can work does work. People who reach their time limits but can't find jobs must work for their benefits in temporary, subsidized jobs.

In contrast, the Contract ends all adult assistance after 2 to 5 years. Even if the recipients are willing to work but can't find work, even if the recipients are caring full-time for disabled children and even if the recipients are disabled themselves, the Contract ends all of their assistance.

Moreover, this is a lifetime limit. Once adults reach their limits, even if they have gone to work for many years and then lose their jobs due to a serious accident or an illness or recession, they cannot get aid.

We are pleased that the Contract's welfare provisions have been revised since when it was introduced last week to eliminate the mandate that aid to children must be cut off after their adult care givers reach their 5-year lifetime limits.

The second key value in our approach is responsibility. We believe that because every child has two parents both of them should be required to provide support. That is why, as an integral part of welfare reform, we have proposed a tougher, more uniform child support enforcement system as well as a stronger requirement for paternity establishment.

We also would impose tough new penalties for those who refuse to pay, including stronger wage withholding efforts, suspension of drivers and professional licenses and even property seizure. In stark contrast, the Contract includes few child support enforcement provisions and could actually reduce funds for child support enforcement.

In addition, our approach would deny AFDC benefits to the mother only after the State has determined that she will not identify the father. Once the mother has identified the father, then the responsibility properly rests with the State, which is given 1 year to establish paternity or face penalties itself under our proposal.

The Contract, on the other hand, denies benefits to any child for whom paternity has not been established. Even when the mother has identified the father and the State has not made a serious effort to locate him, the innocent child is held accountable. This is unfair. I think we can work together to address this issue.

We also demand responsibility and accountability from government by requiring States and the Federal Government to work together to implement new state-of-the-art measures to detect and prevent many types of fraud and abuse. These new systems will also help locate absent parents who are not paying child support. The Contract With America does not create any of these systems.

Our final bedrock value is reaching the next generation. We would put into place preventative measures to break the cycle of dependency. Welfare dependency could be reduced significantly if young people delayed sexual activity and childbearing until both parents were ready and able to assume the responsibility of marriage and supporting and raising children.

Our approach is aimed toward preventing teen pregnancy, and it requires that a minor parent live at home, identify the child's father and stay in school to get benefits.

Our plan of time limits and work requirements sends a strong message to young people that welfare will never be the same, that it will be a second chance, not a way of life. But we strongly disagree with the Contract's approach of denying benefits to children born to mothers under 18. Whether or not their parents are able to work, whether or not their parents are properly caring for their young children, the Contract With America raises the possibility of sending them to orphanages.

Of course, we are not suggesting that all of these children will wind up in orphanages. In fact, some parents will move on to lives in the mainstream. But States will have to find a way to care for the others.

We believe that the solution to welfare is not to make children go into foster care or into orphanages, it is to make their parents go to work. Yes, we have to take bold steps to tackle the problem of teenage pregnancy, but we can't give up on teenage parents.

To be eligible for support, we must insist that they stay in school. We must insist that they live at home. We must insist that they prepare for work. We all must be part of a national effort against teen pregnancy to make it clear that young people should not become parents if they were not prepared to take on the responsibilities for their children's futures. This is a critical element of welfare reform.

As we join forces to move people from welfare to work, we also have to address the bureaucratic absurdity and the human tragedy of welfare lock for people who want to work but go on welfare or stay on welfare because they have no health insurance and need the Medicaid program. The way to address this tragedy is to reform our health care system so that working families have access to affordable private health insurance.

Mr. Chairman, while the Contract With America does not address health care reform, the statement I have submitted for the record outlines our views on the specific health care provisions included in the Contract. Let me say that the administration remains firmly committed to providing insurance coverage for every American and to containing health costs for families, for businesses and the Federal, State and local governments. As you know, the President has written to the new leadership in Congress to express his strong desire to work in a bipartisan way to take steps toward achieving these goals.

We can pass legislation that addresses the unfairness in the insurance market. We can make coverage more affordable for working families and children. We can assure that the population served by Medicare and Medicaid are protected. We can reduce the

long-term Federal deficit. And we can strengthen tools available to combat health care fraud, waste and abuse.

Mr. Chairman, we in the administration look forward to working closely with you and your colleagues in the new Congress on these critical health care and welfare issues.

I believe that we have a rare opportunity to move this country forward. I believe we can pass bold initiatives in welfare and health care. I believe we can pass the President's Middle-Class Bill of Rights. We can help all Americans to renew their faith in government.

We are ready to sit down and work with this committee, with this Congress, with elected officials across the country and, of course, with the American people to get the job done.

Thank you very much.

[The prepared statement follows:]

Testimony
Donna E. Shalala
U.S. Secretary of Health and Human Services

Introduction

Thank you Mr. Chairman and members of the Committee for the invitation to appear before you today.

I'm pleased to be with you to talk about the Contract with America and to begin what I believe is an important dialogue with each other and the American people.

In the last two major elections -- the presidential election of 1992 and the congressional elections of 1994 -- the American people sent Washington a crystal clear message: They want change.

They want us to stop the gridlock, stop the infighting, and make sure that everything we do makes a positive difference in people's lives.

That is why we are here today.

To write a new chapter in bipartisan government.

One that begins with a conclusion -- And that is to make sure that at the end of the day we have taken action to improve the lives and prospects of every American.

I am here to pledge the commitment of the Clinton Administration to this approach.

We have already picked up the mantle of change and for the past two years we have been about the business of carrying out the will of the people.

We passed the largest deficit reduction plan in history -- nearly $500 billion dollars over five years.

We created over 5 million jobs.

We worked with many of you on this committee to pass NAFTA and GATT -- historic legislation that will open up foreign markets for our products and open up lucrative job opportunities for millions of Americans.

We expanded the Earned Income Tax Credit -- which reduces taxes for 15 million working families and creates a powerful incentive to work and stay off welfare.

And as a next step, we have proposed the Middle Class Bill of Rights to reduce taxes for hard-pressed working families who are struggling to save money, send their children to college, and prepare for a better economic future.

We did one more thing that should not be overlooked or forgotten. We worked long and hard to put the American people first by addressing two of the great domestic policy challenges of the century -- health care reform and welfare reform.

I want to begin today by talking about our vision for welfare reform and our view of the Personal Responsibility Act found in the Contract with America.

Welfare Reform

After consulting with members of Congress, people on welfare, business leaders, welfare experts, and governors all across the country, President Clinton honored his promise to the American people by submitting the Work and Responsibility Act to the Congress last year.

This legislation would fundamentally change this country's approach to helping young parents move from dependence to independence, and it grew out of the President's long-standing commitment to welfare reform.

As governor of Arkansas, he worked closely with national and state officials from both parties to pass the Family Support Act of 1988.

That legislation served as the impetus for states to begin a major effort at changing the welfare system to one that encourages work, not dependency.

When he ran for President, he called for "an end to welfare as we know it."

In the last two years, we have worked with governors and elected officials to give 24 states the flexibility to design welfare reform strategies that meet their specific needs.

This is more waivers than all other previous Administrations combined.

Rooted in the bedrock American values of work and responsibility, the central focus of our approach to welfare reform is a few simple goals:

The first is to move parents off welfare and into jobs as quickly as possible so that they can support themselves and their families.

The second is to require absent parents to meet their responsibilities and pay child support.

And the third is to reduce teen pregnancy.

Mr. Chairman, I believe we all share these goals.

The President's approach to welfare reform emphasizes three important values: Work, responsibility, and reaching the next generation.

I think these are widely-shared values -- American values -- values that built this country in the past and are critical to our future.

Today, welfare has the values wrong: We know this, we agree on this, and both Republicans and Democrats have sought to change this with welfare reform.

Yet, from our perspective, there are elements of the Contract with America that seem inconsistent with these values.

Let's talk about work first.

We strongly believe that welfare as we know it will not have ended until we fundamentally change the system: Welfare must be about earning a paycheck, not collecting a welfare check.

As the President has said, "Work is still the best social program ever invented, and it gives hope and structure and meaning to people's lives."

To reinforce and reward work, our approach is based on a simple compact. Job training, child care, and child support enforcement will be provided to help people who are willing to work to make the move to independence.

But time limits will ensure that welfare is seen as a hand up, not a handout.

We are committed first and foremost to ensuring that everybody who can work does work. The American people want a government that honors their values and rewards people who play by the rules.

If we want to help welfare recipients become taxpayers, we must challenge individuals to take responsibility for their own lives -- and help them get ahead when they do.

For years, Republicans and Democrats alike have agreed that the central goal of welfare reform must be work. That's still the case: People who can work ought to go to work and earn a paycheck, not a welfare check.

That is what this great national debate on welfare reform must be about. More "something for nothing" is not the answer. More orphanages are not the answer. Work is the answer.

Our approach to welfare reform puts work first, and in so doing, it differs from the Personal Responsibility Act in some important ways.

First, our plan sends a critical message to people from the very first day they go on welfare: You must work; we expect you to work; and we will help you prepare for work so you can stay off welfare for good.

To prepare people to work and support their families, we would require those who are employable and who would benefit from having more skills to move into work as quickly as possible by engaging in upfront job search, education, and training -- and we would expect states to hold up their end of the bargain.

Indeed, we believe that people on welfare ought to sign a personal responsibility agreement and develop an employability plan.

Most of them will welcome the opportunity to move rapidly to work. But for those who refuse to train for work, look for work, or accept work once it is offered, the consequences are clear: Cash assistance will first be reduced, then eliminated.

We also believe that people who can work should be treated differently from those who can't. And here is where I draw a sharp distinction between our approach and the Personal Responsibility Act.

In 1988, Congress passed and Ronald Reagan signed the Family Support Act, which established the important principle that welfare should be a transitional system leading to work. Education and job training were to be required for most job-ready applicants.

Unfortunately, over one-half of the caseload was exempted, and, among those who were not, only twenty percent were required to participate. For example, broad exemptions were made for women with <u>any</u> child under age three, young mothers under age sixteen, and women in the second trimester of pregnancy.

We believe that these exemptions should be significantly narrowed, but we have suggested exemptions for people with disabilities or for those who need to care for disabled children. Temporary deferrals also would be narrowed: Twelve months for the birth of a first child, and twelve weeks for the birth of a second.

In addition, under our approach, once people reach their time limits, if they are able to work but can't find jobs, we require them to work for their benefits in temporary subsidized jobs.

This also sends an important message -- it says to people on welfare and to their children that work is an expected and necessary part of life and one of our society's greatest values.

In contrast, in the Personal Responsibility Act, all adults simply are cut off from assistance after two to five years, even if they are willing to work but can't find jobs, are providing full-time care for disabled children, or are unable to work because of disabilities.

Moreover, this is a lifetime limit: Once adults reach their limits, even if they go to work for many years and then lose their jobs during a recession or due to illness, they cannot get aid.

The second key value in our approach is responsibility.

We believe that because every child has two parents, both of them should be required to support their children.

That's why we have proposed the toughest child support system ever. Both parents must live up to their responsibilities -- and child support enforcement is an integral part of welfare reform.

Today, 63 percent of absent parents contribute no child support, and an average parent who receives child support receives a total of only $2,995 a year.

That's just $8 dollars a day for a parent who's lucky enough to get child support, and nothing at all for the majority of single parents and children who have been financially abandoned.

These are shocking statistics.

Overall, the potential for child support collections is estimated at $48 billion per year. Yet only $14 billion is actually paid, leading to an estimated collection gap of about $34 billion.

We must close that gap -- and we will.

We have proposed a comprehensive child support strategy to help custodial parents escape welfare and stay in the workforce.

It includes a tougher, more uniform child support enforcement system, as well as a stronger requirement for paternity establishment.

We also would impose tough new penalties for those who refuse to pay: Wage withholding, suspension of drivers' and professional licenses, and even property seizure.

In stark contrast, the Personal Responsibility Act includes few child support enforcement provisions and could actually reduce resources for enforcement by capping funding for child support enforcement and other low-income programs.

The Family Reinforcement Act does include some minor changes in the rules governing interstate enforcement processes, but, by themselves, these changes would do little to increase collections.

We must do much more. That is why child support enforcement is a central part of the President's approach. Governments don't raise children, parents do.

Moreover, attempting to implement welfare reform without strengthening child support enforcement sends the wrong message: It says that the non-custodial parent who is one-half responsible for the birth of a child does not have any responsibility for supporting that child.

In addition, our approach would deny AFDC benefits to the mother only after the state has determined that she will not identify the father.

Once the state determines that the mother has identified the father, then the responsibility properly rests with the state to establish paternity. We give the state one year to establish paternity or face penalties.

The Personal Responsibility Act denies benefits to any child for whom paternity has not been established -- whether or not the mother has identified the father, whether or not the state has made a serious effort to locate the father, and regardless of how long ago the child was born.

One of the most basic ways to reinforce responsibility is to hold the right person accountable: What sense does it make to hold children accountable when, in fact, their mother has cooperated and the state has not done its part to establish paternity?

I hope we can work together to address this issue.

In our approach to welfare reform, we expect individual responsibility, but we also demand responsibility and accountability from government. That's why our approach requires states to work with the federal government in implementing new, state-of-the-art anti-fraud measures.

These new systems are designed to detect and prevent many types of fraud and abuse, such as unreported employment and earnings, misrepresentation of the numbers of children in a family, and duplicate receipt of welfare, food stamps, unemployment compensation, and other government benefits.

These new systems also will help to locate absent parents who are not paying their child support.

The Personal Responsibility Act does not create any of these systems; in fact, it reduces funding for anti-fraud efforts.

The final bedrock value in our approach to welfare reform is the importance of reaching the next generation.

By that, we mean putting into place preventive measures to break the cycle of dependency and ensure that future generations don't pick up where their parents left off.

A key to doing that is taking a strong stand against teen pregnancy.

We recognize that welfare dependency could be reduced significantly if young people delayed childbearing until both parents were ready and able to assume the responsibility of supporting and raising children.

That's why our approach requires that a minor parent live at home, identify her child's father, and stay in school to get benefits.

Our plan of time limits and work requirements sends a strong message to young people that welfare will never be the same. From now on, welfare will be a second chance, not a way of life.

But we strongly disagree with the approach taken in the Personal Responsibility Act, which would be to deny benefits to children born to mothers under age 18 -- whether or not their parents are able to work, and whether or not they're properly caring for their young children.

Ironically, under the Personal Responsibility Act, those mothers can receive aid for themselves and additional children if the children are born after the mothers turn 18 (or 21 at state option).

The question we have to ask ourselves is what would happen to the hundreds of thousands of children who would be denied aid by this provision -- and the millions more who could ultimately be denied assistance because of other sections of the Personal Responsibility Act.

The Personal Responsibility Act suggests sending them to orphanages. We are convinced that this proposal is both wrong and unworkable.

It will divide families when we should be strengthening them. It will let teen fathers off the hook when we ought to be holding them accountable. And it could lead to more poverty, more spending, and more bureaucracy at a time when we desperately need less.

According to the Child Welfare League of America, the average annual cost per recipient of orphanage care is $36,500 per child. We estimate that the federal AFDC savings from the Personal Responsibility Act returned to the states could fund fewer than 9,000 orphanage slots for the entire country -- all fifty states!

Even if we add in all state and federal dollars for AFDC recipients on AFDC, Food Stamps, WIC, the school lunch program, and housing aid, the average benefit per recipient amounts to only about $3,300 per year. The Personal Responsibility Act returns far less than that.

So, what will happen to the other children?

Of course, we're not suggesting that all of them will wind up in orphanages.

In fact, some parents will move on to lives in the mainstream.

But, for those who cannot do so, there are several things that could happen.

First, states could pick up the bill for orphanages at $36,500 per child -- potentially a huge cost shift to states.

States could try to expand the already strapped foster care system -- but foster care costs $10,950 per child per year and is four times the cost of caring for a child in the AFDC program.

Or, governors and citizens could hope and pray that private charities or the children's other relatives rise to meet the demand.

We don't believe that's right or realistic.

The solution to welfare is not to make children go to orphanages, it's to make their parents go to work.

We must take bold steps to tackle the problem of teenage pregnancy -- but that does not mean that we should give up on teenage parents.

To be eligible for support, we must insist that they stay in school, live at home, and prepare for work.

We know that there are abstinence-based programs that are working in communities all over this country.

We must give more of those programs a chance to succeed.

All of us must be part of a national effort against teen pregnancy, and make it clear that young people should not become parents if they are not prepared to take responsibility for their children's futures.

Teenagers must be discouraged from having children, but if they do, they must also get the help they need to become good providers and role models.

That is to say, welfare reform must strengthen families, not weaken them.

It should help young mothers and their children escape welfare, not support long-term dependency.

That is why the President's approach would require work, not encourage orphanages; put a two-year time limit on welfare benefits and then insist that recipients go to work; devote more resources to child support enforcement -- not less; and mount a new effort to fight welfare fraud.

The American people deserve a government that honors their values, spends their money wisely, and rewards people who work hard and play by the rules.

We stand ready to work with this Committee and this Congress to make these values the centerpiece of welfare reform.

I am hopeful that as these issues are debated we remain committed to seeking bipartisan solutions through an open dialogue that will benefit all Americans.

Mr. Chairman, as we join forces to move people from welfare to work, we will need to address the bureaucratic absurdity and human tragedy of "welfare lock," which occurs when people who want to work go on welfare or stay on welfare because they do not have health insurance and therefore need the services provided by our Medicaid program.

The way to address this tragedy is to make sure that all working families have access to affordable private health insurance.

This will require some reform of our health care system, which is another area where this Administration has taken up the people's call for change.

Health Care Reform

While we are disappointed that we could not achieve broad-based agreement on a health reform initiative in the 103rd Congress, there can be no disagreement on the fact that we still face the enormous problems of increasing health care costs and decreasing coverage.

The Administration remains firmly committed to providing insurance coverage for every American and to containing health care costs for families, businesses, and Federal, State, and local governments.

As the President has said, in this session of Congress, we can and should take steps toward achieving these goals.

We can pass legislation that addresses the unfairness in the insurance market, makes coverage more affordable for working families and children, assures that the populations served by Medicare and Medicaid are protected, reduces the long-term Federal deficit, and strengthens tools available to combat health care fraud, waste, and abuse.

We stand ready to work with the 104th Congress in confronting these challenges on a bipartisan basis.

Long-Term Care

Another health challenge we must face is long-term care.

On long-term care, we continue to endorse assistance to states to develop home and community-based care systems that support people with disabilities, regardless of age, condition, or income;

that strengthen families' abilities to care for their disabled family members;

and that allow flexibility so that states and communities can tailor services to their specific needs.

Such support is an essential component to assuring the availability of services for people with disabilities throughout our country.

Alongside promotion of home- and community-based care, we support changes in the tax code that would give long-term care insurance (and services) the same preferred tax status as standard health insurance, provided that insurance policies meet certain consumer protection standards.

While we agree with the notion of extending preferred tax treatment to long-term care insurance, we feel strongly that insurance should include information and be marketed in ways that help seniors understand the benefits and limitations of insurance policies.

We also agree with the notion of helping caregivers, but the tax credits proposed in the Contract may not be the best way to target limited resources to caregivers and families in need. We may be better able to help caregivers and people with disabilities with grants to states for services tailored to community needs. We look forward to working with you on this.

Balanced Budget Amendment

All of the policy issues I have discussed today would be profoundly affected by the provision in the Contract with America that would require all federal budgets to be balanced in the year 2002 and afterwards.

Let me be clear: While we support the goal of a balanced budget, the proposal that is included in the Contract would require an unprecedented level of reductions in our programs -- including Medicare, Medicaid, SSI, Head Start, and NIH research.

This is because all of the savings likely would have to come from the domestic spending side of the federal budget.

If Social Security is protected as some have promised, and defense reductions and tax increases are not on the table, all other domestic spending programs, including those at HHS, would have to be reduced by 28 percent. Such reductions would drive millions more families into poverty.

Analyses conducted for my Department by the Urban Institute suggest that even a 20 percent cut in our programs would reduce incomes for over seventeen million individuals and families and result in 3.7 million additional people being on the poverty rolls.

We should not forget that our Department also has responsibility to ensure the safety and health of all Americans through the work of critical HHS agencies charged with protecting the public health. The cuts that could be required under the Contract proposal for a balanced budget could seriously jeopardize our capability to meet these obligations.

Conclusion

Mr. Chairman, we in the Administration look forward to working closely with you and your colleagues in the new Congress.

We still have a big job ahead of us as we work to improve health care for the American people by promoting health insurance security and containing costs.

And, in welfare, we must work together to put in place a system that moves people from welfare to work, that protects children, that rewards people who work hard and play by the rules, and that holds parents accountable.

I believe that we have a rare opportunity -- on welfare and many other issues -- to move this country forward, to help all Americans, to renew our people's faith in government.

Just as it's time to end welfare as we know it, we also must end politics as we know it.

We're ready to sit down and work with this Committee, this Congress, elected officials across the country, and the American people to get the job done. Thank you.

Chairman ARCHER. Thank you for your testimony.

The Chair will yield his time to the ranking Republican, Mr. Crane, for inquiry.

Mr. CRANE. Thank you, Mr. Chairman, and Madam Secretary.

Madam Secretary, in your statement you indicated that the Personal Responsibility Act suggests sending children to orphanages, and I was wondering where in the act you came to that conclusion.

Secretary SHALALA. I suggested that one of the alternatives suggested in the Personal Responsibility Act is orphanages, and it is listed in the bill, and money is provided to the States.

The point I made both in my press conference and here again is that large numbers of children are turned away from the welfare rolls because their parents are teenagers, and the question that I raise is what will happen to these children.

Mr. CRANE. Well, on page 25 of the bill it says use of grant funds. And under that provision it says each qualified State that receives grant funds shall use these funds, one, to establish or expand programs to reduce out-of-wedlock pregnancies; two, to promote adoption; three, to establish and operate orphanages; four, to establish and operate closely supervised residential group homes for unwed mothers; or, five, in any manner that the State deems appropriate to accomplish the purpose of this part.

There is no effort in the Contract to insist that kids have to be placed in orphanages. That is a State decision and has been a State decision, and all the Contract attempts to do is to provide some direct grant funds.

Secretary SHALALA. And outlines orphanages as one of the options that is available to the State.

Mr. CRANE. Well, to be sure, and it is right now, has been.

Secretary SHALALA. I think we are consistent. I think we are saying the same thing.

Mr. CRANE. Well, except your statement is a little bit misleading in that it says the act suggests sending them to orphanages.

Secretary SHALALA. The act suggests that one option available to the States is for the States to establish and operate orphanages. The point——

Mr. CRANE. Which States do right now.

Secretary SHALALA. Some States operate alternatives for at-risk children.

The point I was making was a point about what is going to happen to millions of American children who are not eligible for support because their parents happen to be teenagers.

Mr. CRANE. Well, do you see any inconsistency with current law in this provision in the Contract?

Secretary SHALALA. Well, the inconsistency with current law is that current law does not throw millions of children or does not exclude millions of American children who are born to teenagers and born into poverty, into destitution or—on to the hands of the States without any Federal support at all and then give a limited amount of money to the States, which is what this proposal does, to deal with a variety of different kinds of options.

Mr. CRANE. Well, I was going to say all under the provisions of the Contract that is gone is AFDC. The other benefits are still available.

Secretary SHALALA. Benefits are not available to children of teenagers, to children born of teenagers under the Contract's provisions would not be eligible, their parents and they would not be eligible for aid.

Mr. CRANE. Why do you believe that to be the case? What language in the Contract?

Secretary SHALALA. Under our original analysis of the bill—and I could give you the page numbers of the bill—5 million children would lose AFDC eligibility under the original Personal Responsibility Act which was presented to the public with the Contract in September. Now, there were some recent changes made to the legislative language that would no longer make this provision retroactive. Our analysis of the revised bill shows that almost 1.3 million children would lose their eligibility for AFDC the first year of implementation if the States adopt the least restrictive option available to them.

So the issue that I raise is what is to happen with millions of American children who are not eligible for aid because they are born to teenage parents? And the only options presented in the bill is this list of options for those children, and those are the resources that are provided by the Federal Government under the bill.

Mr. CRANE. There is no provision, Madam Secretary, in the bill that is retroactive.

Secretary SHALALA. No, that is correct, and I indicated that. However, in the first draft there was such a provision. In the second draft, which is the new legislation, H.R. 4, that provision has been deleted. But what I have said is that in the first year of implementation, even without the retroactivity, assuming that the States took the least restrictive approach, that there would be children that would be born to teenage parents who would be ineligible for aid.

Chairman ARCHER. The gentleman's time has expired. Mr. Gibbons will inquire.

Mr. GIBBONS. I will yield to whatever Democrat is eligible.

Chairman ARCHER. Mr. Gibbons yields to Dr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

Secretary Shalala, this country in the thirties had a system of orphanages and workhouses at the local level. The national program that we now call welfare really grew as a response to that failure of that system. Can you explain to me why the Governors of this country are coming in here saying they want to take welfare back and get less money from the Federal Government? How are they going to provide a better system than they presently have with less money? Because they surely will get less money with these caps that are in the Contract With America.

Secretary SHALALA. I cannot explain it, Congressman McDermott. The only thing I can suggest is that I don't think that all the Governors have looked at the implications of either the proposal they are negotiating or what exists in the Contract because they are giving up the flexibility of the program to respond to economic changes in their States. And they are agreeing, depending on whether they agree with the Contract or in their own negotiations, on block grants with a program that may well exclude Federal money from large numbers of children.

What would happen to those children in their States? I can't come to a conclusion. My hope is, knowing some of the Governors, that this is the beginning of a longer conversation about the implications of this proposal, of the President's proposal, and we will go back to the principles. The principles of all this are work and responsibility, making parents take responsibility for their children and turning the program a complete turn to make it focus on a transitional program to get people into work.

Mr. MCDERMOTT. Are you suggesting that it is good national policy that a child born, let's say, in the State of Florida where they might have a humane Governor ought to be treated better than a child who is living in the State of Michigan where the Governor is less humane? Would there be any fairness in the arbitrary system that would result from giving welfare back to the States?

Secretary SHALALA. Congressman, welfare has been a Federal-State partnership. We have left some of the setting of benefits to the States. That would continue under the President's proposal as he has laid it out.

The fundamental issue that you are raising is what is the responsibility of government for the children in this country. Should there be some minimal benefits available for every child so that a child born in Mississippi doesn't go hungry because the State is poor versus a child born in Michigan or in my own State of Wisconsin? Is there a minimal role for national standards and national framework?

And that is essentially the real core of the welfare debate. And the President and this administration has concluded that there is indeed a place for the National Government in a partnership with the States.

We have also conceded and enthusiastically supported the efforts by the Governors to get more flexibility in designing the programs themselves. And no one can accuse us, having approved over a 2-year period, 24 waivers, of not helping the Governors to find and explore ideas that they want to test for moving people from welfare to work.

So it is a fundamental issue. It is the most fundamental issue. I would argue it is what defines us as Americans on what the role is of the National Government versus the State governments and what that partnership is about.

Mr. MCDERMOTT. I would like to raise one other question, and that is as I read these proposals—and I am not sure which proposal they are finally going to roll out here—but the proposals look to me to be very sexist. The proposal says we will punish women for having babies, but we won't really go after the fathers who fathered the children. It is very clear that there is an unbalance, and I wonder about your position on that.

Secretary SHALALA. Well, as I indicated in my testimony, I was disappointed that the Personal Responsibility Act, the Contract did not have more on child support enforcement because there are members of this committee on both sides who have spent part of their careers fighting for very strong child support enforcement measures. And, Mr. Chairman, I hope that that is one of the things that we can work on to make sure we don't move ahead with a welfare reform bill that doesn't hold both parents responsible and

make sure that both parents take the responsibility for both providing resources as well as nurturing the children. And that needs to be a very important element that is introduced as part of this effort, Congressman.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

Chairman ARCHER. I will assure the gentleman from the State of Washington that on this side of the aisle we intend to go after the fathers and see that they are responsible for taking care of their children. It is a major thrust of our effort.

Mr. Ensign will inquire.

Mr. MCDERMOTT. I would just say, Mr. Chairman, I don't see that in the proposal yet, and I hope that you would.

Chairman ARCHER. You can believe that we intend to do that.

Mr. Ensign will inquire.

Mr. ENSIGN. Secretary Shalala, the concern that I have with the administration's welfare proposal and actually with a lot of the proposals coming out of Washington and at the State level, is that when you are trying to design a system that has make-work type programs, job training, and so on, we have programs where an individual can get around the various requirements, such as in job training.

Has anybody put a pencil to it in the administration? How long someone could actually stay on welfare without actually going to work, going in and out of some of these job training programs, but actually not fulfilling the spirit of what you are intending to do?

Secretary SHALALA. In the President's proposal, 2 minutes, and that is——

Mr. ENSIGN. No. How long could they actually continue receiving benefits while actually not legitimately going after work?

Secretary SHALALA. In the President's proposal, the maximum is a 2-year period in which someone would prepare for work. That is excluding a teenager that would have to finish high school first.

And so what I meant by the 2-minute response is from the moment someone walks into a welfare office, the purpose of that welfare office—and we need to change the culture of that welfare office—is to get people ready to go to work. For some people, it literally will take a few weeks to get ready and to do the job search because they are job ready. For other people, it may take up to 2 years of some kind of a training program.

We recommend an employability plan, an actual contract, with the kind of contract with the individual that lays out what the expectations are. And my point here is that the goal must be to move people into private-sector jobs.

In our proposal there are subsidized jobs only if the State certifies that there are no private-sector jobs, and those public-sector jobs are temporary jobs while the person continues the search. Those public-sector jobs are temporary jobs as the person continues the search for a private-sector job. Our goal is to move people into private-sector jobs.

The timeframe that we have put together is based on research in this area. So for many people it may be 3 months.

We know something about people getting off welfare: 70 percent get off in 2 years; 90 percent get off in 5 years. The problem is staying off of welfare. Some of that is related to child care. Some

of it is related to health care. And some of it is related to the kind of job readiness expectation piece of it.

Mr. ENSIGN. Would your proposals in the administration be just new people coming into the system? Or would people, everyone existing in the system now, be also required to get into work programs and training programs?

Secretary SHALALA. Well, it is interesting. We had originally recommended when I first testified before this committee last year that we start with the youngest people. That is the most high-risk group. The proposals that are in the Contract, some of them suggest that we start with the older people because, frankly, you will be more successful.

All the research shows that you will be more successful with the people that are currently on the system that have been for a period of time, where their children are older, for example.

We have come to the conclusion, after listening to the Governors, that this is exactly one of those issues, and in fact we put the flexibility in our own first draft of the plan that we actually introduced, that it is really up to the Governors on what group they want to start with.

For some States, it may make sense when they look at the profile of their older population. For other States who want to deal with the teenage pregnancy thing immediately, they may want to put their resources—it really is a resource question. There are States in this country where the Governors will grab these reform proposals and do it for everyone and immerse everyone in the program. So it clearly is one of those issues where in conversations between us I think we all probably end up letting the Governors do that kind of design because that is one of those appropriate things.

Mr. ENSIGN. Thank you.

Secretary SHALALA. You are welcome.

Chairman ARCHER. Mr. English will inquire.

Mr. ENGLISH. Thank you.

Secretary Shalala, in your testimony you state that the Personal Responsibility Act is flawed because it would actually reduce resources for enforcement by capping funding for child support enforcement and other programs. I was wondering, could you please clarify for this committee the programs that you feel should not have spending limitations?

Secretary SHALALA. Child support—it is not a question of spending limitations; it is a question of providing appropriate resources so that we can get the job done. And what we need to do—and it seems to me in conversations with the Governors and with other people that deliver these programs and decide what are the principles we are trying to achieve I would suggest that holding both parents responsible is a very important principle. And, therefore, child support enforcement ought to have the kind of investment that is necessary to put the national program out there that will do the job for us. And we have enough experience State by State to have some sense of what that would cost.

I would also suggest that we ought to have a serious program on waste, fraud and abuse, that part of the principles of making certain that we have the credibility that we need with the American people is to make sure that we have put in place an effective sys-

tem to reduce waste, fraud and abuse, whether it is a computer system that connects up across States, in regions, as we have tested in certain parts of the country. But we need to make that kind of investment.

I am not saying——

Mr. ENGLISH. Those are principles, Madam Secretary——

Secretary SHALALA. Pardon?

Mr. ENGLISH. I guess I should reframe the question. Where in our welfare reform legislation, our welfare reform proposal, would you be willing to accept Federal spending limitations?

Secretary SHALALA. The Federal spending limitations in our proposal, the Federal spending limitations are based on putting time limits on the periods of time that people can invest and budget limitations on the investments. We have made our proposal budget neutral, and the decisions about how much child care, for instance, to put in place is part of the proposal. So we have submitted a budget-neutral proposal.

What I am suggesting, in answer to your specific question, is that by lumping together a set of programs, some of which may be priorities that ought to be fully funded and others ought to be the choices of Governors, we ought to make some of those decisions. And I, in particular, believe that child support enforcement and waste, fraud and abuse ought to be two of those.

Mr. ENGLISH. Thank you. Can you—can the administration support any restrictions on additional AFDC benefits specifically for those already on welfare who have additional children?

Secretary SHALALA. We have in the welfare waivers—we have in our own proposal left that decision to the States, and we have approved in welfare waivers from one end of this country to the other limitations on additional money for a child born while the person was on welfare. So we have been consistent both in the President's recommendation as well as in our approval of waivers.

Mr. ENGLISH. How would you feel about writing that in as a standard in Federal legislation?

Secretary SHALALA. Our preference—we have indicated that our preference is that that decision be left to the State and to the Governors and to the representatives of the State. It is, as you know, a very sensitive issue. We are consistent. The Federal-State partnership has always allowed the States to set the budget, the spending limitations in terms of the payments, but our preference is to leave that decision to the State.

Mr. ENGLISH. Thank you. Madam Secretary, what is the position of the administration on encouraging through Federal legislation the random drug testing of welfare recipients?

Secretary SHALALA. We have supported welfare recipients being mandated as part—for addicts as part of the requirements of the job to go into drug treatment programs. Most of those drug treatment programs actually have testing as part of them, and we have accepted that as part of the drug testing programs.

Anything beyond that I understand—and I am not a lawyer—raises some constitutional issues, and we would be happy to explore that with the committee. But as part of the requirement for a welfare recipient to be in a drug treatment program, and that being built in as part of the program, we have been supportive.

Mr. ENGLISH. Thank you, Madam Secretary.

Secretary SHALALA. You are welcome.

Chairman ARCHER. Mr. Neal will inquire.

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

Madam Secretary, I had the chance a few months ago to ask you that famous Murphy Brown question here, and you shed new light on it. I want to thank you for that, and I thought you did a very good job this morning.

You focused on four areas that I think we all ought to be able to agree on: The minor ought to live at home; that we ought to identify the father; that we ought to encourage, if not require, work; and that we certainly ought to encourage staying in school. In fact, we ought to insist upon those options.

I would suggest today that every member of this committee, as we begin this debate on welfare which is surely to be contentious, make reference to an April 1993, article that appeared on the cover of the Atlantic magazine by Barbara Dafoe Whitehead. While the article is entitled, "Dan Quayle Was Right," the truth of the matter is that Pat Moynihan was more right 30 years ago, and we haven't come very far in advancing those arguments.

I just want to suggest to you today that this is an item that I think belongs on the front of the American agenda for Democrats and Republicans alike. There is nothing—and I served as mayor of a big city before coming to Congress a few years ago—there is nothing that has done more to destroy the reputation of urban living than the current framework of welfare. It is linked to crime. It is linked to a lack of adequate health care. It is linked to the issue, in my judgment, of the deterioration of the American family and its current fate.

I think you and the President deserve credit for having had the courage to force some debate on this issue. You have taken positions, and I think those positions are clarified for the American people that we are going to find a lot of common ground here on both sides of the aisle.

I would hope that we wouldn't shrink from this notion here of identifying the father. I think that ought to be the cornerstone of our initiative on the Democratic side. And this can be done—and there is evidence in Massachusetts where there are experiments that have taken place that that can be done far more aggressively.

So my point in using this time, this short time I have, is to give you a chance to go on about those initiatives but most importantly to thank you because I think you have been forthright, I think you have been very candid with us, and I think the options you have laid out for us today ought to be options that everybody on both sides of this forum can agree on. Thank you.

Secretary SHALALA. Thank you very much, Congressman.

Let me repeat the issue of paternity because I think it is very important here the differences between the President's proposal and what, unfortunately, is in the Contract because I have a feeling that this committee will come down somewhere near where we came down.

What happens in paternity establishment is that the mother is asked to identify the father, and before anyone gets on welfare they

are asked to do that in all of the proposals. The issue is then whose responsibility is it to establish legal paternity.

We have argued, and it has been consistent around the country, then the State must follow up. The mother fully identifies the father, gives his address, all the information she can—the baby may have been born a number of years ago—and then the State must follow up. Some States are very good about following up, they do it immediately, and we hold them accountable to do it within 1 year.

The issue is while the State is following up should the child be penalized and not be able to get aid because the State doesn't have its act together and has a bureaucracy in which it hasn't followed up? When the mother has done what is expected of her, when we argue that the current welfare system has its values all messed up, we have got to get the values right this time.

And our argument here is if the mother has followed all the rules that we have laid out, she has identified the father, should she and the child in particular be penalized because the bureaucratic mechanism of the State has not followed up for the legal establishment of paternity?

Most people don't understand this. They think the mother just isn't identifying the father. But our point is once she has done that to the satisfaction of the State, it is only fair that she get some temporary help for that child while she gets ready to go to work.

Again, it is a fairness issue, but we must get the values right this time. We cannot get all confused about our values in terms of who is responsible. The responsibility must be both of the parents as well as the institutions themselves, and in this case the State as well as the Federal Government.

Mr. NEAL. Thank you.

Chairman ARCHER. Madam Secretary, if I may jump in here very quickly. I would like to ask you two brief questions. Number one, what percent of the welfare recipients will be covered by your work requirement in your proposal?

Secretary SHALALA. In the President's proposal?

Chairman ARCHER. Yes.

Secretary SHALALA. Well, it is phased in over time. What we have done in the President's proposal is narrowed down the number of exemptions that are allowed. We are somewhat more flexible than what is in the Contract. The Contract, for instance, does not allow for an exemption for a mother that is taking care of a disabled child. We would actually allow for an exemption for a mother that is taking care of the disabled——

Chairman ARCHER. I am sure others will inquire as to the details. I just simply wanted the percentage.

Secretary SHALALA. Well, we provided enough money to start phasing in the program, and the first group that was phased in were all of the youngest recipients who are under 25, and I will have to give you the percentage.

Chairman ARCHER. But can you tell the committee the percentage of the recipients at the beginning and the percentage at the end?

Secretary SHALALA. Yes, I will give you that number right now.

Chairman ARCHER. While you are getting that information, let me ask another question. In the event that a welfare recipient does not show up for work and fails to comply with the work requirement, what sanctions do you contemplate?

Secretary SHALALA. We start by reducing the benefits. And, eventually, if someone does not play by the rules, does not show up for work, does not show up for their schooling or their educational training, they can be cut off of the program.

We expect people who play by the rules to have the opportunity to move into a private-sector job or a public-sector, subsidized job if necessary for a short period of time, but we are tough minded about people that are unwilling to participate in getting ready for work or to take a job when offered.

Chairman ARCHER. I assume that there would not be any great leniency for people calling in sick or having excuses for failing to show up for the work requirement?

Secretary SHALALA. I think that what is important, Mr. Chairman, is that the work requirements for workers in the United States are the same work requirements that we have for the welfare group that is moving in to work. The reason that we are so anxious to have people earn a paycheck and not simply work off their welfare is to make a very simple point, that what we are trying to do is to move people into real private-sector jobs where they get a paycheck.

Chairman ARCHER. I understand that motivation, and of course I think most all of us would agree with that, but I am just curious specifically as to the sanctions. You have said, as I understood you, that all welfare benefits would ultimately be taken away from these people.

Secretary SHALALA. Can be taken away if people do not——

Chairman ARCHER. Then what happens to the children?

Secretary SHALALA. We cover the children.

Chairman ARCHER. How do you cover the children?

Secretary SHALALA. With Medicaid and with food stamps and with——

Chairman ARCHER. You continue to give those to the mother?

Secretary SHALALA. We continue to give them to the mother for the child. And we cover AFDC, right? I think the fundamental—I have got the phase-in numbers, too.

Let me say that a parent that is unwilling to play by the new rules under the welfare reform proposal, who is unwilling to do what is necessary to get into a private-sector job, that gets both the sanctions as well as in a relatively short period of time perhaps the benefits taken away, that those children eventually—within that period of time, the child welfare system has to take over because, again, this is an issue of responsibility. If a parent is not prepared to take responsibility, then the child welfare system must move in to take responsibility for those children.

I do have your phase-in——

Chairman ARCHER. So you contemplate that under those circumstances the children would be taken away from the parent by the State authority and be taken care of perhaps in an orphanage or in a foster home or something of that nature?

Secretary SHALALA. There would be a number of options that are available if the parent doesn't fulfill their responsibility under the welfare reform plan. Under our plan, one-third of the recipients are phased in immediately, we reach one-half in 5 years, and everybody is phased in eventually. All of that depends on the financing of the system, the financing we presented, which was about a $10 billion bill. If there were more resources available, we, of course, could do this more quickly.

This phase-in plan, which was discussed with the Governors in terms of what they thought they could absorb and to make the kind of dramatic changes that are necessary, was very much part of the decisionmaking in our proposal. There is no question if there were more resources available we could phase-in more quickly if that is what the States had the capacity to do and were prepared to do it.

Chairman ARCHER. OK. Now let me be certain about this. Your plan does contemplate that where the mother refuses to comply with the work requirement that the children can be taken away from the mother. If you take away the AFDC cash benefits from the mother, you take away the source of support for those children. Under those circumstances, if the children are to have adequate monetary support, I hear you saying that the State could then take the children away from the parent and that the children then, I assume, under current law and under your proposal could be put in orphanages. Is that not correct?

Secretary SHALALA. Let me repeat.

Chairman ARCHER. No, but is that correct? Is that or is that not correct?

Secretary SHALALA. The children would be taken into the child welfare system. In foster care, in some cases put into an adoption situation, in some cases put into group homes depending on their ages.

Chairman ARCHER. Could they be put into orphanages is my question.

Secretary SHALALA. Well, they wouldn't be put into 19——

Chairman ARCHER. Not would they, could they be?

Secretary SHALALA. If they were babies, it is likely they would not.

Chairman ARCHER. Could they or could they not be put in orphanages? It is a very simple question.

Secretary SHALALA. If they were teenagers they could be put into group homes, which is the modern version of residential settings for children.

Chairman ARCHER. If they were less than teenagers, if they were preteens, could they be put into orphanages by the States under your program?

Secretary SHALALA. Most of the residential settings in this country, most young children are put into foster care in this country. Most of the residential homes are for slightly older children, but——

Chairman ARCHER. Could they be put into orphanages by the State? That is a simple question. Yes or no?

Secretary SHALALA. As part of the overall series of options that a State has before it, the answer is yes.

Chairman ARCHER. Yes.

Secretary SHALALA. But they would not be put in there because they were born to a teenage mother who was willing to work, who was willing to go to school, who was willing to stay at home. There is a difference between cutting off large numbers of children because they were born to a teenager.

Chairman ARCHER. I understand. Simply put, under the sanctions contemplated in your proposal, children could be put in orphanages, is that correct?

Secretary SHALALA. Some children could be put in residential settings. No one is calling them orphanages.

Chairman ARCHER. You can call it whatever you want to, but that is the reality as I understand your proposal. I appreciate your testimony, and I thank the committee for their indulgence.

The Chair recognizes Mr. Christensen to inquire.

Mr. CHRISTENSEN. Thank you, Mr. Chairman. I thank the Chairman for helping the Madam with the definitions there because, basically, you have already said that they could be put into orphanage homes.

I have heard a lot of rhetoric today mouthing the words of Ronald Reagan and Bill Bennett, a lot of talk about values, but I have seen very little in terms of action as far as the administration is concerned.

I want to be exactly clear on your proposal as far as when we send this back to the States that they will be allowed to form their own kind of program. Let me ask you, would a Governor be able to cut off welfare payments, for example, after 6 months rather than 2 years under your proposal?

Secretary SHALALA. If someone chose not to work, if someone did not participate in the program and chose not to work, could the individual be cut off? The responsibility parts are very clear. One is expected to participate in the program. So during the 2-year period, which is the period in which someone is given to participate, they could be cut off for not participating at all or refusing to participate in preparing for work or in searching for a job.

Mr. CHRISTENSEN. But could a Governor have discretion to cut off that welfare recipient based upon their own standards, not based upon your standards?

Secretary SHALALA. No. The answer is no because the standard is——

Mr. CHRISTENSEN. Thank you. So, really, the Governor——

Secretary SHALALA [continuing]. Work requirements.

Mr. CHRISTENSEN. So, really, the Governors will not have the discretion that you were implying here earlier?

Secretary SHALALA. Pardon?

Mr. CHRISTENSEN. The Governors will not have the discretion to formulate their own program as you have just stated here?

Secretary SHALALA. No, that is not true, and I think it is a bit unfair. One of the things that I pointed out is we have already worked with the Governors in over half the States where they have shaped programs to move people off welfare into work. And what we see the President's proposal as is providing a framework which is based around two—three principles actually. One is work and

that everybody goes to work, and the other is the responsibility of the individual for getting prepared for work.

Mr. CHRISTENSEN. But if we send this back to the States for them to create their own program, basically you are going to tie their hands?

Secretary SHALALA. No, I do not believe that the President's proposal—I think it has enormous flexibility.

I think that one of the things we learned as part of the hearings and one of the reasons we are prepared and enthusiastic about working with this committee is that in 1 year working with the Governors on a number of these welfare proposals they clearly have indicated that there are other kinds of flexibilities they would like to have.

Mr. CHRISTENSEN. Madam Secretary, for example, if a State like Nebraska wanted to eliminate benefits for any additional children to teenage mothers.

Secretary SHALALA. They would be allowed to do that under the President's proposal.

Mr. CHRISTENSEN. Within the 2-year timeframe, 6 months, immediately? You name it. Could they do it right away?

Secretary SHALALA. They could do it right away.

Mr. CHRISTENSEN. Thank you.

Secretary SHALALA. You are welcome.

Mr. CRANE [presiding]. I think Ms. Dunn is next.

Ms. DUNN. Thank you, Mr. Chairman.

Madam Secretary, I am pleased by the fact that you have given waivers to 24 States during the last 2 years, and I agree with your emphasis on the Federal-State partnership. Certainly, our reform proposal is along that line.

What I would like you to clarify for me or perhaps contrast is the differences between the administration's proposal and the majority's proposal on what responsibilities would be retained by the Federal Government in this partnership.

Secretary SHALALA. The Federal Government would agree to pay its share of the bill under the partnership. One of my problems is—do you want me to talk about the contrast between the Contract or this new negotiation with the Governors, or—I am trying to figure out what bill I am comparing myself to. Let me give you——

Ms. DUNN. Tell me what the administration's proposal is on what responsibilities the Federal Government would keep.

Secretary SHALALA. The Federal Government would have a handful of responsibilities. One is that we develop a framework, and that is, every program must move people to work within a time-limited period of 2 years. The States would design the training programs, the employment programs. They would work with the recipients. They could put the recipients in their own training programs. They could contract out for the training programs they wanted to use. The whole process of getting people into job training—we have taken the recommendations, for instance, for teenagers to stay in their own home, to stay in school. Those come out of our welfare experiments from around the country. So those are consistent with what the Governors have been wanting to do all along. Again, that is part of a framework.

What the third piece of the Federal Government would do is work with the States to develop the child support enforcement piece, because there is a national piece to that as well as a data bank and other kinds of roles for the National Government. But the States would basically use resources to develop a kind of program that worked for them, though the basic information would have to be shared between the States if they were going to follow somewhat up.

So what we see the President's proposal, which has only a handful of elements on work and responsibility by both the individuals as well as the State, is providing the basic framework, and the States would design the programs to fit with how that State wanted to operate its program.

We have put a time limit on it. We have insisted on child support enforcement. We have insisted that teenagers stay in school and stay at home. We have left a number of things to the States' discretion, including, for instance, benefit levels as well as whether they want to continue to pay benefits to people who have an additional child on welfare.

Ms. DUNN. Thank you. Thank you, Mr. Chairman.

Mr. CRANE. Next is Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman, and welcome, Madam Secretary, and I want to first commend you and your department and the administration for the work you have done on this issue over the past 2 years. As my colleague Mr. Neal said earlier, certainly you have moved this debate forward so that we are in a position to act on this very quickly, I would hope.

Let me go back to some things you said in your testimony and then I have a question. You stated that 63 percent—this has to do with child support enforcement—63 percent of the absent parents contribute no child support—63 percent. The potential then in the country is that there are now on an annual basis $48 billion that should be paid in child support, yet only $14 billion are currently paid, leaving $34 billion uncollected that is available for our children in this country.

You then in your statement mention that the Personal Responsibility Act could actually reduce the resources for enforcement because it does cap the amount of money that is available for child support enforcement.

I was very pleased to hear the Chairman, Mr. Archer, say that he felt that was something we needed to work on in a bipartisan way, and I feel that is the way we will get the very best welfare reform, is to work on this in a bipartisan way.

My question, though, really has to do with fiscal responsibility and money and back to the $34 billion that is there that could be collected. Some of this money now our taxpayers are paying in lieu of the people who should be making these payments. Is there any estimate concerning how much exactly that is? How much money might be made available to assist us in welfare reform if, in fact, we were able to implement the collection programs that you anticipate?

Secretary SHALALA. I think the number is 25 percent, that there would be a 25-percent reduction in current welfare expenditures if we were able to collect from the parents.

As you probably know, I am sure you do know, most of the noncustodial parents who have not paid child support are not the fathers of children that are on welfare; that we have a large number of noncustodial parents whose children are not on welfare, but simply are not living up to their obligations.

So the child support enforcement piece should be seen not simply as part of the welfare effort in this country, but part of our effort as a country in partnership with the States to make certain that the children in this country are supported by both parents.

So I think that our enthusiasm for doing this in the context of welfare reform is that while it is significant for welfare reform on expenditures, it is more significant for us as a country to hold both parents responsible and to be clear about responsibilities for parenting.

Mr. PAYNE. And this is money, though, that would be returned to families, just as any kind of tax reduction that we are discussing would also be returned to them?

Secretary SHALALA. And it would make a difference of lifting families out of poverty.

The proposal that we have made would also move this out of the courts, which will get clogged into an administrative procedure with regular updates, perhaps every 3 years. And I know that a number of people here have worked on this issue on both sides of the aisle, have worked on the child support issue, and I am very pleased that the Chairman has agreed this is something that we can work through.

I think child support enforcement, paternity, there are a number of issues here we ought to be able to work on together.

Mr. PAYNE. I agree with that and thank you very much, Madam Secretary.

Secretary SHALALA. You are welcome.

Mr. CRANE. Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman.

Madam Secretary, I look forward to working with you and the administration on this particular issue, and I note in your testimony that you—your written testimony—you mentioned writing a new chapter in bipartisan government. I would like to work on that with you, but I do believe we are going to need more direct responses from you.

Your testimony, in some ways, was misleading, and I am glad, in response to Chairman Archer, that we did establish that both the administration bill and the majority bill will terminate the custodial parent's AFDC benefit at some point. We may differ as to when and how, but both bills are similar in that respect.

Second, the suggestion that the majority welfare bill in our Contract With America sends children to orphanages is absolutely wrong. And I think it has been clarified to some degree, but under current law States may send children to orphanages or group homes. Under the administration bill States would continue to be able to do that, and under the majority bill, States would continue to do that.

I just think it is important to understand that we have similarities in our bills in that respect.

Last, you made a comment that the majority bill denied welfare benefits to the children of minors. And I just want to make it clear that the majority bill would continue to allow the children of a minor parent to receive, and the parent, him or herself, to receive Medicaid and food stamps, as I think the administration bill does.

We do change the nature of the AFDC in housing benefits, which would change to a block grant to the States, and the States then would be free—and I know you also agree with greater State flexibility—to establish programs for minor parents to replace the AFDC in housing grants.

The Washington Post has an editorial today that says that since election day politicians have been engaged in a largely self-serving debate about what to do with children caught in the welfare trap. Each side has been behaving as if it had discovered a political gold mine; each mischaracterizing the other's position. And I want to make it very clear as to what our position is, and, in some cases, we have greater similarities than your earlier testimony had made clear.

Thank you, Mr. Chairman.

Mr. CRANE. Thank you. Next is Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Madam Secretary, like you, I am concerned about the proposal that Mr. Camp just talked about, and that is the denial of benefits to unwed teenage mothers.

My reading of the bill is the same as yours, Mr. Camp, wherein the dollars saved would be going to the States in block grants, at which time the State could use the dollars for programs to dissuade young females from getting pregnant, underage females; it would also permit the States to use the dollars for group homes, foster homes, and, like the Secretary, I think that the possibility should exist of a possibly reduced AFDC payment but one which would go to the teenager who remains at home.

Having been a State legislator, like probably most of us on this panel, and dealing with group homes and foster homes, those things do not come cheap by any stretch. If we can encourage the unwed mother to, one, remain at home; and, two, hopefully remain at school, I think the payment that goes in that situation will be well spent. But to put it in block grants and encourage group homes, I think we will be costing the taxpayers a lot of money and doing damage to society in the same respect.

Madam Secretary, would you like to comment on that?

Secretary SHALALA. Yes, thank you very much, Mr. Kleczka.

Let me simply say the difference between the two bills is when you get sanctions and what your behavior is to get the sanction. In our bill, the only time that an individual who is needy gets penalized is when they refuse to work. In the Contract, if you are a teenager and you have a child, you lose the possibility of getting a payment, a cash payment, in addition to the fact if you do not work you also lose it.

The issue is, is that fair? We all agree that teenagers ought to live at home, all of us. There is not anyone here who does not want to say to American teenagers and do everything we can to send the clearest possible message that they should not be engaging in sex in the first place, let alone getting pregnant. But the point here is

should we, because a child is born to a teenager, because of the fact of age, because the child is born to a 17-year-old as opposed to a 19-year-old, arbitrarily make a decision that they should not get AFDC.

I am simply saying if we are going to get our values straight, that penalizing someone because they refuse to go to work makes sense, because those are the standards of the bills, but making innocent children suffer because of a teenager, a child themselves had a child, it seems to me is so unfair and indefensible. And we will argue about this, I am sure, for the next few months, but we are not disagreeing on what happens if someone refuses to work. What we are simply disagreeing on is how America's youngest and most vulnerable citizens ought to be treated by the Government of the United States and by the States.

Mr. KLECZKA. Thank you.

On another point, Dr. McDermott mentioned that there will be a migration of poverty from one State to another if in fact one State happens to be more generous than the other, and as we all know, poverty and pollution cannot be confined to a particular State or its boundaries.

We find in the State of Wisconsin, where I hail from, that our payment levels are somewhat higher, and we do serve in some respects as a magnet to recipients from Illinois and Texas and other parts of the country. So I say that with the knowledge that total States' rights will promote that, and also encourage my colleagues to look at some continued Federal role as far as benefit levels or some other programming to make sure that does not occur.

Last, Madam Chair, there are members of the panel who are working on an SSI reform for the SSI children's program, and although we do not have time today to discuss that, hopefully, we could possibly include some reform for the SSI kids' program in this welfare reform bill, and maybe you might have a thought on that.

Secretary SHALALA. Congressman Kleczka, let me make a comment on the last point, the last two points you made quickly.

One of the advantages of having national work requirements and some kind of a national framework is that it will do someone no good to try to go to another State in which there will be time limits, because they will have to fill the work requirement and they will not be able to add on 2 years because they went to another State.

Second, on the issue of SSI and children, in the independent Social Security bill, you and your colleagues asked me in January, this month, to appoint a commission to take a look at that program. I have done that and the chair of that commission will be former Congressman Jim Slattery of Kansas, who has agreed to chair that very important commission. They will report directly back to Congress. I think it is the end of November they are expected to report back.

Mr. KLECZKA. Well——

Mr. CRANE. The gentleman's time has expired.

Mr. KLECZKA. If I might finish with one comment, Mr. Chairman. That commission was part of the Social Security reorganization bill. The bill was also signed in August and we have waited from

August until now. I am fearful that there are members of the committee, including myself, who are going to want to move ahead on this issue prior to November. So maybe you can tell our former colleague, Jim, and the commission members to speed up their review.

Secretary SHALALA. They are going to come up and talk with you and they are well aware of the speed that is required.

There is also an internal review going on within the administration of the program.

Mr. CRANE. Mr. Houghton.

Mr. HOUGHTON. Secretary, good to see you. Thank you very much for being with us this morning.

Secretary SHALALA. You are welcome.

Mr. HOUGHTON. It still is this morning, isn't it?

I would like to revisit the job issue problem for a moment. Mr. Gephardt was here and he talked about four basic human standards, and one of them was creating jobs and opportunities. You have mentioned this in your testimony, a few simple goals, and the first is to move people off welfare and into jobs. And then you further expand on that when you talk about the possibility of their not being able to get jobs then to move into temporary subsidized jobs.

Seems to me this is really the key issue of this whole program, is to get people back to being well-serving, proud citizens of this country, but they have to have work. Many times those jobs are not available. So what will we do? What does the private sector do? What are these temporary jobs? Maybe you would like to expand on that for a moment.

Secretary SHALALA. The States can create the temporary jobs in any way they wish. They can provide a small subsidy to the private sector. They could get some private sector—some employers to volunteer to do some temporary jobs. It is really up to the State. The point is that what we are trying to do is to move people into permanent private-sector jobs and what we do not want to do is to overdevelop the public sector or put in someone's head that what they are going to be in is a subsidized public-sector job forever as opposed to that as a transition, given the economy of the community they happen to be in.

So I think we would like to stay very focused on private-sector jobs and on taking and staying in a private-sector job.

Mr. HOUGHTON. Thank you.

Mr. CRANE. Next, Mrs. Johnson.

Mrs. JOHNSON OF CONNECTICUT. Thank you, Mr. Chairman, and welcome Madam Secretary.

Secretary SHALALA. Thank you.

Mrs. JOHNSON OF CONNECTICUT. First of all, let me commend you on the number of waivers you have granted States. It has been exciting to watch and it has taken some courage to allow States to do some of the experimenting you are going to allow them to do, and I commend you on that.

I also commend you on this bill in lowering the participation age requirements. I tried hard in 1988 to get the right to bring to the floor an amendment that would have required young mothers when their first child was 1 year old to be subject to the work requirement and was denied the right to even bring it to the floor. So I am very pleased to see you looking to bring young people into the

work program when their youngest child is 1 and when their second child is 12 weeks.

There is, however, some misunderstanding about the provisions in our bill that deny benefits to children who have children. It seems to me from your comments that you are not acknowledging or perhaps understanding the aspects of our legislation that will give States the same dollars that they used to spend on benefits for teenagers, teen mothers, but will free them to use those dollars in a way that I think will far better serve those teen parents.

I think it is unwise at this point in our history to treat children as adults simply because they have a child. And that is what the old mandate did. It mandated that the only way a State could respond to a teenager who had a baby was to give them an income.

What we are saying is, States, you get the same money. Now you can use it for very, very much better developmental day care, you can require teenagers to not only go to school but also to come back to the developmental day care center after school and participate in parenting education, or supervised study, or money management courses, or whatever. We will have resources now to much more aggressively address the career development, the personal development needs of these young mothers. And I think that has been the big failing of the system in the past.

So, far from looking at the repeal of the mandate to provide an income to kids under 18, who are not prepared to manage an income, much less a family, we are going to free those resources to pair with the parent. After all, the law requires if you have a child when you are under 18 you are responsible for him or her. So we are merely going to hold parents to their continued responsibility, their legal responsibility, and require States to provide services and to use the money to provide services to that group. I just wanted to clear that up.

I have two questions. One is, why do you oppose denying benefits to anyone applying for welfare who does not identify the father? Now, recognizing that there is a small, very narrow slice of a problem in this issue of paternity determination, putting enormous pressure on people to identify the father, given our ability to verify paternity, seems to me far more progressive public policy, both for men in America and for women in America, and for children. So I am interested in your thoughts of paternity determination.

And my second question concerns the lack in our bill of any prohibition on supplanting, on eliminating public-sector jobs. I do believe that it is wise at this point to use welfare benefits to pay wages for jobs that welfare recipients could easily do that local taxpayers are currently funding and that that old prohibition in the 1988 bill prohibiting supplanting public jobs was simply backward looking.

It will take some time, but through attrition we should be able to open up some jobs that welfare recipients can cycle through, so that they learn to get there on time, they learn to take supervision, they learn a lot of skills and then can move to the private sector.

So I think both of those "outside the dots" issues in paternity determination and in using welfare dollars to actually pay for real work and keeping those options available, a whole different approach to what we used to call public employment, are very con-

structive aspects of the Republican bill that are not being acknowledged for the potential that they have for us in the dialog that I think has to produce a really good welfare reform bill.

Secretary SHALALA. Let me say quickly on your first point, if the explanation is that those dollars are available to work with those teenage mothers in other sorts of ways, then why the need for a lifetime limit on those children never having access to public funds for any purpose?

Mrs. JOHNSON OF CONNECTICUT. The lifetime limit is only in the Contract bill. It is not in the bill that went through the Republican conference and not in the bill the Ways and Means Committee members introduced 2 years ago. That is an issue we will all talk about. The logic for the limit, of course, was to try to deal with the issue of people residing in public service jobs for a decade.

But Governors will have some ideas about that. We will all talk about that. But certainly in a number of major radical welfare reform bills proposed by Republicans, our interest is work.

Secretary SHALALA. Well, I am happy to hear that, and, obviously, you and I have agreed on a number of aspects of welfare before and I am sure that we will again. But it is a harsh program when you give a lifetime limit to a child because they were born to a teenage mother when they are off for 18 years from getting any kind of aid other than Medicaid and food stamps. So my point there is that we need to look at it.

On paternity, let me say I must have been misunderstood. My point was if the mother has identified the father, and, that is, she has done her part of the paternity establishment, she has done her part, then our view is she would be able to get aid for herself and for her child for the limited period of time of the program.

Mr. CRANE. The time——

Secretary SHALALA. Because the establishment of paternity, if the State does not do its part, why should she be harmed? She has done what she is expected to do. The State has certified she has provided the information.

Mrs. JOHNSON OF CONNECTICUT. Just to conclude, since our time——

Mr. CRANE. Time of the gentlelady has expired.

Mrs. JOHNSON OF CONNECTICUT. I would say current law does require that and we are not really forcing paternity determination and we have to be much tougher than that to find a way to do it.

Mr. CRANE. Mr. Lewis.

Mr. LEWIS. Thank you very much, Madam Secretary. Thank you for being here.

Like my colleagues from the State of Washington and from the State of Wisconsin, I am deeply troubled by this rush to embrace State rights. I think the welfare system must be uniform. You cannot have one system in New York and another system in Georgia. In another period of our history we had a great migration in our country from one region to another region, for many reasons, but one was because of welfare benefits.

The Federal Government has played the role of a sympathetic referee. Could you explain, elaborate, how we are going to avoid one part of the country receiving better benefits?

Secretary SHALALA. Well, I think that the proposal that we have put before this committee last year tries to establish, to find a balance in this Federal-State partnership. It tries to establish minimum benefits to protect children, which, after all, is the fundamental point here. And, second, tries to raise the bar and have expectations for parents.

So it tries to change the current welfare system for everyone from one end of the country to the other. So the focus is on a transitional system, on work, and on the responsibility of parents for supporting their children.

So I think that, Congressman Lewis, what we are trying to attempt here is a framework in which we all agree that work ought to be the purpose of transitional help for our citizens; that children ought to be the responsibility of both parents, not simply of the government, and we must do everything we can to help citizens move into work so that they can support and provide for their families. And that that requires some minimal national standards. What we do not want to do is establish a program in which because you are born in Georgia you might go to bed hungry, and if you are born in Wisconsin, the State is more generous in terms of the kinds of benefits it provides.

So there is a national interest in a small number of things. We have established it for the elderly, to make certain that we lift people out of poverty, and I believe that this country has long had a commitment to children. How we do that and how we maintain the kind of flexibility that the Governors very much want and need but, at the same time, have a floor and a flexible floor that responds to different kinds of economic situations State by State, which is very important, because many of those people who come on are workers who need temporary help, is what this debate is really all about.

Mr. LEWIS. Madam Secretary, let me move to another question. The new Speaker spoke a great deal about preparing our children, I guess last week, last Wednesday, preparing our children for the 21st century.

The Republican Contract With America will reduce funding for the Federal nutrition program, including the school lunch program, by $11 billion over the next 5 years. I do not understand how reducing school lunch programs will help our children prepare for the future. When they are hungry, they cannot learn. I do not understand how poorly educated children will help business create jobs in America.

Do you believe that the Republican proposal to cut nutrition programs is consistent with the Speaker's statement about supporting children?

Secretary SHALALA. I believe that the food safety—that eliminating or substantially reducing the food safety net that has been put in place in this country in a bipartisan manner and supported over the years, that it would be a national tragedy. That fundamental to learning, to working, to being able to live to get to the 21st century is proper nutrition. And we have long, as a Congress and as a Nation, supported providing fundamental nutrition programs to our citizens.

I sat in a food stamp office in a Southern State a number of years ago when there was an economic downturn, where working parents came in for food stamps, ashamed and embarrassed but wanting very much to do the best for their families, at least until they found another job, and these programs are not simply for people that are a part of a long-term dependency that we need to break, but they are also for short-term needs as there are economic downturns in different parts of the country. There is no way to write a formula that will solve that problem.

There have to be some fundamentals here of what we believe as a country and what defines us and one of them ought to be that children ought not to go hungry, that adults ought not to go hungry when they are willing to work, and when they want to do the best for their families.

Mr. CRANE. The time of the gentleman has expired.

Mr. LEWIS. Thank you, Madam Secretary. Thank you, Mr. Chairman.

Mr. CRANE. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

Madam Secretary, certainly the issue of welfare reform is a very complex one and involves much more than AFDC or food stamps, but we appreciate your coming before us today and sharing with us your thoughts on the issue and we look forward to working with you and the administration in trying to solve some of the problems that we have in our welfare system.

Let me ask you, though, your estimate of children to be deprived of AFDC benefits has changed, I think, in the last couple of weeks. What is it now that you are estimating the number of children that would be thrown off, as you say, welfare when you really mean AFDC, I think? According to the Contract proposal.

Secretary SHALALA. If the States adopt the least restrictive option available to them, 1.3 million would lose their eligibility for AFDC after the first year of implementation.

Mr. MCCRERY. On what methodology is that figure based?

Secretary SHALALA. It is based on an analysis of the bill that was submitted.

Mr. MCCRERY. I am sure it is. But what was the methodology that was used to reach that figure?

Secretary SHALALA. We assumed that the States would adopt the least restrictive options, which would include denying benefits to children born to mothers under 18, denying benefits to children of AFDC applicants who do not establish paternity for those children, and denying benefits to children conceived or born after their parents received AFDC.

So we took three of the major elements of the plan and worked our way through those numbers.

Mr. MCCRERY. Let me see if I can be more precise in my question. Since this is a prospective provision, and since none of those children have been born, how did you reach the figure of 1.3 million? Did you just reach in the air and pull that down or——?

Secretary SHALALA. No. We calculated—we know what the trend line is of children born to mothers under 18, obviously. We know something about a paternity establishment in the States and how effective the current State systems are. And since there was not

child support enforcement, though there obviously is going to be as part of this, we made a calculation based on that. And we also know something about children born while their parents are on AFDC, so we made a calculation based on that. So we based it on behavior and on the trend lines of behavior, and these are the least restrictive options.

I would be happy to provide this to you in some detail showing you what our assumptions were, but we used 1993 data.

Mr. McCrery. OK. I would be interested in receiving from you the methodology that you used.

Secretary Shalala. Be happy to.

[The following was subsequently received:]

The Department of Health and Human Services estimates that the welfare proposal will deny AFDC to 1.3 million children one year after implementation. This analysis assumes the following provisions within the proposal are in place:

- deny AFDC to children born to unmarried mothers under 18
- deny AFDC to non-exempt non-citizens
- deny AFDC to children conceived or born after the AFDC case began
- deny AFDC to children without paternity establishment
- deny AFDC to minor mothers not living with related adults.

The mandatory five year time limit on AFDC receipt (2 years at state option) has no effect one year after implementation.

The Department's estimate is based on data from the 1993 Quality Control file (QC) and generated via the AFDC-QC microsimulation model. Data from the QC file were collected during fiscal year 1993 and includes demographic characteristics and average monthly income amounts for the month in which the case was reviewed for the sample. Characteristics used in the analysis included age of mother, age of children, reason for eligibility (i.e. parents unmarried) and immigration status. The full AFDC-QC dataset contains roughly 54,000 unweighted households. Each observation is a "snapshot" of the sampled unit in a particular month. The results of the AFDC-QC model simulations represent effects on AFDC caseload in the "average month" of the fiscal year.

The Department's estimate represents the combined affect of each provision of the proposal as if 1993 was one year after implementation. The AFDC-QC microsimulation model tabulates the number of children affected by each provision. The model applies the rules of the AFDC program - both actual and proposed - and applies them to each AFDC unit in the QC sample. The effects of the proposal are determined by comparing the results generated by the modified AFDC program to the results simulated under the actual rules.

The estimate assumes no change in behavior. For example, no reduction in teenage fertility, no increase in teenage marriage, etc.. The estimate above also assumes that states do not take the more restrictive options such as two year time limits and denying AFDC to children born to unmarried mothers 18-20 years of age.

Summary Revenue Table
(Numbers in Billions)

Revenue Provisions	Administration's Original Estimates
Emergency Assistance	1.6
Immigrants	3.8
DA and A	0.8
Farm Income	0.5
EITC	0.3
Superfund	1.5
Day Care Homes	0.5
Other Expiring Provisions	0.3
TOTAL	9.3

Secretary SHALALA. Could I say something about your first comment, because I think it is important that I set a tone here?

Mr. MCCRERY. Sure.

Secretary SHALALA. And that is that this is hard to do. We are all so glib. We can have our fun with the orphanages issue, and I appreciate the fact that you want to make sure that everybody has orphanages in their plans. But this is hard to do. It is hard to move people. Every single one of those States that we granted waivers to, every single one of those Governors—doesn't make a difference whether they are a Republican, a Democrat, a Liberal, or a Conservative—will tell you it is very difficult to break long-term dependency, to move people into jobs.

So we can debate about whether our plan moves people quickly enough. We can look at the literature. But what every experiment that we have approved, and we do not have finals, obviously, on these, what every Governor and every county official, what every welfare worker and recipient has told us is this is tough to do and that we should not——

Mr. MCCRERY. I agree, and, as I said, we are looking forward to working with the administration to try to solve the problems.

But let me get back to the methodology for just a moment. Did you in your methodology assume a change in behavior due to the change in public policy?

Secretary SHALALA. We did not——

Mr. MCCRERY. Or did you take numbers from 1993 and move them forward into 1995 or 1996?

Secretary SHALALA. I think what we did was simply assumed that the first year there would not be a major change in behavior. But even if we assumed a 50-percent change in——

Mr. MCCRERY. What about the second year? Did you assume a change in behavior in the second year?

Secretary SHALALA. I don't think we did. I don't think we did, but——

Mr. MCCRERY. And on the third year?

Secretary SHALALA [continuing]. But let me say——

Mr. MCCRERY. My question, Madam Secretary. How about the third year? Did you assume any change in behavior?

Secretary SHALALA. No, and I have not given you numbers for the third year. I have given you numbers only for the first year.

Mr. MCCRERY. My point, Madam Secretary, is I am afraid we may have a basic disagreement. Throughout your testimony you keep going back to government as the answer. If people cannot get a job, we will give them a public job. And we are not going to restrict the time they are on that public job. If people cannot have any personal responsibility and take care of themselves or not have a baby when they are not economically able to care for that baby, fine, we will take care of them.

I think maybe that is a basic disagreement that the majority has with the minority and perhaps with the administration. That remains to be seen. But we think that if you make very powerful changes in public policy, then you will drive, to some extent, more responsible behavior in our society, and that may, just may, affect the numbers that you have given us. So I think—and I am anxious to see the methodology.

Maybe I am wrong, but I suspect you used what we might call a static model of projecting the numbers of children who would be deprived of AFDC in your analysis. And if that is the case, then I think it is a faulty methodology.

We think public policy changes can affect behavior in this country. That is what the welfare reform debate, I think, should be all about: What public policy changes can we make to positively affect behavior in this country, because we think public policy for the last 30 years has affected behavior negatively.

Mr. CRANE. The time of the gentleman has expired.

Secretary SHALALA. Mr. McCrery, we have no disagreement on the power of what is very strong reform changes in the President's bill as well as in the other bills. The issue for us is to what extent we wish to punish innocent children as part of the process of changing——

Mr. MCCRERY. Madam Secretary, the current system is punishing innocent children every day. If you deny that, you are missing the point.

Mr. CRANE. Time of the gentleman has expired.

Secretary SHALALA. Congressman, we are in this bill's business because we want to change and provide opportunity for innocent children. That is exactly why we are both in this business. And all of us use powerful incentives, and all we are saying is that there is a point at which that perhaps the proposals are too punitive, where we can achieve the same result without being overly punitive.

Mr. MCCRERY. And I agree with that, Madam Secretary, and we look forward to working with you to make sure that occurs.

Secretary SHALALA. Fair enough.

Mr. CRANE. Mr. Gibbons.

Mr. GIBBONS. Madam Secretary, you have done a great job during your 2-year tenure here, and you have done a great job this morning testifying and working in a very factual manner.

I think one of the most important provisions of any child welfare bill that we develop here is parental responsibility, not only for those who qualify for welfare but those who are just above the poverty line.

There has been a great neglect, mainly, I regret to say, on the part of fathers of their offspring. And what I want you to do for me right now is to outline what the responsibility is of the father, whether the child was born in or out of wedlock, will be under the new legislation, as you see it developed, versus the status quo today.

Secretary SHALALA. Well, we have basically—the father will be expected, under the new proposal, to provide financial support for their child. That is an uneven process today in this country. It will be uniform under the President's proposal. Whether or not they are the custodial parent, whether or not they are living with the mother and with the children.

Mr. GIBBONS. Whether or not the child was born in or out of wedlock?

Secretary SHALALA. Whether or not the child was born in or out of wedlock. We will establish paternity and expect the other parent to take responsibility for helping to provide support for that child.

Mr. GIBBONS. Whether or not the child is a welfare recipient or a nonwelfare recipient?

Secretary SHALALA. Whether or not the child is a welfare recipient, or whether or not the child was born out of wedlock, we will expect both parents to take responsibility for supporting that child.

Mr. GIBBONS. Now, how are we going to do that in the future versus the way we do it now?

Secretary SHALALA. By putting in place a very strong child support enforcement system that begins with the establishment of paternity. And in the process that we had outlined last year for the committee, the mother identifies the parent—the father—and the State has 1 year to legally establish paternity. The child support enforcement system kicks in.

Nationally, every State will have a system in which they will be expected to follow up. It will be an administrative procedure as opposed to clogging up the courts, with regular updates, and there will be sharing of information between States.

As you know, one of the problems now is that a father escapes to another—I am trying to be careful about the language, there are some mothers involved, too.

Mr. GIBBONS. I understand.

Secretary SHALALA [continuing]. And where a father leaves the State and will want to follow up. We will use W–2 forms. We will use sanctions. The State of Maine this year, last year, wrote a letter to every father who had not paid their child support and said, what is at risk now is your driver's license, your professional license, and people came trotting in very quickly to start paying their child support payments. So it is not only access to wages and perhaps to property, but also to licenses. And the States will be able to use these tools to collect child support.

The updating is almost as important, Congressman Gibbons, as anything else because there are child support orders out there, but often they are not updated and the mother does not have the wherewithal to go back into court to do that.

Mr. GIBBONS. I understand that. Answer this question, if you can, please, ma'am. It is very frustrating now to go across State lines and enforce an order. How would that be improved?

Secretary SHALALA. There are a number of recommendations that have been made for approving that, including putting a national system in place. The Interstate Commission made some recommendations that would allow one State to pass the information on and make the collection and allow a national information system to kick in as part of this. And this will make it very easy to move from one State to another to collect child support enforcement.

There will be a national clearinghouse. We will use national W–4 reporting as a way of identifying parents.

Mr. GIBBONS. Let me tell you, one of my practical experiences in trying to enforce these types of orders has been that once the responsible person goes to another State, the other State takes very little interest in the mutual support. It drags on and drags on until finally the family has to abandon any real hope that they can ever get help. And I think that child support enforcement is one of the

most important things we can do here. Our interstate enforcement is, frankly, not good and we need to improve that substantially.

Secretary SHALALA. Right.

Mr. CRANE. Time of the gentleman has expired. Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. Madam Secretary, I would like to join my colleagues in welcoming you to this meeting.

As you recall, we spoke very briefly at the White House over the Christmas holidays and were talking about how we were going to move this forward and wanted to work in a bipartisan way, and I certainly would want to repeat that today, because I think it is important to emphasize the similarities between the administration's bill and the various Republican bills, including the Contract With America bill, which, in itself, I think has the same philosophical underpinnings. I think they both recognize that the present system we have is going the wrong way. It encourages illegitimacy, it discourages marrying, and it discourages work.

My criticism of the administration's bill, I have a number of them, but the main criticism is it did not go far enough. I was interested in the answer you gave to Mr. Archer in response to his question on who was covered under that bill and the percentages. And if I recall correctly, you said one-third was included in the first year, and after 5 years it went up to 50 percent.

As I recall, and I have not looked at the administration's bill in a number of months, but as I recall in the administration's bill, after 5 years, there was a dispute as to whether it covered 190,000 or a quarter of a million people, but because of an age cutoff it only applied to the younger people and did not attempt to apply to the mothers who were born before 1975, and that it was almost anemic in the coverage that it gave.

Could you review those figures with us again?

Secretary SHALALA. Yes. Let me explain, first, the phasing in strategy that we used in the bill, though. I think one of the things we want to make very clear is that in that bill, while we suggested we start with the younger people, the States had the flexibility of taking on a much higher percentage of their population if they were prepared to do that, and that was, in fact, part of the proposal.

The reason that we put together a bill that in fact phased in over time is the answer that I really gave earlier; that it is very expensive to put the program together.

Mr. SHAW. I understand that, if I could reclaim my time.

Secretary SHALALA. Because the Governors themselves indicated they would have to phase in. It is a function of resources and the willingness of the Governors to move much more quickly.

Mr. SHAW. Oh, I am very aware of that.

Let me—it is my time, Madam Secretary, and I am going to have to insist that you answer the question. Does it cover 50 percent of the population after 5 years, of the welfare population?

Secretary SHALALA. Yes, it did, it covers 50 percent of the targeted, phased-in population.

Mr. SHAW. I will be very, very interested to review those figures. Does it cover more than a quarter of a million people?

Secretary SHALALA. Our numbers indicate that we phased in one-third right away and got to 50 percent after 5 years and everybody was phased in eventually.

Mr. SHAW. This is of the total AFDC population?

Secretary SHALALA. This is of the total AFDC population. But, remember, the difference between our bill and what is in the Contract is that there were some exemptions in our bill.

Mr. SHAW. Fifty percent of the total AFDC population would be 2.5 million, Madam Secretary,. You must reexamine your figures because you do not cover that.

Let me go to another point.

Secretary SHALALA. OK, 2.3—let me read you the—let me read you the numbers. Remember that when we are talking about phasing in, you are using the number of jobs and we are talking about people that are parenting in the mandatory training in the education placement programs, and so we are counting the whole number as we are moving through.

In 1997, we are assuming that there were 1.6 million adult cases with a parent born after 1971. Two hundred eleven—I can give you the chart—211,000 would be working or off welfare; 904,000 would be in time-limited mandatory training, educational placement programs with strict participation standards; and about 500,000 were deferred or exempted by the States due to a disability; they were caring for a disabled child or an infant or some other exemption the State gave them.

Mr. SHAW. Let me begin by expressing disappointment in your statement in which you said attempting to implement welfare reform without strengthening child support enforcement sends the wrong message. It says the noncustodial parent is not one-half responsible for the birth. Your statement indicates that the Republicans have not addressed that issue.

I can assure you, Madam Secretary, we did not require paternity establishment in order to advise the father he can hand out cigars.

I might also say I was very disappointed that you chastised the Republicans in that bill when the Republicans have been talking to the ladies and gentlemen right behind you. We said that we wanted to move forward with a separate bill in a bipartisan manner to address that issue. That issue is of prime importance. Paternal responsibility is something that this country has to come down on with a hard foot. We are going to proceed with that. Madam Secretary, you know that, your staff knows that, and I would hope that we can put this aside and move forward on that as a separate bill. That is tremendously important and it is one that this Member, as chairman of the Human Resources Subcommittee, plans to make of prime importance.

You heard from Chairman Archer. Now you have heard from me. We are going to do it, and we would like to do it in cooperation with the administration.

Chairman ARCHER. The gentleman's time——

Secretary SHALALA. We would, obviously, love to cooperate, Mr. Shaw.

Chairman ARCHER. Gentleman's time has expired. The Chair recognizes Mr. Hancock to inquire.

Mr. HANCOCK. Well, thank you, Mr. Chairman.

I just wanted to get back and follow up a little bit on Mr. McCrery's comments about the static and the dynamic model. I mentioned it earlier when Mr. Gephardt was testifying. I think that is something that we fail to look at; we consistently fail to look at it.

You have been testifying for about 1 hour and 50 minutes now. I appreciate your coming by, and thank you very much for the information, but, seriously, let's look at the impact of the changes that we make on the dynamics of a dynamic country where people do have the opportunity to solve their own problems rather than to ask us to sit here in the U.S. Congress and solve the problems for them. Thank you.

Secretary SHALALA. You are welcome.

Congressman, I would love to make very strong assumptions about behavioral changes that will occur once the bill gets put together. We obviously all agree that it must be a very strong bill. The President is committed to a very strong bill that does change the behavior of the welfare system but, in particular, that provides opportunities for people to move quickly off of welfare and to take their responsible places as taxpayers.

The fact that we did not assume these changes in the first years of our projections, I have stated very clearly that we did not, and been honest about that, even if we assume 50-percent change we would still have large numbers of people who—large numbers of children who did not have access to cash payments, to be very clear, and we simply disagree on that. But we have a lot of work to do together, and I look forward to working with you.

Chairman ARCHER. Mr. Rangel will inquire.

Mr. RANGEL. Madam Secretary, it is always good to see you, and I am going to need a lot of help from the administration in order to work out something with my friend, Chairman Clay Shaw.

The emphasis now is on a very unpopular subject, that is, people who are receiving government checks. All of America, and probably they wish that they were working.

You mentioned that 70 to 90 percent of AFDC mothers are off welfare between 3 to 5 years. I need your staff to sit with me to find out the profile of these people that we are talking about. The problem, as I see it is children who are raised in communities where most of them do not get out of high school with a certificate and those that do do not have jobs or job opportunities, the future really does not hold much for them, whether they are male or female. That is why the males more often than not have no alternative to getting involved with drugs and crime and violence, and they end up in jail. And you can have death penalties and mandatory sentences, but you still see that flow coming.

Now, take the girls. When I was a kid, girls didn't have sex because they were afraid of getting pregnant. They were hoping to get married. They wanted to be considered decent, and not have jobs but at least marry someone who was working. I see generations of young women having kids so that we now have welfare grandmothers that are less than 40 years old. And everyone says, well, they should be working.

Why can't we get some help from the Secretary of Labor? Why is it that we are saying that we should have training and they

should have jobs, and if they do not, this is what is going to happen?

We do need people with certain skills in this country. I go into any hospital, veterans', private, public hospitals, and the nurses are coming from Ireland, the Caribbean, the Philippines. It just seems to me that somewhere along the line, whether you are a welfare recipient or not, someone should say, this is what your country needs, we are going to train you, you are going to have pride, you are going to enjoy it, and you are going to work.

We talk about day care. My God, there has to be a need for people to be trained in taking care of other people's kids.

Libraries, to me, you do not even have to subsidize it.

You have to invest in the training, not just to punish children and mothers but to prevent people from believing that there is a better life having a kid and being on welfare, which is a terrible life.

Can't we get the Secretary of Labor to identify for my Chairman the jobs that we are going to need in the future. Not just for welfare recipients, but for those who live in communities that foster dependency, whether dependency with a warden or dependency with a socialworker, and that way we would know the job is there rather than saying that we will not take care of your kid if you are not working.

Can we get a team? Because I am convinced that Clay Shaw is the type of sensitive person that if he knows there is no job, and if he knows there is no training, that just cutting off somebody is not going to deter the problem that we face today. Can we get a team besides your office to identify who we are dealing with? Because it seems as though this person has got a lot of problems other than just having a baby.

And the second thing is to identify the needs of a community and to lock that up with making certain that there is a job to be had. Can that be done?

Secretary SHALALA. Certainly, Mr. Rangel. And I have a feeling you and Mr. Shaw are going to work very well together.

We had agreed as part of the President's proposal that we would use the Department of Labor's JOBS programs, that the Governor would be able to have access to the one-stop shopping and the streamlining of the JOBS programs that is taking place. And I know both you and Mr. Shaw have been long supporters of streamlining this so it is an easier process to use and so that we do not duplicate these services as part of our overall effort.

Second, your point about generations is very important. I spent the weekend rereading the literature on teenage pregnancy, and what struck me was that all of us are using the language about the kind of rules that we have to lay out for these young people—they have to live with their families—when what is really happening is, in part, they obviously have to take responsibility for their behavior, but they are getting very ambiguous messages from the adults around them. It is not just the media and those of us in public life, but it is the mother—it is the young girl that said to me, if I have a baby, my mom and my grandmother said she would help me, they would help me bring it up. It is the messages and it is not just low-income communities, it is middle-income communities, too.

We need to send a clearer and more deliberate message about teenage sexual activity, period, let alone the next piece, which is pregnancy. And the adults need to do it. This business about responsibility is not only about teenagers, but it is also about the adults in society and the way in which we organize ourselves and send young people messages. It may be peers. It is remarkable how the literature reflects on older siblings and their own sexual activity and their own messages on kids that they go to high school with or junior high in many cases, which is of course tragic.

So we have a lot of work to do in this area, and I look forward to working with you and the Chairman and Chairman Shaw and Mr. Gibbons.

Chairman ARCHER. The gentleman's time has expired. Mr. Ramstad will inquire.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Madam Secretary, coming from your neighboring State, it is always good to see you. And I know the hour is waning, and I will be brief. I have but one question.

I truly hope that we can take off, to the maximum extent possible, our Republican hats and our Democrat hats and work in a bipartisan, pragmatic way to radically reform the welfare mess in America. I am encouraged when you say that your overriding objective is to break the cycle of long-term dependency, and I think that is ours as well on this side of the aisle.

And I know that you agree because I have heard you say it before that the astronomical increase in teenage girls having babies is a devastating social crisis in America that we must deal with. But what I don't understand is, absent the sanctions in our Contract With America, how in the world can we reverse this alarming trend in teenage girls having babies? I mean, if there aren't any sanctions such as we propose, how are we going to address the problem?

Secretary SHALALA. I think that 90 percent of the sanctions or what I considered the nurturing responsibilities we agree on. Mr. Shaw and I agree that teenagers ought to live in their families. They ought not to move out and set up a separate household. We agree that these teenagers ought to finish school as part of the requirements of getting any kind of aid. We agree that they must establish paternity as part of that requirement. We agree that they have to get additional training and get ready to go to work as soon as they finish high school.

So those parts, the central parts of what our expectations are for young people, in addition to all of the earlier things that go on—a long-term strategy for teenage pregnancy prevention that involves communities organizing for abstinence and to reduce the number of young people that are engaging in sexual activities—all of those things we agree on.

We agree on the work requirements. We agree that there ought to be some kind of a time limit. Where we are having this disagreement is about whether there ought to be cash payments, whether there ought to be some money provided for the child.

My suggestion—I have enormous confidence in the good sense and the great experience of Chairman Shaw, and I just think that we can work through this together. That is why I am here. I think

we are very close on a number of these issues, and we just have to work through this and not harden our positions. And that is what we are prepared to do, and I simply look forward to the opportunity to work with all of you.

Mr. RAMSTAD. Thank you, Madam Secretary. I am very encouraged by your conciliatory tone as well as the areas of consensus you identified.

Thank you, Mr. Chairman.

Secretary SHALALA. If I don't get a smile out of Mr. Shaw before I leave here, I am in big trouble, Mr. Chairman.

Chairman ARCHER. Mr. Stark will inquire.

Secretary SHALALA. Oh, this will be tough.

Mr. STARK. Thank you, Mr. Chairman.

I have heard some reference to abstinence, which has never been very popular in the 13th Congressional District in California, and I have never chosen to run on that platform, but if that is what Mr. Shaw wants to sponsor, I suppose I could go along with it.

I am concerned, though, that we, with a great deal of delight and hard work and support from the Secretary and the administration last year, passed the Family Preservation Act, and principal to that was that at all costs, absent abuse of the child, that the child should be retained in a situation with a parent.

Now I am getting mixed signals, and I must say I have heard questions on the Contract and on the President's plan, and I am reminded of what Tip O'Neill would have told you. He would tell you that those Republicans are just trying to cut welfare off at the hips, and you are trying to cut it off at the knees. I don't know if you choose not to punish innocent children, how turning a child over to the welfare system because the child's mother is unable to find a job can qualify as anything but punishing innocent children.

Now, you criticize President Reagan's Family Support Act for exempting women with children under 3 and mothers under 16—I presume that is so they could be in school—and pregnant women in their second trimester. I happen to think that those exemptions are quite worthwhile. And you then proceed to say, well, in Indiana you are going to let them punish children if a woman on AFDC has a second child without regard to how old that mother is.

So on the one hand I am hearing that in Indiana it is OK to kick them off AFDC and punish the innocent child, but it was wrong for President Reagan to do it. And I must say that it is going to be very difficult to convince me that we are not going to punish innocent children if that is what I read all the way through your testimony.

I am tremendously concerned by the fact that we are abandoning what we passed which I thought was good legislation and—in our haste to show who can be the toughest and the nastiest to children, beating up all over them. I would hope that the Democratic Party would begin to distinguish itself.

I think Mr. Shaw is going to go along with me before we are done and say that it is absolutely unacceptable to punish innocent children. If it is done through a waiver, it would be much simpler. Clay and I wouldn't have anything to do if we would just grant all 50 States a waiver. Then we have a block grant and all the kids could get kicked off AFDC, and we don't have to go through all these

long hearings and markups. We can beat Gingrich to the punch. We could get those waivers done in 30 days. Then we don't have to wait for 100 days.

So I hope that either we are going to define the Democratic policy with more distinction and not in matters of degree, or we are going to sit down and work out a compromise with Mr. Shaw. I would be willing to start at the point where Mr. Shaw will guarantee me that we are not going to punish innocent children. And I include punishment as dumping them into the welfare system. So I would like us to see from our side of the aisle where we are going to fight, and if we aren't, let's get to work and see that we protect the children.

Thank you for being with us today.

Secretary SHALALA. Congressman Stark, I have been very clear about the President's proposal, and that is, the President's proposal does not remove an adult from the welfare system who is willing to work, who is willing to go through the training program.

Mr. STARK. It does in Indiana under the waiver you just granted.

Secretary SHALALA. The Indiana waiver—if you are talking about the family cap——

Mr. STARK. I am.

Secretary SHALALA. It is true that we have allowed some family caps, and the President's proposal allows some family caps depending on what a State wants to do. It is also true that it is the States that set the benefit level, and we see the family cap within the context of setting the benefit level. A State could increase the benefit level and have a family cap for an extra, if someone had a child while they were on welfare.

But in the basic proposal that we have put forward, only if a parent absolutely—an able-bodied parent absolutely refused to go to work, to be part of a training program, to look for a job, would they suffer some sanctions. All I have said is then the child welfare system has to kick in and take a look at whether that parent is properly caring for that child.

But we have been firm on those who are looking for work. If they can't find work, then we need to provide a subsidized work opportunity on a temporary basis until they can find a permanent job.

Chairman ARCHER. The gentleman's time has expired. Mr. Zimmer will inquire.

Mr. ZIMMER. Thank you, Mr. Chairman.

Madam Secretary, I would like to commend you for the conciliatory tone that you have taken today and your expressed interest in reaching an accommodation with Mr. Shaw and other leaders of the majority. It certainly is in contrast to what I considered to be the harsh and confrontational and misleading aspect of your recent press conference on the Contract With America's welfare proposal, and I think it is a step in the right direction.

I would like to clarify a point that you made earlier. You said that in 5 years 50 percent of the welfare population would be covered by the administration program and eventually 100 percent would be covered. When does that eventually occur?

Secretary SHALALA. I don't know whether we costed out the whole program. What we did in our welfare proposal is to get start-

ed with the younger recipients and to phase them in beginning in 1997.

And once you go beyond the 3-year period—I mean, one of the discussions we are having here is when does behavior start to change as part of this proposal and is this proposal going to, in fact, change behavior in relationship to teenage pregnancy or anything else. So I don't have a set of figures in front of me that phases this in, assuming that there is no change in behavior over a long period of time, but I would be happy to give you our short-term numbers.

Mr. ZIMMER. So you—well, let's assume that behavior doesn't change because I think you were making that assumption.

Secretary SHALALA. Only for the first year.

Mr. ZIMMER. Well, could you give me two assumptions, one if it is static and one dynamic?

Secretary SHALALA. I do not have that on the President's plan. All I did was answer a question about the Contract plan, and that is what the impact would be in the first year if no other changes took place.

Mr. ZIMMER. Now, as I understand it, the phase-in is dictated as much by budget considerations as by any other considerations.

Secretary SHALALA. And, well, capacity. The phase-in discussion in the President's plan was in part a discussion with the Governors about how much they wanted to take on and how much their capacity to take it on. Some Governors said they wanted to take their whole system on. And our budget allowed—assumed that some of the Governors would take on their total numbers, and some of the Governors wanted to take on a piece. We suggested they start with the younger people. That is where we had some disagreements.

All I am saying about that is that it seems to me that that is an area where we all ought to be flexible.

Mr. ZIMMER. Do you have a plan for getting from 50 to 100 percent and a timetable?

Secretary SHALALA. I am sure that we have—the plan is to get to 100 percent. Once you get beyond——

Mr. ZIMMER. That is an objective.

Secretary SHALALA. Yes, we have an objective. The objective of the overall proposal by the President is obvious: To halve the entire welfare population and to reduce the number of people that are coming in. I mean, that is the purpose of everything we have said about teenage pregnancy prevention, for example, is start to reduce the actual numbers.

I will provide you with all the numbers that we do have, but, again, once you get out, after a certain number of years, beyond the first couple of years, then you have to start thinking about whether you want to build in some assumptions, and that is the kind of thing where the committee and the administration—where the Democrats and the Republicans and the administration ought to sit and talk about what kind of assumptions we are going to build into the long-term plan.

Mr. ZIMMER. You have said that for the first 3 or 5 years the program is designed to be revenue neutral. It is revenue neutral I guess in part because you are phasing it in so slowly.

Secretary SHALALA. Well, it is a $10 billion program.

Mr. ZIMMER. $10 billion in additional expenditures?

Secretary SHALALA. No, it is $10 billion. It is not new expenditures. It is $10 billion that is budget neutral. We have identified——

Mr. ZIMMER. Reprogrammed funds from the Department of Labor.

Secretary SHALALA. For the purposes of setting it up we have identified sources of revenue to pay for the bill when we sent it up last year.

Mr. ZIMMER. Do you have a plan or a timetable for assuring that it is going to be revenue neutral or I would hope ultimately to the benefit of the taxpayers when it is 100 percent in force?

Secretary SHALALA. We would—when we submitted the bill at the beginning we submitted the budget for a period of time, and I think that none of us have projected what is the impact of the teenage pregnancy pieces 5 years out and whether the numbers start to go down.

It is the kind of thing that I would not want to get into an argument with, rather sit down with the committee and work through and see if we could agree on the assumptions. We would have to do it based on some research we have.

We do have some research now that the States have been out, and we ought to have information about what is happening in the States that are trying these various kinds of changes. Some of the States are 2 years in. Some of them are 1 year in. So I think it is important that we bring what the experience out there is to bear on what our joint assumptions are about a change of behavior.

Chairman ARCHER. The gentleman's time has expired.

Mr. ZIMMER. Thank you.

Chairman ARCHER. Mr. Jacobs will inquire.

Mr. JACOBS. Mr. Chairman, I will follow the excellent example of Mr. Gibbons and yield my time to some other member.

Chairman ARCHER. Well, if the gentleman has no one in particular to yield to, the Chair will follow the orderly procedure.

Mr. JACOBS. I mean, I will make room for another member. I will let people go to lunch. How is that? Let the record show?

Chairman ARCHER. The Chair recognizes the gentleman from Georgia, Mr. Collins, to inquire.

Mr. COLLINS. Thank you, Mr. Chairman, and thank you, Madam Secretary. You have been very patient.

I want to refer back to the comments of the gentleman from New York. He mentioned a lot about jobs. I have asked this question several times. When we talk about moving people from welfare to the jobs, what jobs? He had a very good point there.

We must create more and more jobs in this country. And in order to do that, in accordance with Mr. Gephardt's statements, we have to have tax reform. So I am pleased to hear that Mr. Gephardt is very interested in reforming the alternative minimum tax which is a disincentive for the capital investment that creates jobs.

Another issue I would like to raise is parental responsibility. We have discussed children having children, and we have also discussed the denial of cash benefits or cash payments for those children of children, but yet we all agree that we are going to leave in place programs such as food stamps and health care and hous-

ing. The purpose of parental responsibility is not just to the parent of the child, of the teenager who had the child, it is also to the parents of the teenager who had the child, to insure that they understand if their child has a child then they have some parental responsibility. Requiring responsibility may lead to a change in behavior such as abstinence.

But I want to move to the other end of the spectrum, and that is to our seniors. We have a lot of seniors who need assistance such as in the area of long-term care.

You mentioned waivers, and I do know that there are some States who have requested waivers so that whereby Medicaid funds can be used for long-term care in areas other than institutionalized care, such as nursing homes. Does the administration have any position on making that a national effort to encourage States to move away from complete institutionalizing of seniors in nursing homes and allowing or requiring States to use those funds in other areas that are less costly than nursing care?

Secretary SHALALA. As part of health care reform we did make a recommendation that would allow States much more flexibility on moving to home care, day care for the frail elderly, ways of avoiding—helping. And there are some tax credit recommendations within the Contract helping families to keep their loved ones at home and making sure that families have choices other than institutionalization. We have a number of national demonstrations going on now looking for alternatives and trying to price alternatives.

I think all of us are enthusiastic about opportunities for more home care so that we can keep our loved ones at home as long as we possibly can. So I think all that flexibility has been very much a part of our discussion and the recommendations that we have sent up here.

I think the Contract has some things that are interesting that would help in terms of long-term care, and I hope, Congressman Collins and Chairman Archer, that we get a chance at some point to talk about, not today, but to talk about some of the things that we need to do in terms of long-term care that may be a combination of tax credits and some State grants and some more flexibility under the Medicaid program.

Mr. COLLINS. Well, we are now waiting for the States to request the waiver to use Medicaid funds for personal home care versus nursing home care. Should we not encourage States to use those funds for personal home care versus nursing home care where the cost is one-third of nursing care?

Secretary SHALALA. The answer is, are we prepared to move into a much more flexible framework with the Medicaid program? And I think that the answer is yes. And, in fact, there are all sorts of revolutions going on in the Medicaid program today that have to do with the movement to managed care as well as to trying to find a way around institutional care.

What has scared people away on home care is——

Mr. COLLINS. I said personal home care, which is not——

Secretary SHALALA. Personal home care, which I think is a combination of the States' right to have to supervise it, establish standards—and there are many States that are deeply involved in the home care business that already provide their own resources for

home care as part of their own health package. What you are suggesting is are there more things that the Medicaid program could do itself. I am sure that there are, and I would be happy to sit down with you and discuss some of those options that are being explored now.

Chairman ARCHER. The gentleman's time has expired.

Mr. COLLINS. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Matsui will inquire.

Mr. MATSUI. Thank you, Mr. Chairman.

Thank you very much, Madam Secretary. I appreciate the fact that you are here today, and would like to say that you and your staff have really done an outstanding job on this issue.

You know, you really are, as you indicated, under somewhat of a burden at this particular time because we really don't know what the Republican proposal is. First, we started with the Shaw-Santorum bill in 1993. Then we had the Talent bill and then we had the Contract With America. And now they are talking about some form of—they call it block grant, but it could end up as a revenue sharing program.

I do feel that you are kind of speaking or maybe punching a marshmallow here because we really don't know what their proposal is, and, until we do, we are going to have a very difficult time responding to it.

I think what we need to do really is clarify a few things. One, I don't know how you really can do an adequate welfare reform bill unless you have health care because, as you stated in your testimony, approximately 70 percent of the women who are on welfare go off of welfare within 24 months. And the problem is that 65 percent of them—that is 65 percent of the 70 percent—end up within 1 year going back on welfare. And both Dr. Ellwood and Dr. Bane have showed graphically the demographics of the welfare population, and the real problem most people say is because health care benefits run out.

As Members on the other side of the aisle have indicated, women, like businesspeople, are going to do what is in their best interest. When they get a minimum wage job that does not cover them with health insurance, they are going to end up going back on welfare because that way they can at least cover their children with Medicaid benefits.

Tell me how we can possibly do welfare reform, in a comprehensive way, without dealing with the issue of health care for these people.

Secretary SHALALA. It is very tough, Congressman, as you have so eloquently stated. It is very tough to do welfare reform without child care and health care.

When you go out and ask welfare recipients what is it that is stopping them from finding a job, many of them—most of them will tell you their experiences getting out to get a job, often a minimum wage job. A child gets sick, and they have to go sit in a clinic. Their child care falls apart, and they are not able to make it to work that day.

And for every mother—and we are talking mostly about single mothers here—the combination of child care and health care and combined with what this Congress has already done on the earned

income tax credit is a very powerful package for at least taking a significant percentage probably of the population and allowing it to stabilize itself in jobs.

And I think child care-health care combined with the earned income tax credit are very powerful tools for welfare reform. And I hope that we don't give up on the need to continue to look for some first steps, as the President indicated in his own letter to the leadership, for working families. Because what we are often talking about, the people that don't have health care in this country are often low-income workers, and being able to put that combination together I think is critical. That is why it is so hard to do all this.

Mr. MATSUI. It really is very difficult.

Let me discuss with you the further problem, the job training program, then the job search and then eventually the job. We in California were very innovative in the early eighties. We established the GAIN program. That program was actually the program that in 1988 President Clinton, then Governor Clinton, and others looked to in terms of reforming the welfare system at the national level, the 1988 welfare reform package, Family Support Act.

We have found—at least in studies I've seen, and perhaps your studies might show differently—but one of the most successful programs in the country is in Riverside County. There they have a public-private partnership between the county and the business community. That program has a success rate of 20 percent. That is the most successful program in the country, a 20 percent success rate. Do you anticipate how we can get that up to 40 or 30 percent, maybe 50 percent? Because we don't want to create expectations out there with the American public or perhaps expectations that nobody is going to be able to fulfill. What are your thoughts on that, allowing the private sector, which we need to do, to help these people find jobs?

Secretary SHALALA. Well, as I indicated at the beginning, this is tough to do. The experiments around the country have made it very clear that even the most successful programs demonstrate 20 percent. And we don't have the numbers in on the welfare waivers that we have granted around the country so we don't really know whether we are going to get larger numbers because most of those programs are in their infancy.

What we would like to try is what is clearly in the President's bill and in some elements of some of the earlier Republican bills, and that is a total immersion. And that is to change the culture of that welfare office so that everybody walks in with the intention of getting ready to work. And so that we have some of the support system in place so people can stay in the workplace, and child care is critical for that.

We believe that health care is also going to be a significant part and necessary. It is not only getting ready to get into the job but all of our experience is it is staying in the job. And what we have to organize and what the States are organizing themselves for is the support system to keep people in the jobs.

People seem to get their initial job. There is a high success rate of getting off welfare and getting into the first job. It is staying in the job. It is not rotating back into the system. And then, more than anything else, it is reaching that new generation with dif-

ferent expectations, with different standards, with different behaviors on behalf of the system.

But all of this is going to be very tough, and we have to go into it with an enormous amount of humanity and humility, which I think is even more important.

Chairman ARCHER. The gentleman's time has expired. The Chair recognizes Mrs. Kennelly to inquire.

Mrs. KENNELLY. Thank you, Madam Secretary. I heard you say, which is true, we all agree on a great many things. We agree that the individual, if possible, should live with the family. But, of course, there has to be a functional family. And what happens when that individual, that child is living in a welfare family and then a paternity——

I am so glad you pointed out that the person could say who the father was and be very clear about that and then have the State, which is notoriously slow in establishing paternity—right now I understand most States are 6 months behind in establishing a paternity—that the child shouldn't be penalized. The mother and child shouldn't be penalized if they have, in fact, tried to establish paternity.

But then you add also that we agree about training. Yes, but there has to be a job. So I think the Devil is in the details, that maybe our role is going to be making sure that we just don't all agree on these things and pat ourselves on the back and now we have done welfare reform and go home and find that the communities have increased poverty, the children are hungry, and there is homelessness.

As you keep saying—and I think I am saying the same thing—there is a lot of work to be done.

What I would like you to comment on, though, Madam Secretary, is something else we are struggling with and that is, yes, we are talking about block grants more and more, but do you foresee a capping on welfare, a capping on food stamps? Is there a possibility that we are going to agree on that also?

Secretary SHALALA. Well, I think on the President's proposal he feels that his proposal, which does not cap or block grant the major programs, because those programs have played a very important role in economic adjusting, and that is, as a State, if the State of Connecticut had a terrible economic downturn, there would be large numbers of workers, often low-income workers, who would need to come in for a very short period of time and get some food stamp benefits so that they could feed their families. And these programs have played an important role during recessions of kicking in for short periods of time.

It would be, in our judgment, a serious mistake to exclude hard-working folks who because of no fault of their own lose their jobs and need short-term help. And these programs have had the effect, during recessions in particular or other kinds of economic disasters, of cushioning the recession and stopping it from going wider and deeper. And, therefore, it is very important that we look at the economic effects of the way the programs are designed, in no way backing off from the kind of major reform that we think must take place centered on work and on proper parental responsibility.

Mrs. KENNELLY. Thank you. Let me take you further on that. That is what I worry about. I think we all agree the system is broken, the system doesn't work and that we have to reform it, but the block grant does have some limitations. There is no doubt about it.

You talked about child support enforcement, and that is another area which, when you look at block grants, sending back to the States—as I recall, having worked with this for years, one of the reasons we took it into the Federal area was because the States weren't putting it forth as a primary situation, and it had gone down to the bottom of the barrel. The judicial system didn't look at it. The Governors didn't look at it. So would you suggest that we do child support enforcement in a block grant fashion in the future?

Secretary SHALALA. You know, I haven't thought about that. The point that we have made about child support enforcement is that it is, in fact, a partnership where there are clear roles for the National Government, obviously, in the W–4 form new hire database as well as in the national clearinghouse of child support orders, and there are clear roles for the States.

How much uniformity we need ought to be part of our discussion. And we have had that discussion, Congress has had it, through the Interstate Commission. The Women's Caucus has had—has been part of this discussion. And I think that what I would say on our behalf is that there are clear, differential roles, and it is the kind of thing we ought to talk about. The important point is we ought to get it done, and it ought to be done now as part of this overall effort.

Mrs. KENNELLY. Thank you, Madam Secretary.

Chairman ARCHER. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Welcome, Madam Secretary. As you know, Medicare accounts for roughly 16 percent of the spending in the Federal budget. Do you in the administration have any estimates about how much Medicare would have to be cut to provide for the tax cuts that are contained in the Contract that we are dealing with here today? Or would it have to be cut at all?

Secretary SHALALA. There is no question under the balanced budget amendment if we excluded Social Security and defense that it would be tough to protect the Medicare and the Medicaid programs. We're looking at cuts of 25 to 30 percent in both programs—about $100 billion in Medicare cuts, and $58 billion in Medicaid cuts in 2002. Cuts of this magnitude would certainly have a detrimental effect on program beneficiaries.

Mr. COYNE. Would it be your thinking, to the extent that there were cuts, that there would be increases in the premiums that seniors would have to pay for their benefits?

Secretary SHALALA. The President has said that he is not anxious and does not intend to cut Medicare, though there may be—unless it is directly related to health care reform. He has left a little flexibility in this area, and I think our budget will reflect his desire to protect the Medicare program. And I think I should leave it at that, and I don't want to anticipate anything that he has not either spoken on or intends to do.

Mr. COYNE. On another subject, on the welfare issue, has this idea of time limits for welfare recipients been tested anywhere in the country?

Secretary SHALALA. Actually, as part of the waivers, we have been—the States have been working with time limits.

I should say that Dr. Ellwood, Dr. Bane and I have been long advocates for time limits. We first made recommendations on time limits in 1986 as part of a report to the Governor of New York, so we have long believed that welfare should return to a transitional program to give people a hand up, and some of the experiments around the country have, that we have approved do have some limitations on them.

We also know—and one of the reasons that we are convinced that this will work is that 70 percent of the welfare recipients find jobs in 2 years and 90 percent in 5 years. So there is no reason to believe that serious time limits with genuine opportunity attached to them would not be useful, helpful and effective.

Mr. COYNE. So it is your experience that there has been, in limited instances, some positive results?

Secretary SHALALA. And if you look at the behavior of the current welfare population, there is some reason to believe that people do not stay on welfare for a very long period of time. They try to get off. And it is staying off that we have to focus on.

Mr. COYNE. Thank you.

Chairman ARCHER. Mr. Levin will inquire.

Mr. LEVIN. Thank you, Mr. Chairman.

Welcome. You know, I think some progress has been made here this morning in the search for common ground here probably more than some expected. I think as we continue the search for common ground we also have to be frank about why we differ.

And it isn't clear to me, for example, the proposal to eliminate benefits for teenage mothers. What drives that difference of opinion? Whether there is a difference of opinion if you withdraw benefits whether you automatically will change behavior. In a sense, that is saying that if you increase poverty, you will change conduct. Maybe so, but I think we have to be careful that we don't lose children in the meanwhile.

How much of it is budget driven? I think we have to ask ourselves honestly about that and other provisions. There may be different assessments about how we change human behavior, and it has been suggested this morning we need dynamic scoring not only on economic policy but on human behavior, but I think we need to be careful about that.

In that regard, let me ask you about the proposals to block grant. Do you have any idea how much of a reduction there would have been for the States if one of the proposals to block grant at a stationary level for 5 years had been in effect in the late eighties?

Secretary SHALALA. We are in the process of doing that run right now, and Assistant Secretaries Ellwood and Bane will be prepared to testify on that in the subcommittee later this week.

Mr. LEVIN. So you expect on Friday that we will have that information?

Secretary SHALALA. We are working on that information. I can't guarantee that we will have it on Friday, but we certainly are try-

ing to take a look at what would happen if a block grant was—a block grant is proposed.

Mr. LEVIN. Let me express my hope that you will have some figures ready by Friday because, as you know, I had a disagreement with the Clinton proposal of a few years ago. I did not think there was adequate State flexibility in the administration's welfare proposal, because I am in favor of providing more flexibility to the States.

I do have concerns, though, about proposals that would block grant on a level funding basis without any kind of a notion as to what would happen in times of recession and in particular because recessions have tended in recent years to be somewhat regional in their impact.

The industrial States were hurt the most in the early eighties and then, as I remember it, Texas and some of the other Southwestern States were next and then California came after that. And I think, in view of that, we can't be sure that if there isn't some mechanism to respond to that that our motto would not in the end be budget driven more or as much by what was the actual impact on children pulling—being pulled out of poverty. So I will look forward to that.

But, again, Mr. Chairman, I think it is not only the spirit but some of the substance of the discussion today has given some glimmer of hope that maybe we will be able to find some common ground here if we are also honest with our differences. Thank you.

Secretary SHALALA. Congressman Levin, I think that your point is very well taken.

It was—I started to make it a little earlier, and that is about the economic stabilizer effect of these programs, that we have long used them in that way. And that if we moved to some other kind of approach and left these programs, these fundamental programs, to discretionary budgets, to caps coming down, to allocations every year, that would make it difficult for Governors to budget if the money didn't come in in October, if they couldn't be responsive to economic downturns that don't happen uniformly across the country. It would be low-income workers, workers who lost their jobs, who could not come in and use the programs on a temporary basis.

And I hope in the process of all of our focus, which is so heavily on teenagers and who is coming into the system, we don't forget about those hard-working Americans who have used these programs—food stamps, AFDC in particular—for very short periods of time when they were between jobs and all they wanted to do was to make sure that they had food on the table for their children.

Chairman ARCHER. Has the gentleman completed his inquiry?

Mr. LEVIN. Thank you very much.

Chairman ARCHER. Madam Secretary, thank you for your patience and for spending so much time with us today. I agree with my friend from Michigan. I think this has been an extremely constructive discussion and exchange today on an issue that really crosses party lines and covers something so important to everybody in this country. We need to find a way to do better, to find solutions to these problems, and I particularly thank you for that.

There are two very precise questions that I would like to ask you that I do not think have been developed in this hearing this morn-

ing. They are very quick. One is, can you identify the sources of revenue offsets for the $10 billion that your proposal would cost? Could you just quickly list those for us?

Secretary SHALALA. I am not sure I have them. I don't have them with me. We provided them to the committee last year, and we will provide them for the record.

Chairman ARCHER. All right.

[The following was subsequently received:]

FINANCING PROVISIONS

Vision

The financing for welfare reform comes from three areas: (1) reductions in entitlement programs; (2) extensions of various savings provisions set to expire in the future; and (3) better EITC targeting and compliance measures. Estimated Federal savings for all proposals are roughly $9.3 billion over five years.

A. ENTITLEMENT REFORMS

1. Cap the Emergency Assistance Program

Vision

The AFDC-Emergency Assistance (EA) Program is an uncapped entitlement program. In fiscal year 1990, expenditures totalled $189 million; by fiscal year 1999 they are projected to reach almost $1 billion. While the intent of the EA program is to meet short-term emergency needs and help keep people off welfare, States currently have wide latitude to determine the scope of their EA programs. Recently, States have realized that the definition of the program is so broad that it can fund almost any critical services to low-income persons. Some States have begun shifting costs from programs which the States fund primarily on their own such as foster care, family preservation, and homeless services into the matched EA program. States appear to be funding services that address long-term problems as well as true emergency issues.

Specifications

(a) Modify the current Emergency Assistance program by establishing a Federal cap for each State's EA expenditures. The cap will be set in fiscal year 1995 and increased by the Consumer Price Index in each subsequent year.

(b) The basic allocation formula is a combination of two components:

(i) Allocation among States proportional to their requested expenditures in 1994; and

(ii) Allocation among States proportional to their total AFDC spending in the previous year.

(c) There will be a ten-year transition period, and the weighting of the components will shift over time, with increasingly more weight being given to the second component. Beginning in 1995, the weighting will be 90 percent by component 1 and 10 percent by component 2. The weighting will be altered by 10 percentage points each year such that by 2004, the weighting will be 100 percent by component 2.

Rationale

The proposal ensures that all States will receive continued funding equal to their actual 1991 levels. The Federal match will continue at 50 percent up to the cap. This proposal raises about $1.60 billion over five years. The basic allocation formula balances the need to protect States that have been spending heavily on EA in and before 1994 with the potential claims of new States which have not previously had claims for services under EA.

2. Tighten Sponsorship and Eligibility Rules for Non-Citizens

Vision

In recent years, the number of non-citizens lawfully residing in the U.S. who collect SSI has risen dramatically. Immigrants rose from 5 percent of the SSI aged caseload in 1982 to over 25 percent of the caseload in 1992. Since 1982, applications for SSI from immigrants have tripled, while immigration rose by only about 50 percent over the period.

Most of the legal permanent resident applicants enter the country sponsored by their relatives, who agree as a condition of sponsorship that their relatives will not become public charges. To enforce this commitment, until this year, current law required that for 3 years, a portion of the sponsor's income in excess of 110 percent of poverty be "deemed" as available to help support the legal permanent resident (LPR) immigrant should they need public assistance. Currently, about one-third of the LPR immigrants on SSI subject to the deeming rules apply in their 4th year of residency. Last fall, to pay for extended unemployment benefits, Congress extended the time of deeming under SSI from three years to five years until 1996 when it reverts to three years again.

The Administration proposal related to non-citizens contains two parts—extending the deeming period for sponsor income and coordinating eligibility criteria under four Federal assistance programs.

Specifications

(a) Deeming Make the current five-year period of sponsor responsibility permanent law under the SSI program and extends from three years to five years sponsor responsibility under the AFDC and Food Stamp programs. The sponsor's income would be deemed as available to support the immigrant should they apply for public assistance. For the period beginning with six years after being lawfully admitted for permanent residence in the U.S. and until a sponsored immigrant attains citizenship status, if the sponsor has income above the U.S. median family income ($39,500), the sponsor will continue to be responsible for ensuring the support of the immigrant.

Rationale

This will have the effect of denying benefits to immigrants with sponsors with income above the median. Once immigrants attain citizenship, they will be eligible to apply for benefits on their own. Any immigrant whose sponsor is receiving SSI or AFDC benefits would be exempt from sponsor-to-alien deeming under SSI, AFDC and food stamps. The proposal affects applications after the date of enactment (i.e., it would grandfather current recipients as long as they remained continuously eligible for benefits). These changes in deeming rules would not apply to, and would have no effect on, Medicaid eligibility for immigrants. This part of the proposal saves about $2.8 billion over five years.

(b) Set consistent deeming rules for sponsored immigrants across three Federal programs (SSI, AFDC, and Food Stamps). Sponsor responsibility is based on longstanding immigration policy that immigrants should not become public charges.

Rationale

Sponsored immigrants most often apply for SSI benefits on the basis of being aged, and are different from most citizens in that the latter typically spent their life working and paying taxes in the U.S. At

the same time, this proposal ensures that truly needy sponsored immigrants will not be denied welfare benefits if they can establish that their sponsors are no longer able to support them, if their sponsors die, or if the immigrant becomes blind or disabled after entry into the U.S. The policy would not affect refugees or asylees.

Vision

Currently, due to different eligibility criteria in statute, and litigation over how to interpret statutory language, the four Federal programs (SSI, AFDC, Medicaid, and Food Stamps) do not cover the same categories of non-LPR immigrants. For example, aliens whose departure the INS does not contemplate enforcing are eligible for SSI, but not for Food Stamps. The Food Stamp program has the most restrictive definition of which categories of non-LPR immigrants are eligible for benefits (i.e., the eligibility criteria encompass a fewer number of INS statuses). SSI and Medicaid have the most expansive definition of which categories of non-LPR immigrants are eligible for benefits, and the AFDC program falls between these extremes. This element establishes in statute a consistent definition of which non-LPR immigrants are eligible for welfare benefits.

(c) Eligibility criteria Establish similar eligibility criteria under four Federal programs (SSI, AFDC, Medicaid, and Food Stamps) for all categories of immigrants who are not legal permanent residents.

Rationale

This proposal makes eligibility criteria in the SSI, Medicaid, and AFDC programs similar to the criteria that currently exist in the Food Stamp program. The new list of INS statuses required for potential eligibility to the SSI, Medicaid, and AFDC programs is also virtually identical to those listed in the Health Security Act providing eligibility for the Health Security Card. Like the extended deeming provisions, this part of the proposal affects applications after date of enactment (i.e., it would grandfather current recipients as long as they remained continuously eligible for benefits). This part of the proposal saves about $900 million over five years.

3. New Rules Regarding SSI Benefits for Drug and Alcohol Addicted Recipients

Current Law

Current law requires that all SSI disability recipients for whom substance abuse is material to the finding of disability must be in available treatment and must have their payments made through a representative payee (a third party who receives and manages the funds). Payments to these SSI drug addict and alcoholic (DA&A) beneficiaries are suspended if the individual fails to participate in appropriate alcohol or drug treatment, if such treatment is available. No similar requirements are made of Social Security (Title II) disability beneficiaries who receive benefits on the basis of addictions. The representative payee and treatment requirements have been part of the SSI program since its inception over 20 years ago. However, the provisions have not been implemented effectively.

Specification

(a) Strengthen sanctions and apply new time limits to benefits paid to individuals receiving Supplemental Security Income (SSI) and Social Security Disability Insurance (SSDI) benefits who have substance abuse problems that are material to their disability finding.

Rationale

The Congress is reaching decisions on these proposals currently in conference on H.R. 4277, a bill which the Administration supports. We anticipate savings of $800 million over five years. Should the final bill yield savings of less than $800 million, we are committed to working with Congress to fully finance the package.

4. Income Test Meal Reimbursements to Family Day Care Homes

Current Law

The Child Care Food Program provides food subsidies for children in two types of settings: child care centers and family day care homes. They are administered quite differently. The subsidies in centers are well targeted because they are means-tested; USDA believes that over 90 percent of Federal dollars support meals served to low-income (below 185 percent of poverty) children. The family day care part of the program is not well targeted because it has no means test (due to the burden it would place on the providers). A USDA-commissioned study estimates that 71 percent of Federal food program dollars to family day care homes support meals for children above 185 percent of the poverty line. While the child care center funding levels have been growing at a modest rate, the family day care funding levels are growing rapidly--16.5 percent between 1991 and 1992.

Specifications

(a) Amend section 17(c) of the National School Lunch Act (42 U.S.C. 1766(c)) to establish a two-tiered reimbursement structure (in the Child and Adult Care Food Program) with a higher level of reimbursement for meals served by family day care homes located in low-income areas. Low-income areas would be defined as those in which half of the households have incomes below 185 percent of poverty. Family day care homes not located in low-income areas would have the option of receiving lower rates of meal reimbursement or administering a means test to enrolled children.

(b) Under the means tested option, meals served to children whose family income is below 185 percent of poverty would be reimbursed at the higher rate, while those served to children from higher income families would be reimbursed at the lower rate. Meals served to children enrolled in programs operated by low income providers would also be reimbursed at the higher rate. Finally, meals served to the day care providers' own children would continue to be means-tested.

(c) Provide family day home sponsoring organizations with an additional $10 per home per month for each home it sponsors in low-income areas. Authorize $2 million to States agencies for technical assistance to sponsors to help implement the new reimbursement system in FY 1995. Technical assistance funding would increase to $5 million in FY 1996. Authorize for FY 1997 through FY 2000 $5 million for the licensing of family day care homes in low-income areas.

Rationale

This approach better targets the family day care food program funding to low-income children and creates minimal administrative requirements for providers. This provision yields savings of about $500 million over five years.

5. Limit Deficiency Payments to Those Making $100,000+ from Off-Farm Income Per Year

Vision

USDA farm programs are criticized for unfairly supporting large farms and wealthy producers rather than smaller farms and lower-income farmers. The Congressional Office of Technology Assessment concluded that most big farms "do not need direct government payments and/or subsidies to compete and survive."

Specification

(a) Make producers receiving $100,000 or more in off-farm adjusted gross income ineligible for Commodity Credit Corporation (CCC) crop subsidies (price support loans and income support payments).

Rationale

The proposed targeting of subsidies would direct farm payments to smaller, family farms, which deserve Federal financial help more than large agricultural enterprises and individuals with sufficient off-farm income. It would cause an estimated 1-2 percent of program participants to drop out of USDA farm programs. Most of these wealthiest participants include corporations and individuals for whom farming is not a primary occupation or source of income. This proposal would save about $500 million over five years.

B. EXTEND EXPIRING PROVISIONS

1. Hold Constant the Portion of Food Stamp Overpayment Recoveries that States May Retain

Vision and Rationale

States are permitted to keep some portion of the 100-percent Federal Food Stamp recoveries as an incentive payment for pursuing program violations. This proposal raises about $100 million over five years.

Specification

(a) Extend the 1990 Farm Bill provision which reduced the percentage of recovered Food Stamp over-issuances retainable by State agencies for fiscal years 1991-95. Under this provision, which would be extended to fiscal years 1996-2004, States could retain 25 percent of recoveries from intentional program violations (previously 50 percent) and 10 percent of other recoveries (previously 25 percent).

2. Extend Fees for Passenger Processing and Other Custom Services

Vision and Rationale

A flat-rate merchandise processing fee (MPF) is charged by U.S. customs for processing of commercial and non-commercial merchandise that enters or leaves U.S. warehouses. The fee, adopted by OBRA 1986, generally is set at 0.19 percent of the value of the good. Other variable customs fees are charged for: passenger processing; commercial truck arrivals; railroad car arrivals;

private vessel or private aircraft entries; dutiable mail; broker permits; and barge/bulk carriers. NAFTA extended the MPF and other fees through September, 2003. This proposal would save about $1 billion in that year.

Specification

(a) Extend the fees through September, 2004.

3. Extend Railroad Safety User Fees

Vision and Rationale

Railroad safety inspection fees were enacted in the Omnibus Budget Reconciliation Act of 1990 to pay for the costs of the Federal rail safety inspection program. The railroads are assessed fees according to a formula based on three criteria: road miles, as a measure of system size; train miles as a measure of volume; and employee hours as a measure of employee activity. The formula is applied across the board to all railroads to cover the full costs of the Federal railroad safety inspection program. The fees are set to expire in 1996. The 1995 President's Budget proposed to extend the fees through 1999 and expand them, effective in 1995, to cover other railroad safety costs. The proposal raises about $200 million over five years.

Specification

(a) Extend the Railroad safety inspection fees permanently.

4. Extend Expiring Corporate Environmental Income (CEI) Tax Used to Finance Superfund

Vision and Rationale

A broad-based environmental tax, based on corporate alternative minimum taxable income (0.12 percent) in excess of $2 million, was first enacted in 1986 and is set to expire at the end of 1995.

Superfund reauthorization legislation would provide a further CEI tax extension through the year 2000, which would provide sufficient additional credit needed for budget scoring of the Superfund legislation's "orphan share" proposal. All revenue from the CEI tax extension, whether enacted in welfare reform or Superfund legislation, will continue to be dedicated to the Hazardous Substance Superfund to be used only for Superfund cleanups.

Specification

(a) Extend the CEI tax into 1998.

C. EITC TARGETING AND COMPLIANCE MEASURES

1. Deny EITC to Non-Resident Aliens

Vision and Rationale

Under current law, non-resident aliens may receive the Earned Income Tax Credit (EITC). Because non-resident taxpayers are not required to report their worldwide income, it is currently impossible

for the IRS to determine whether ineligible individuals (such as high-income nonresident aliens) are claiming the EITC. We estimate that about 50,000 taxpayers will be affected by our proposal, mainly visiting foreign students and professors. The proposal raises about $100 million over five years.

Specification

(a) Deny the EITC to non-resident aliens completely.

2. Require Income Reporting for EITC Purposes for Department of Defense (DoD) Personnel

Vision and Rationale

Under current law, families living overseas are ineligible for the EITC. The first part of this proposal would extend the EITC to active military families living overseas. To pay for this proposal, and to raise net revenues, the DoD would be required to report the nontaxable earned income paid to military personnel (both overseas and States-side) on Form W-2. Such nontaxable earned income includes basic allowances for subsistence and quarters. Because current law provides that in determining earned income for EITC purposes such nontaxable earned income must be taken into account, the additional information reporting would enhance compliance with the EITC rules. The combination of these two proposals raises about $200 million over five years.

Specifications

(a) Extend the EITC to active military families living overseas.

(b) Require DoD to report the nontaxable earned income paid to military personnel (both overseas and States-side) on Form W-2.

Chairman ARCHER. Can you also tell me, under the work requirement where an individual does not comply and is removed from the rolls, under what circumstances can they reenter the rolls and become a part of the welfare system as a beneficiary under your program?

Secretary SHALALA. I am not sure they can come back in. Oh, they can come back if they are willing to work after 6 months. So they get a chance to come back and work.

Chairman ARCHER. Six months.

Secretary SHALALA. But they have to work. It is not coming back into the educational training. They have to come back to work.

Chairman ARCHER. I understand. At any point is there a lifetime cutoff or can this just occur over and over and over again?

Secretary SHALALA. There is a cutoff. Let me consult with my colleagues. The lifetime limitation is on the education and training program, not on the work program, so it is focused on the work program.

Mr. Chairman, let me say I appreciate your graciousness. I hope I was not rude to either you or any of your colleagues. Sometimes my enthusiasm gets ahold of me. You should not interpret it as anything else than our desire in this administration from working with you to produce real welfare reform, a substantial step forward. I think it is what the American people expect, and it certainly is what the President wants to do.

Chairman ARCHER. Well, I thank you very much. Your appearance here today I think has been a major step forward in attempting to find some bipartisan answers to this very, very knotty problem. So I am very grateful to you, and I know all the members of the committee are, also. Thank you very much.

Secretary SHALALA. Thank you.

Chairman ARCHER. For the benefit of the members, we intend to work right through the lunch period because we have many, many witnesses to hear, and members will have to accommodate their own appetites as best they can.

Our next witnesses will be members of the committee: Dr. McDermott and Mrs. Kennelly. Dr. McDermott, you may proceed. As a respected member of the committee, we welcome your testimony.

I see Mrs. Kennelly is here now. She can join you at the witness table. Will you proceed as she moves to the witness table?

I am going to encourage all witnesses to limit their testimony to the committee for 5 minutes. If it is anything in addition to that, it can be inserted into the record.

STATEMENT OF HON. JIM MCDERMOTT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Mr. MCDERMOTT. Thank you, Mr. Chairman. I appreciate the opportunity to testify today before this committee.

While the majority party has chosen to name the collective legislative proposals the Contract With America, a more accurate label, in my opinion, for this agenda is "The Private Health Insurance Price Increase Act of 1995."

It is absolutely clear that it will take massive cuts in Medicare and Medicaid to finance the Contract. As hospitals lose major fi-

nancing, they will simply have to charge patients, particularly Medicare beneficiaries, more out of pocket and force greater hardship in terms of denied access to care. Prices raised on private patients will cause insurance premiums to skyrocket.

This, in my opinion, is nothing but a gigantic cost shift onto the private pocketbooks of the American people. The impact on the health insurance premiums for the average working family will be much greater than any tax increase one could reasonably imagine. However, it will be a silent, hidden tax increase for which Republicans will seek to avoid responsibility by attributing it to the vagaries of the holy marketplace of health care.

And no one on this committee should make a mistake about it. People will lose their medical care that they currently receive. Premiums will go up, and people will lose access to care. Who are those people who are going to lose the benefits? Mothers, children and grandparents of this Nation.

Look at one area, for example, children's hospitals. They rely on Medicaid on average for between 40 and 70 percent of their revenues. It is doubtful that one single children's hospital in this country would survive a fundamental disruption of the Medicaid funding. And if children's hospitals go out of business, not even the rich will be able to use them.

The hard truth is that we cannot contain costs in the public health sector alone without creating huge distortions throughout the entire delivery system. I think we really need to be honest with the American people about this. For a contract to be valid, there must be full understanding and a meeting of the minds on both sides.

When we talk about senior citizens—about giving seniors more choices, what we are really talking about is taking away their existing Medicare coverage, taking away their free choice of provider and giving them what I think is a worthless voucher that will force them into managed care.

It is simply a big lie to say we will increase senior citizens' choices. The voucher they will get will not be worth enough to actually purchase any insurance policy with Medicare benefits in this country today. They will have to pay more out of pocket for less choice and poorer access to care.

Now, contrary to the assertions made by the Speaker sitting at this table last week, managed care for seniors has not saved the taxpayers money; it has cost them money.

The GAO audit found that Medicare managed care companies were only insuring the healthy seniors who cost the Medicare program virtually nothing, and these companies received more money than Medicare would have paid for these beneficiaries under the traditional fee-for-service programs where the patient had free choice of provider.

No one knows whether managed care saves money when actually confronted with taking care of people who need medical services. But more importantly, what this committee is going to have to think about is what you are saying to young families in this country really is that, in addition to worrying about your own children's health care costs, you now will have to assume the health care costs of your parents and your grandparents, something people in

this country have not had to worry about for 30 years. You can have a choice. You can watch them do without.

No one would sign such a contract, I believe. The Contract is more like a contract on America. It offers only chaos in the financing of our health care system. The challenge for Americans in the 104th Congress is to make sure that these disruptions do not occur. Thank you.

Chairman ARCHER. I thank the gentleman for his testimony.

The Chair will now recognize for her testimony another respected member of the committee, Mrs. Kennelly of Connecticut.

STATEMENT OF HON. BARBARA B. KENNELLY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CONNECTICUT

Mrs. KENNELLY. Thank you, Mr. Archer, and thank you, Mr. Chairman, for allowing me to testify.

I was absolutely delighted to see accelerated death benefits taken up in the Contract. This is a bill—and for new members, accelerated death benefits means that if in fact you find out that you are terminally ill, that you have 1 year or less to live and it is certified by a doctor that this is true, that you could collect on your life insurance.

This has two results. One, obviously you get better care because you are able to afford it. The other thing is it could be a situation where the taxpayers are going to have to pay for that health care, and this way you pay for your own health care.

This is a piece of legislation that I introduced in the 101st Congress. I got this idea from an insurance company in my district. It was a very innovative idea, and I became very involved in it.

It seemed like a simple piece of legislation. As time went on, I realized that it was getting complicated. So I turned to the Bush administration and began working with them on this, as I said, simple piece of legislation, to have people die in dignity and receive the benefits that they had paid for.

I didn't stop trying with the Bush administration. The Clinton administration came into office, and once again I started to promote this idea. The President put this idea of accelerated death benefits into his health care package and this very committee put it into our health care package when we addressed health care last year.

So it keeps getting so far, and that is why I was so glad to see it in the Contract. I am here today to give you some technical advice from my long experience with this bill so that you won't get caught up on those same points and not have this go through with the Contract or go through as quickly as it can.

First of all, I want to talk to you about not allowing these benefits to be discounted too much. When it first became apparent that this could happen, we really had some people—companies come forth. They weren't insurance companies, but companies sprouted up. We began to call them the grim reapers because what they would do is discount the policy by 55 percent. Then with a straight face would say, well, we can give 55 percent because expenses accounted for the rest.

I am sure nobody here would want to have anyone take advantage of the sick and be unscrupulous like that, and yet we had that experience, so I want to forewarn you on that.

The other thing that I ran into was tax treatment of the insurance companies that would treat this as a lien or really as a loan. We had many conversations with the Joint Tax Committee and the Treasury. They were very forward, up front that this wouldn't be abusive. It was just technical language and that this could be treated in that manner. And the point being get the money to the person who is sick before they die.

Then there was one third area that I wanted to bring up to you and that is the prohibition of acceleration of COLI, corporate-owned life insurance.

On this provision I also dealt with the Joint Tax Committee. The reason they were worried about this was that this could be used as a shelter.

That is not the point. The point is that it would be terminal, 1 year or less, certified through a doctor that you are going to die.

So I just really wanted to talk to you about those things so that you wouldn't run into what I ran into. Every time I thought we were going somewhere we had somebody either want to add an amendment or had some reason why we shouldn't do this.

The other thing we have talked about this morning, child support enforcement. I see it in your Contract. It is not in there to a great extent, but I think we really should talk about whether this should be in the Contract, should be in a block grant or, in fact, some of this should be kept with the Federal Government.

To answer Mr. Collins, we spend $1 to get $4 back in child support enforcement.

I worked for years on this in a bipartisan manner, began with Carroll Campbell, the former member of this committee and Governor, working on child support enforcement. We made our inroads—we got refunds on taxes, we have been able to use it concerning licensing, and it has been Federal efforts that have been able to increase our collection of child support enforcement.

There is a lot to be done, but we have made some progress. We should look at where this should come, but it should move forward.

Thank you, Mr. Archer, very much.

[The prepared statement follows:]

The Honorable Barbara B. Kennelly
Testimony before the House Ways and Means Committee
On Accelerated Death Benefits and Child
Support Enforcement and the Republican
Contract with America
Tuesday, January 10, 1995

Thank you Mr. Chairman. I appreciate the opportunity to come before the Committee today to discuss two issues in the Republican Contract I have long championed--accelerated death benefits on life insurance contracts and child support enforcement.

I introduced the very first accelerated death benefit legislation back in the 101st Congress when a small company in my district first brought this innovative product to my attention. The idea is to allow individuals who are certified by a physician to have a terminal illness or injury which can reasonably be expected to result in death within 12 months, to receive the proceeds of their life insurance contracts on a tax free basis.

This legislation had over 100 bipartisan cosponsors in the 102nd Congress including a number of members of this committee. I then worked closely with the Bush Administration in its attempt to accomplish this important goal by regulation. The regulations, however, were not final when the Clinton Administration took office and have not yet been finalized. The Administration subsequently included this provision in the President's Health Care plan. And this Committee included this provision in the health care reform bill it reported. A version of this legislation is included in the Republican Contract with America. And last week, I reintroduced this legislation with a number of bipartisan original cosponsors.

Mr. Chairman, at this point I would say that I hope we can move this legislation quickly, perhaps separately, and that it not be held back for any reason. Unfortunately, it was always held up because of amendments that would have complicated this very simple legislation. It clearly has bipartisan support. I would be pleased to work with you to find a way to pay for it.

I would like to make a number of technical comments regarding the version in the contract. First, my legislation includes a protection for beneficiaries by limiting the amount a policy can be discounted. The bill reported by this Committee contained a similar provision. I originally added this provision in response to reports that in some cases beneficiaries were only receiving 55% of the proceeds of their policies. The Contract contains no such protection and I think we should all be able to agree that the terminally ill ought not to be taken advantage of by the unscrupulous.

My bill also accords favorable tax treatment in those situations where these benefits are provided in the form of a lien. The bill reported by this Committee last year also included this provision. I assume that the fact this approach is missing from the Contract is simply an omission that can be corrected.

Finally, my bill contained a prohibition on the acceleration of Corporate Owned Life Insurance Policies (COLI). This provision was added after consultation with the Joint Committee on Taxation and Treasury in response to their concern about possible tax shelter opportunities. The Contract does not contain such a safe guard. I would hope that we could work together to assure that this important provision does not provide tax shelter opportunities.

In the area of child support enforcement, there has also been a long history of bipartisan cooperation. While past

legislation has certainly improved collections for child support, we as a nation still have a long way to go. Only half of all custodial parents receive their full child support awards, leaving millions of children without adequate support. Congress must act to end this disgrace.

More than ten years ago, I fought to enact into law mandatory wage withholding from individuals with delinquent child support awards. In 1992, I served on the non-partisan U.S. Commission on Interstate Child Support, which issued a series of recommendations on how to improve child support enforcement, especially in difficult cases where the non-custodial parent resides in another state. Two years ago, I introduced legislation that reflects many of the Commission's recommendations, and again introduced this measure on the first day of the 104th Congress. Legislation introduced by the Womens' Caucus last year closely mirrors many of the provisions in my bill, titled the Interstate Child Support Act.

The Interstate Child Support Act would crack down on parents who are evading their responsibility by: enhancing the coordination for collecting child support across state lines, improving federal tracking of delinquent orders, withholding business and driver's licenses from individuals owing child support, and denying federal benefits to individuals with large unpaid child support awards.

While the Contract with America mentions child support enforcement, it contains very few details on how to improve the current system. I am also discouraged to hear that child support enforcement legislation might not be considered by this committee at all in the first 100 days of Congress.

Some members of this committee have urged that we send a strong message of personal responsibility to young mothers through welfare reform legislation. Can we really do this without sending an equally strong message to young fathers? We should also consider that improved child support enforcement might prevent some mothers from going on to welfare in the first place. And finally, we must remember that millions of Americans outside of the welfare system depend on child support, and they deserve a more effective enforcement system. For all of these reasons, I hope the Chairman will have the committee consider child support enforcement in the earliest possible time frame.

Thank you, Mr. Chairman. I would be pleased to respond to any questions the Committee may have.

Chairman ARCHER. My compliments to both of you. As usual, you have been very thoughtful and presented your comments exceedingly well.

I particularly am thankful to you, Mrs. Kennelly, for pointing out something that has almost been lost with so many other items in the Contract. It is a very, very important provision regarding the accelerated death benefits which will not only assist us in reducing the impact on taxpayers for health care but also on families who feel they have the obligation to take care of their loved ones. It could very well have a major beneficial impact on AIDS patients, for example.

It just shows that there is no monopoly on ideas on any side of the aisle. So, I congratulate you in your efforts to attempt to accomplish this, and we will, I believe, get it done with the Contract.

Mrs. KENNELLY. Thank you, Mr. Chairman.

Chairman ARCHER. Let me at this time turn over the chair to Mr. Crane because I am going to have to leave for a few minutes. He will recognize the members for inquiry.

Mr. CRANE [presiding]. First, Mr. Gibbons.

Mr. GIBBONS. Very briefly. Mr. McDermott, I want to thank you for bringing up the critical point that the most important thing we could do for welfare reform is to make sure that we get some adequate health care for those who would prefer to stay on welfare because it is the only way in which they can get coverage for their health care needs of their family. We can't really talk about welfare reform unless we make an integral part of it health care reform.

What do you think is the minimal amount that this Congress ought to do in this session in order to bring that question to a satisfactory solution?

Mr. MCDERMOTT. Well, I think, Mr. Gibbons, there are two groups that are, in my opinion, the most important groups to really look at. I don't think you should cut Medicare and Medicaid. I think there are ways in which to restructure it in a better form, but I don't think they should be cut.

There are two groups, however, that are really seriously problematic for this society. One is those between the ages of 65 and 50 who are being offered early retirement today but cannot take retirement because they do not have health insurance, and they have to hang on to the job. That has two effects: One, it keeps them in the job, and two, it prevents a younger person from getting a full-time job.

But an even larger area of concern to me—because 50 percent of the people in this country who have full-time jobs do not have health care benefits. When you look at all the people who are not covered, 50 percent of them are working full time. The temporary employee in this society—and business is structuring their hiring on a temporary basis.

And I think we have to do something for the young people in this country who come out of college, got all the training, go out and work full time and do not get benefits. You have to do that. Otherwise, they feel the system has let them down.

Mr. GIBBONS. Mrs. Kennelly, I want to thank you, too, for bringing up the two items that you brought up: Namely, the responsibil-

ity of both parents for their children and providing for them. We have got to solve these issues.

This item that we are working on, this welfare reform—I realize that some of the people that are penalized by a failure to be able to force family responsibility, financial responsibility, are not on welfare, but they are headed for welfare. And we are really hiding behind State sovereignty as an excuse for doing the correct thing about these children. Parents just escape responsibility by disappearing across State lines.

Mrs. KENNELLY. I thank you for bringing that up, Mr. Gibbons, because that is another thing I hope the committee does do.

Back, as I mentioned, when we began reform of child support enforcement in the 1984 amendments, it was a very extensive bill. What we did was bring back in the idea that there were not only those on welfare that were not getting child support but many people are not getting their court-ordered support—they have a court order in their hand and they are not getting that. And that was brought back in the mix so that that would keep people from falling back on to welfare.

So I hope we will address both the welfare client and the person that does not want to be on welfare.

Mr. GIBBONS. Thank you.

Mr. CRANE [presiding]. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman, and I thank the members of our panel for taking time to testify today and putting together excellent testimony. I just have one quick question for my colleague, Mr. McDermott.

It has to do with the health care issue, to follow on what Mr. Gibbons was speaking about. One point of clarification. You had said 50 percent of those who are uninsured have a full-time job but prior to that you had said that 50 percent of those working full time do not have health care. Which of those is correct?

Mr. MCDERMOTT. I misspoke at the beginning. It is 50 percent of those without health insurance who are working full time.

Mr. PORTMAN. Work full time?

Mr. MCDERMOTT. Yes.

Mr. PORTMAN. That is an important clarification. Thank you.

Mr. MCDERMOTT. Yes.

Mr. PORTMAN. I agree with you with regard to the cost shifting. I think it is irresponsible for us to continue to cut Medicare in particular through reimbursement and simply have the problem grow of private sector cost shifting.

You had indicated your willingness to look at the programs in a more systemic way, Medicaid and Medicare. I assume that we will be doing that. I hope we will be doing that in this committee and the full Congress, and I assume you would support that kind of undertaking to meet the kind of budget needs we are going to have.

Mr. MCDERMOTT. I certainly would welcome the opportunity to do real health care reform in this committee. It would be a nice way to finish the year, if we were able to actually do it.

But I think the crucial issue is going to be whether or not you think that everybody has to have health care in order to get control of cost. If you do not have universal coverage, can you control the cost?

I believe you have to have universal coverage, and I think that is the fundamental decision that we have to make in this committee if we are really going to control cost. Otherwise, we will continue what we have always done, which is shift the cost to somebody else, and the game really now is who can we pass the hot potato to, and right now we can cut Medicare but we are simply passing it to the private sector. That is not health care reform. I want to have universal coverage, get everybody covered with some kind of health care.

Mr. PORTMAN. Well, you have been a leader in that, clearly, and although your preferred approach was not successful last year, I would look forward to working with you, perhaps short of universal coverage, at least on reforming the system so that whatever cuts need to be made are done in a sensible way and not simply by means of a sleight of hand, which I consider the reimbursement cuts to be.

Thank you for your testimony. Thank you, Mrs. Kennelly.

Mr. CRANE. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman.

Just a brief comment, and thanking you for your testimony, I do hope, Mrs. Kennelly, that you will pursue, I know you will, your longtime effort to make sure we act on child support. I threw in a bill last year to provide another alternative, but you have been a leader here and I hope that we will wrap it into other action on welfare reform.

And, Mr. McDermott, let me say that sometimes when we raise the issue of Medicare, they say, well, in the legislation last year there were proposals for major reductions in Medicare payments to providers. But while that is true, it was combined with some reforms that would have provided some major increments to those providers that are truly under serious pressure. And I know you have been a leading spokesperson on that and I hope will remind people that the Medicare reductions proposed last year were combined with some major reforms, and if you do not put the two together, you are simply going to have some major detrimental impact on providers, some of whom are already under severe pressure. I think you may agree with that.

Mr. MCDERMOTT. I think, Mr. Levin, you are absolutely correct. The important thing to remember about last year's proposal was that the cuts were combined with universal coverage. And if you do not have universal coverage and you cut in one place, you simply shift those costs someplace else. And you have to have everybody in the system.

What is proposed in this Contract With America is that if you were going to balance the budget and you are going to do it without cutting Social Security and without cutting defense, by the year 2000, that is, between 1996 and 2000, you will have to cut $256 billion out of discretionary spending. And that means Medicare and Medicaid will get the biggest hits because they are the biggest programs. And that is why the proposal last year, that said, yes, you can make some cuts if you have got a situation where everybody is covered and you have the whole system working.

I think that is what is missing in the Contract With America, is there is no guarantee of universal coverage.

Mr. LEVIN. Thank you, very much, Mr. Chairman.

Mr. CRANE. Well, I thank you both for your testimony, and we have present now four of our colleagues; Mr. Traficant from Ohio, Ms. Pelosi from California, Mr. Goss from Florida, and Mr. Nadler from New York. If you will come up to the dais. And I think your colleagues will agree, ladies first.

STATEMENT OF HON. NANCY PELOSI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. PELOSI. Thank you very much, Mr. Chairman. Thank you for the opportunity to present my views on the potential impact of provisions of the Contract With America. I hope you will convey my gratitude to the chairman of the committee, Mr. Archer, for his making this time available for Members.

While I have many problems with the Contract, Mr. Chairman, I wanted to focus my comments today from the viewpoint of an appropriator and address the proposal to switch entitlement programs to discretionary spending, which I believe will only increase poverty, homelessness, and hunger for millions of American children.

Let me stipulate for the record that there is broad agreement that welfare programs need fundamental reform. Most welfare reforms initiated by States tie cuts in basic income support to employment and breaking the patterns that lead to long-term dependency. One of my great concerns is that the provisions in the Contract would indiscriminately cut basic income support without creating new opportunities for low-income people.

The authors of the Contract included language in the Personal Responsibility Act which would impose a cap on spending for income support programs for the poor. In the past, a number of Republicans and Democrats, for example our colleague, Mr. Stenholm, among others, had proposed placing a cap on total spending for all entitlements, except Social Security. The Contract is unique in that it places a cap only on the 6 percent of programs designed to assist the poorest Americans.

The authors of the Contract apparently assumed that savings of $40 billion from these safety net programs would finance other parts of the Contract, such as the reduction in the capital gains taxes, which would provide tax relief to some of the wealthiest of Americans. Thus, one could conclude, money being fungible, that the poor children in America are being placed in extreme peril to provide tax breaks for the privileged.

The Contract would also convert critical programs which are now entitlements, such as SSI and AFDC, into discretionary programs whose funding level would be set each year through the appropriations process. As a member of the Labor-HHS-Education Appropriations Subcommittee, which has struggled with the competing priorities for the poverty-related programs, I find this approach a source of extreme concern.

As you know, Mr. Chairman, the Budget Enforcement Act has established tight caps to restrain Federal discretionary spending. As a result of these caps, domestic discretionary spending will, by fiscal year 1998, consume a smaller share of the national economy than any year since 1962. Because the authors of the Contract call

for increased defense spending, funding for priority domestic programs will be further constrained.

Adding income assistance programs to the competition for appropriated funds would almost certainly result in reductions far greater than those projected by the House Republican Conference. These crucial programs each will be reduced to the debilitating role of the baby bird fighting its brothers and sisters for the only worm. Those that are left to go hungry have no viable alternatives. This hunger is what needy children will face every day if these proposals become a reality.

It is my understanding there is now considerable interest among some Republican Governors and the authors of the Contract in replacing Federal safety net programs with block grants to the States. Such an approach would not only result in pain and suffering for poor people, particularly children, it would also hinder welfare reform efforts in some States.

Some States want to expand child care and job training programs for AFDC mothers to promote maximum employability. Because the block grant approach would provide much less money, States would be placed in the difficult position of further cutting benefits or abandoning reforms aimed at self-sufficiency. In my view, the Federal Government should be providing increased matching funds for States adopting such positive approaches.

In the interest of time, I have submitted my statement for the record, but I want to also call to your attention my concern about the SSI reductions, which I think are difficult to defend, and also want to address the specific provision of the financing proposal that relates to benefits for legal permanent residents. These legal immigrants have played by the rules, are here legally, and are tax paying. They are helping raise the next generation of Americans. By denying health benefits to the elderly, we are punishing the grandparents of the future generations of Americans.

Mr. Chairman, I want to say that government is a social contract with the American people. Thomas Jefferson wrote that, "The care of human life and happiness, and not their destruction, is the first and only legitimate object of good government." The Republican Contract, I believe, does not pass this test.

Mr. Chairman, once again, thank you for the opportunity to present my views on the critical issues before your committee. I hope to work with you in having real welfare reform which does not increase poverty in America.

[The prepared statement follows:]

STATEMENT OF
THE HONORABLE NANCY PELOSI
ON THE IMPACT OF THE CONTRACT ON LOW-INCOME AMERICANS
JANUARY 10, 1995

MR. CHAIRMAN, I APPRECIATE THE OPPORTUNITY TO PRESENT MY VIEWS ON THE POTENTIAL IMPACT OF PROVISIONS OF THE "CONTRACT WITH AMERICA" ON LOW-INCOME AMERICANS. IN PARTICULAR, I WANT TO EXPRESS MY CONCERN OVER PROVISIONS IN THE CONTRACT WHICH I BELIEVE WILL ONLY INCREASE POVERTY, HOMELESSNESS AND HUNGER FOR MILLIONS OF AMERICAN CHILDREN.

THE AID TO FAMILIES WITH DEPENDENT CHILDREN (AFDC) PROGRAM PROVIDES CASH TO NEEDY CHILDREN WHO LACK SUPPORT BECAUSE AT LEAST ONE PARENT IS DEAD, DISABLED, UNEMPLOYED, OR CONTINUALLY ABSENT FROM THE HOME. IN ADDITION TO THE PAYMENT, ELIGIBLE FAMILIES RECEIVE MEDICAID, ELIGIBILITY FOR FREE SCHOOL LUNCHES AND USUALLY FOOD STAMPS. FEDERAL LAW REQUIRES STATES TO REQUIRE ABLE-BODIED AFDC RECIPIENTS WITH NO CHILD UNDER AGE 3 TO PARTICIPATE IN THE STATE'S EDUCATION, TRAINING AND WORK PROGRAM, THE JOB OPPORTUNITIES AND BASIC SKILLS (JOBS) PROGRAM. APPROXIMATELY 5 MILLION FAMILIES ARE ENROLLED IN THE AFDC PROGRAM AND APPROXIMATELY 9.5 MILLION CHILDREN DEPEND ON THIS MONEY TO SURVIVE.

LET ME STIPULATE FOR THE RECORD THAT THERE IS BROAD AGREEMENT THAT WELFARE PROGRAMS, INCLUDING AFDC, NEED FUNDAMENTAL REFORM. REAL WELFARE REFORM HAS THE POTENTIAL TO MOVE INDIVIDUALS AND FAMILIES TOWARD LASTING SELF-SUFFICIENCY. BUT REAL WELFARE REFORM MUST BE REALISTIC IN RECOGNIZING THE CHALLENGES IN ACCOMPLISHING THESE GOALS. YES, WHERE SIMPLE LACK OF SELF-INITIATIVE IS THE CAUSE OF UNEMPLOYMENT, THE GOVERNMENT SHOULD NOT BEAR THE COST OF SUPPORTING THE INDIVIDUAL. BUT WE SHOULD ALSO RECOGNIZE THE DIFFICULTIES WHERE JOBS DO NOT EXIST, WHEN AN INDIVIDUAL IS UNABLE TO WORK BECAUSE OF A DISABILITY, OR WHEN DEPENDENT SMALL CHILDREN REQUIRE CARE.

MOST WELFARE REFORMS INITIATED BY STATES TIE CUTS IN BASIC INCOME SUPPORT TO EMPLOYMENT AND BREAKING THE PATTERNS THAT LEAD TO LONG-TERM DEPENDENCY ON INCOME SUPPORT. ONE OF MY GREAT CONCERNS IS THAT THE PROVISIONS IN THE CONTRACT WOULD INDISCRIMINATELY CUT BASIC INCOME SUPPORT WITHOUT CREATING NEW OPPORTUNITIES FOR LOW-INCOME PEOPLE.

THE AUTHORS OF THE CONTRACT INCLUDED LANGUAGE IN THE PERSONAL RESPONSIBILITY ACT WHICH WOULD IMPOSE A CAP ON SPENDING FOR INCOME SUPPORT PROGRAMS FOR THE POOR. IN THE PAST, A NUMBER OF REPUBLICANS AND DEMOCRATS, LIKE OUR COLLEAGUE MR. STENHOLM, AMONG OTHERS, HAVE PROPOSED PLACING A CAP ON TOTAL SPENDING FOR <u>ALL</u> ENTITLEMENTS EXCEPT SOCIAL SECURITY. THE CONTRACT IS UNIQUE IN THAT IT PLACES A CAP <u>ONLY</u> ON THE 6% OF PROGRAMS DESIGNED TO ASSIST THE POOREST OF AMERICANS. ACCORDING TO REPUBLICAN ESTIMATES, THE BILL WOULD ACHIEVE NET SAVINGS OF ABOUT $18 BILLION BY PLACING AN OVERALL SPENDING CAP ON AN ARRAY OF ANTI-POVERTY PROGRAMS. ADDITIONAL REDUCTIONS IN SPENDING OF $11 BILLION ARE PROJECTED FOR CONSOLIDATING MOST NUTRITION PROGRAMS INTO A BLOCK GRANT AND DECREASING THEIR FUNDING.

THE AUTHORS OF THE CONTRACT APPARENTLY ASSUME THAT SAVINGS FROM THESE SAFETY NET PROGRAMS WOULD FINANCE OTHER PARTS OF THE CONTRACT. OTHER PARTS OF THE CONTRACT, SUCH AS THE REDUCTION IN CAPITAL GAINS TAXES, PROVIDE TAX RELIEF TO SOME OF THE WEALTHIEST OF AMERICANS. THUS, ONE COULD CONCLUDE THAT POOR CHILDREN IN AMERICA ARE BEING PLACED IN EXTREME PERIL TO PROVIDE TAX BREAKS FOR THE RICH.

THE CONTRACT WOULD ALSO CONVERT CRITICAL PROGRAMS WHICH ARE NOW ENTITLEMENTS, SUCH AS THE SUPPLEMENTAL SECURITY INCOME PROGRAM (SSI) FOR DISABLED PEOPLE AND AFDC, INTO DISCRETIONARY PROGRAMS WHOSE FUNDING LEVEL WOULD BE SET EACH YEAR THROUGH THE APPROPRIATIONS PROCESS. AS A MEMBER OF THE LABOR-HHS-EDUCATION APPROPRIATIONS SUBCOMMITTEE WHO HAS STRUGGLED WITH THE COMPETING PRIORITIES FOR POVERTY RELATED PROGRAMS, I FIND THIS APPROACH A SOURCE OF EXTREME CONCERN.

AS YOU KNOW, THE BUDGET ENFORCEMENT ACT HAS ESTABLISHED TIGHT CAPS TO RESTRAIN FEDERAL DISCRETIONARY SPENDING. AS A RESULT OF THESE CAPS, DOMESTIC DISCRETIONARY SPENDING WILL, BY FY 1998, CONSUME A SMALLER SHARE OF THE NATIONAL ECONOMY THAN ANY YEAR SINCE 1962. BECAUSE THE

AUTHORS OF THE CONTRACT CALL FOR INCREASED DEFENSE SPENDING, FUNDING FOR PRIORITY DOMESTIC PROGRAMS WOULD BE FURTHER CONSTRAINED. IN ADDITION, THE RECENTLY ENACTED CRIME BILL HAS ESTABLISHED A TRUST FUND WHICH PROTECTS CRIME-RELATED SPENDING FROM REDUCTIONS IN DISCRETIONARY APPROPRIATIONS. NONETHELESS, ADDITIONAL CUTS IN DISCRETIONARY SPENDING ARE BEING ACTIVELY ADVANCED IN THIS CONGRESS.

ADDING INCOME ASSISTANCE PROGRAMS TO THE COMPETITION FOR APPROPRIATED FUNDS WOULD ALMOST CERTAINLY RESULT IN REDUCTIONS FAR GREATER THAN PROJECTED BY THE HOUSE REPUBLICAN CONFERENCE. THESE CRUCIAL PROGRAMS EACH WILL BE REDUCED TO THE DEBILITATING ROLE OF THE BABY BIRD FIGHTING ITS BROTHERS AND SISTERS FOR THE ONLY WORM. THOSE THAT ARE LEFT TO GO HUNGRY HAVE NO VIABLE ALTERNATIVES. THIS HUNGER IS WHAT NEEDY CHILDREN WILL FACE EVERY DAY IF THESE PROPOSALS BECOME REALITY.

AN INCREASE IN POVERTY FOR AMERICA'S CHILDREN WILL HAVE FAR-REACHING EFFECTS ON OUR NATION, AS WELL AS ON EACH CHILD. A THREE-YEAR STUDY BY THE CHILDREN'S DEFENSE FUND FOUND THAT FUTURE LOSSES TO THE ECONOMY STEMMING FROM ONE YEAR OF POVERTY FOR 14.6 MILLION CHILDREN RANGE FROM $36 BILLION TO $177 BILLION. THE STUDY, "WASTING AMERICA'S FUTURE", SAYS POVERTY PLACES CHILDREN AT HIGH RISK OF PHYSICAL OR MENTAL DISABILITY, EDUCATIONAL FAILURE AND TEEN PARENTHOOD.

BY ANY STANDARD, THE CUTS BEING PROPOSED IN THE SAFETY NET PROGRAMS FOR LOW INCOME PEOPLE ARE EXCESSIVE. THE PROPOSED CEILINGS ALONE WOULD IMPOSE BUDGET REDUCTIONS THREE TIMES GREATER THAN THOSE ENACTED IN 1981 AND 1982. SUBSEQUENT STUDIES INDICATED THAT THESE REDUCTIONS IN INCOME SUPPORT CONTRIBUTED TO INCREASES IN POVERTY THAT LASTED THROUGHOUT THE 1980'S. IT SHOULD BE NOTED THAT THESE DRASTIC REDUCTIONS IN INCOME SUPPORT WOULD NOT ONLY APPLY TO WELFARE RECIPIENTS, BUT ALSO TO INDIVIDUALS WHO HAVE BEEN FOUND TO BE MEDICALLY DISABLED AND COMPLETELY UNABLE TO WORK.

IT IS MY UNDERSTANDING THAT THERE IS NOW CONSIDERABLE INTEREST AMONG SOME REPUBLICAN GOVERNORS AND THE AUTHORS OF THE CONTRACT IN REPLACING FEDERAL SAFETY NET PROGRAMS WITH BLOCK GRANTS TO THE STATES. SUCH AN APPROACH WOULD NOT ONLY RESULT IN PAIN AND SUFFERING FOR POOR PEOPLE, PARTICULARLY CHILDREN, IT WOULD ALSO HINDER WELFARE REFORM EFFORTS IN SOME STATES. SOME STATES WANT TO EXPAND CHILD CARE AND JOB TRAINING PROGRAMS FOR AFDC MOTHERS TO PROMOTE MAXIMUM EMPLOYABILITY. BECAUSE THE BLOCK GRANT APPROACH WOULD PROVIDE MUCH LESS MONEY, STATES WOULD BE PLACED IN THE DIFFICULT POSITION OF FURTHER CUTTING BENEFITS OR ABANDONING REFORMS AIMED AT SELF-SUFFICIENCY. IN MY VIEW, THE FEDERAL GOVERNMENT SHOULD BE PROVIDING INCREASED MATCHING FUNDS FOR STATES ADOPTING SUCH POSITIVE APPROACHES. STATES SHOULD NOT BE COMPELLED TO ACCEPT A BLOCK GRANT IN ORDER TO OBTAIN INCREASED FLEXIBILITY. I AGREE WITH GOVERNOR HOWARD DEAN OF VERMONT, THE CHAIRMAN OF THE NATIONAL GOVERNORS ASSOCIATION, THAT BY SHIFTING INCOME ASSISTANCE PROGRAMS TO BLOCK GRANTS AND CUTTING SPENDING, THE PLAN COULD CRIPPLE STATE BUDGETS. AS YOU KNOW, GOVERNOR DEAN HAS DESCRIBED THE REPUBLICAN PLAN AS A POLICY "TO STARVE CHILDREN AND KICK OLD PEOPLE OUT OF THEIR HOUSES."

THE AUTHORS OF THE "CONTRACT WITH AMERICA" GO WELL BEYOND WELFARE REFORM DESIGNED TO MOVE PEOPLE FROM DEPENDENCY TO SELF-SUFFICIENCY. THE PROPOSED BUDGET-CUTTING MEASURES WOULD BE IMPOSED WITHOUT ANY SEEMING REGARD FOR MOVING PEOPLE FROM WELFARE TO WORK. THE REPUBLICAN PROPOSAL LIMITS ELIGIBILITY ON A WIDE RANGE OF INCOME ASSISTANCE PROGRAMS. THE PERSONAL RESPONSIBILITY ACT WOULD SHRED THE SOCIAL SAFETY NET. THIS PROPOSAL IS NOT ANTI-POVERTY - IT IS ANTI-POOR PEOPLE.

THE REDUCTIONS FOR SSI ARE EVEN MORE INEXPLICABLE. THE GOAL OF THE SSI PROGRAM IS TO PROVIDE INCOME SUPPORT TO PEOPLE WHO ARE FOUND TO BE MEDICALLY DISABLED FROM GAINFUL EMPLOYMENT. SSI PROVIDES MONTHLY CASH BENEFITS TO MORE THAN 6 MILLION AGED, BLIND AND DISABLED PEOPLE WITH LITTLE OR NO INCOME. TO REDUCE THEIR INCOME SUPPORT SIGNIFICANTLY TO FINANCE TAX BREAKS FOR MORE FORTUNATE AMERICANS SEEMS TO HAVE VERY LITTLE TO DO WITH PERSONAL RESPONSIBILITY.

CONVERTING SSI TO A DISCRETIONARY SPENDING PROGRAM WOULD PRESENT SOME VERY TOUGH CHOICES FOR REDUCING BENEFITS. ACCORDING TO THE CENTER ON BUDGET AND POLICY PRIORITIES, IF REQUIRED CUTS WERE DISTRIBUTED PROPORTIONATELY AMONG THE PROGRAMS UNDER THE CAP, SSI WOULD HAVE TO BE

CUT $5.1 BILLION, OR 15%, IN FY 1999. EITHER THE SOCIAL SECURITY ADMINISTRATION COULD ESTABLISH A WAITING LIST FOR OVER ONE MILLION ELIGIBLE AMERICANS WHO WOULD NOT BE RECEIVING ASSISTANCE, OR BENEFITS FOR THE ELDERLY AND DISABLED COULD BE REDUCED FROM $337 TO $287 A MONTH. AND THESE CUTS REQUIRED TO REMAIN WITHIN THE CAP WOULD GROW OVER TIME.

FINALLY, I WANT TO ADDRESS A SPECIFIC PROVISION OF THE FINANCING PROPOSAL FOR THE CONTRACT: THAT PROVISION WHICH DENIES BENEFITS TO LEGAL PERMANENT RESIDENTS. EVEN IF WE DISREGARD THE FACT THAT WE ARE PUNISHING PEOPLE WHO ARE LAWFULLY PAYING TAXES AND PLAYING BY THE RULES, THERE IS SOMETHING MORE FUNDAMENTALLY WRONG WITH THIS PROPOSAL. BY DENYING NEEDED ASSISTANCE TO LEGAL PERMANENT RESIDENTS, WE ARE DENYING OUR OWN FUTURE. THESE IMMIGRANTS ARE AND WILL BE THE FUTURE OF AMERICA. BY DENYING HEALTH BENEFITS TO THE ELDERLY, WE ARE PUNISHING THE GRANDPARENTS OF FUTURE GENERATIONS OF AMERICANS.

THIS PROPOSAL IS ESPECIALLY HARMFUL IN LIGHT OF THE PROPOSED PLAN TO CONVERT ENTITLEMENTS TO BLOCK GRANTS. THIS WOULD MAKE THE COMPETITION FOR SFAETY NET DOLLARS PARTICULARLY KEEN AND POTENTIALLY LEAD TO ANTI-IMMIGRANT FERVOR.

THIS VIEW IS SUPPORTED BY THE COMMISSION ON IMMIGRATION REFORM, CHAIRED BY OUR FORMER COLLEAGUE, REP. BARBARA JORDAN. IN ITS SEPTEMBER 1994 REPORT, THE COMMISSION FLATLY STATED THAT IT "RECOMMENDS AGAINST ANY BROAD CATEGORICAL DENIAL OF PUBLIC BENEFITS TO ILLEGAL IMMIGRANTS."

THE REPUBLICAN PARTY HAS A LONG HISTORY OF ACTING TO PROTECT THE WEALTHIEST AMERICANS AT THE EXPENSE OF AVERAGE AMERICANS. THE CONTRACT GOES BEYOND THIS TO TARGET THE DISABLED AND THE POOREST OF AMERICANS IN ORDER TO SUPPORT A VARIETY OF TAX REDUCTIONS SUCH AS CAPITAL GAINS FOR THE WEALTHY AND TAX CREDITS FOR FAMILIES MAKING UP TO $250,000 A YEAR. MR. CHAIRMAN, THE AMERICAN PEOPLE ARE FAIR MINDED AND DO NOT WANT TO SIMPLY TARGET THE 6% OF ENTITLEMENT PROGRAMS DESIGNED TO PROVIDE INCOME ASSISTANCE FOR POOR PEOPLE AS THE FINANCING MECHANISM FOR OTHER PROGRAMS IN THE CONTRACT.

GOVERNMENT IS A SOCIAL CONTRACT WITH THE AMERICAN PEOPLE. THE CONTRACT WITH AMERICA SHOULD NOT HAVE A PRICE TAG OUT OF REACH OF ORDINARY AMERICANS AND SHOULD NOT DISCRIMINATE AGAINST THE POOREST OF AMERICANS.

THOMAS JEFFERSON WROTE THAT "[T]HE CARE OF HUMAN LIFE AND HAPPINESS, AND NOT THEIR DESTRUCTION, IS THE FIRST AND ONLY LEGITIMATE OBJECT OF GOOD GOVERNMENT." THE CONTRACT WITH AMERICA DOES NOT PASS THIS TEST; INSTEAD, IT HAS THE POTENTIAL TO LEAVE OUT MILLIONS OF AMERICAN FAMILIES AND CONDEMN THEM TO A PLACE OUTSIDE THE POLICY OBJECTIVES OF GOVERNMENT.

MR. CHAIRMAN, ONCE AGAIN I WANT TO THANK YOU FOR THIS OPPORTUNITY TO PRESENT MY VIEWS ON THE CRITICAL ISSUES BEFORE YOUR COMMITTEE.

Mr. CRANE. Well, thank you, and let me say to all of the witnesses, if there is any extra material that you want submitted for the record, that will be done.

Mr. Traficant.

STATEMENT OF HON. JAMES A. TRAFICANT, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. TRAFICANT. Thank you, Chairman. Thank you for having me here.

I support the efforts of what the Republican Party is trying to do with the Contract With America. I do not support all of it and I will make those positions known on the House floor. But I do agree at least the Republican Party has a program that we can at least take off on, if we choose to, and I question my own party, to be honest about it.

I am here today about a specific piece of legislation I would like incorporated in and the opportunity to offer as an amendment to the Contract With America.

First, very simply this: If you are caught speeding on the highway by a State trooper coming here from Illinois, Chairman, that State trooper has to appear in court and he has to prove that you were speeding because you are innocent until proven guilty. And the amendment I want placed in here, for fairness, is in any court proceeding involving a tax matter with an American taxpayer, the burden of proof is on the Secretary. Very simple.

It is now legend, some of those practices and provisions. And the bill is straightforward. It says in any court proceeding the burden of proof is on the Secretary. The taxpayer, then, would be innocent until proven guilty, like a motorist going 90. Think of that a minute. I would ask that be made in order.

There are three revenue provisions here. Quite frankly, Ronald Reagan in 1981 had revenue provisions and he threw them out in 1986 after having dispatched both Carter and Mondale, because they lost money. And you are trying to find money. You are robbing Peter to pay Paul. We have yet to stabilize jobs in America. And I firmly believe that the November 8 election was turned around because of working people completely despaired with their party, the Democratic Party. They are wondering if there is any voice now on jobs.

The first two bills that I would like included raise approximately three-quarters of a billion dollars in revenue per year. First is the Foreign Subsidiary Tax Equity Act, in essence, would add a sixth category to foreign-based income: You have oil, sales, shipping, service, and investment under 954. The Traficant bill would add a sixth provision: Foreign-based manufacturing-related income.

There are a tremendous amount of incentives and loopholes that allow for the nonpayment of taxes and incentives to take American manufacturers overseas and to avoid the payment of taxes. It is legend with AT&T, that moved to Singapore. Whenever they, in Singapore, now build an addition, and put computers in, they, in fact, can escape the payment of tax to Uncle Sam. So we would add a sixth section under foreign-based income, manufacturing-related, in addition to oil, sales, shipping, service, and investment.

The second part of the tandem that, in fact, will contribute close to $3 billion a year in revenue, is repealing section 903. Here is how 903 works, to my new neighbor from Pennsylvania. When 903 was enacted, these were very unsophisticated foreign countries with very unsophisticated tax codes. They had an income tax code. But over the years they have evolved with the sophistication that has helped pull our jobs in, our subsidiaries. Under 903, any sales tax, excise fee, or value-added tax is a dollar-for-dollar credit against taxes paid Uncle Sam.

Repealing 903 would begin to take away these incentives of tax holidays and tax opportunities from American subsidiaries that have moved overseas. Changing 954, repealing 903, would, in fact, begin to stabilize and bring some consensus to an American tax policy with our subsidiaries overseas, take away some of those opportunities, and, in fact, create revenue.

The last one very simply, I know time is limited, is Ronald Reagan in 1981 came up with an investment tax program. He threw it out in 1986 because it lost money. Under the Reagan program you could buy a $10 million computer, you got a 10 percent tax credit of $1 million, accelerated cost recovery, and money was circulating and flowing and everyone was standing up cheering. One problem with it, though. If they bought that computer in Japan, $10 million went to Japan, the taxpayers gave a $1 million tax credit in accelerated cost recovery. We lost our pants. Reagan himself threw ITC out. I thought it was good.

The Traficant bill is very to the point. It is not only a 10 percent investment tax credit for business incorporation, it goes a step forward. It gives a 7 percent consumer tax credit for the purchase of manufactured durable goods. The condition in the change from the Reagan program: These raise revenue. That item must be made in America. If it is not made in America, it does not qualify for the credit.

We can have debates long and hard, and I am hoping the Democratic Party begins to look at this. None of these programs raise revenue. And this rising tide that was going to raise all these ships has not raised a damn thing around here.

I am prepared to debate it. The Constitution allows us to regulate commerce with foreign nations. Under this incentive, it would say this, and it also goes a step further with automobiles: You buy, in fact when a company invests in a $10 million computer system, if that computer system is made in America, they will get the $1 million. If it is not made in America, all they get is the standard depreciation.

On the 7 percent consumer tax credit proposal, it is very unique. I think our debt is so massive every one of us must be participants. We are fighting to give a tax break to people. Why not to participants in our economy? For example, you buy a $20,000 car: $1,400 tax credit. The Traficant bill captured $1,000 if that car is made in America. And if that car is made in America, you can deduct the sales tax and you can deduct the interest on the car note.

It stabilizes jobs. It increases revenue for Uncle Sam. And, yes, there has to be a debate, but I think it is time that we have that debate and I think the American people want that debate. So maybe I have gone a little too far, but I am asking, at least in the Contract With America, that the Republicans do something the Democrats would not do, look at the burden of proof in the tax case. It is the right thing to do. Appreciate your time.

[The prepared statement and attachments follow:]

JAMES A. TRAFICANT, JR.
17TH DISTRICT, OHIO

COMMITTEES
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
CHAIRMAN, SUBCOMMITTEE ON PUBLIC BUILDINGS AND GROUNDS
SUBCOMMITTEE ON ECONOMIC DEVELOPMENT
SUBCOMMITTEE ON SURFACE TRANSPORTATION
COMMITTEE ON SCIENCE, SPACE, AND TECHNOLOGY
SUBCOMMITTEE ON SPACE

Congress of the United States
House of Representatives
Washington, DC 20515-3517

2446 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-5261

125 MARKET STREET
YOUNGSTOWN, OH 44503
(216) 743-1914

5555 YOUNGSTOWN-WARREN ROAD
SUITE 2685
NILES, OH 44446
(216) 652-5649

109 WEST 3RD STREET
EAST LIVERPOOL, OH 43920
(216) 385-5921

TESTIMONY OF THE HONORABLE JAMES A. TRAFICANT, JR. OF OHIO BEFORE THE HOUSE WAYS AND MEANS COMMITTEE JANUARY 10, 1995

First of all, Mr. Chairman, I would like to take this opportunity to thank you for permitting me to testify before the Committee. I know that Speaker Gingrich's promise of bi-partisanship is sincere, and I want you to know that I am ready to work with you and the committee to solve the many problems this country faces. We, as Members of the 104th Congress, have the responsibility of re-establishing the trust the American people have lost in the Federal government.

I would like to begin with a simple statement about what I feel is the root of this country's social and economic problems. I am talking about the crisis of poverty, welfare, an almost permanent annual trade deficit, unemployment, crime, and the ever growing division between the haves and the have-nots. I am talking about the trade and tax policies Congress has approved for the last four decades. Our trade and tax policies weaken America by allowing major employers to move operations overseas to take advantage of tax havens and holidays after handing out pink slips back home. Ironically, these policies have been pushed by both Republican and Democratic administrations.

Mr. Chairman, and members of the Ways and Means Committee, it is my firm belief that if we provide some real incentives for capital investment in America, slay the regulatory octopus that has strangled and frustrated American businesses, and remove the incentives that currently exist in the tax code for moving manufacturing operations overseas -- we will see a dramatic turnaround in the economic picture in this country.

Some aspects of the "Contract with America" have definite merit, and I commend the Republican leadership for putting these proposals on the table. Among those proposals in the Contract that I support are the repeal of the marriage tax, the $500 per child tax credit, the increase in the earnings limit for social security, the repeal of recent tax hikes on the elderly, and tax incentives for private long-term health care. The Republican Leadership is off to a good start, but I know that more can be accomplished.

I recently introduced four bills that, if enacted into law, will have a positive effect on America's economic and social future. I ask that you consider adding them to the tax package you are now working on. I would like to briefly describe my legislative package.

H.R. 248 would provide a 10 percent investment tax credit toward the purchase of an American-made durable good. Businesses and consumers would be able to deduct up to $1,000 for the purchase of an automobile, a computer, or a new machine. Part of the Contract calls for a capital gains tax, but I would respectfully ask the committee to consider an investment tax credit as well.

H.R. 249, the "Foreign Subsidiary Tax Equity Act," targets multinational corporations seeking tax havens by establishing subsidiaries overseas, despite the fact that America possesses the most productive and committed workforce in the world. These corporations leave to escape our regulatory laws and to utilize tax breaks. H.R. 249 would require U.S.-owned foreign subsidiaries that ship products back into the U.S. to pay the same level of U.S. taxes as American-based companies.

H.R. 250 would shift the burden of proof in all civil federal tax cases from the taxpayer to the IRS. Mr. Chairman, this is a measure I have championed for several years and would like to point out that this measure enjoyed the strong support of both Republicans and Democrats last year. In fact, more than 120 Members signed a discharge petition to force the bill from the Ways and Means Committee to the House floor for a vote. I certainly hope I won't have to resort to that tactic in the 104th Congress! Mr. Chairman, a basic tenet of the American justice system is "innocent until proven guilty." H.R. 250 simply ensures that this sacred principle is extended to every corner of our justice system. All too many lives have been ruined unjustly and without cause by an IRS that is all too often out of control. Most average Americans don't have the financial resources to do prolonged battle with the IRS. Most Americans, when accused by the IRS, simply pay the fine -- even though they know they did nothing wrong. Many of those who choose to fight

either go broke all lose everything. My bill provides some modest safeguards to ensure that the IRS only brings a case when it has clear evidence that a taxpayer has engaged in fraud. Any tax reform measure approved by the 104th Congress should include this provision.

Lastly, H.R. 251 would repeal section 903 of the Internal Revenue Code. As you know, Section 903 extends creditability to those foreign taxes imposed "in lieu of" foreign income taxes. This means that all foreign taxes are creditable as business costs toward their foreign taxes paid. Conversely, domestic U.S. companies are put at a distinct disadvantage and are only able to deduct taxes that are "in lieu of" income taxes.

These proposals can do more to change the direction our country is going than any two years and out welfare reform program. Real and profound economic and social progress can be made in this country by approving the measures I have outlined, along with measures to simplify and lower income and corporate taxes, rationalize and reduce federal regulations, and overhaul ill-advised trade agreements such as GATT to protect American sovereignty.

Mr. Chairman, again, I want to thank you for affording me this opportunity to testify before your august body. I hope to work with you on these tax measures in the weeks and months ahead. I urge you to make my package of legislative proposals part of any tax reform measure sent to the floor by the committee.

At this time, I would be happy to answer any questions you might have.

###

104TH CONGRESS
1ST SESSION

H. R. 389

IN THE HOUSE OF REPRESENTATIVES

Mr. TRAFICANT introduced the following bill; which was referred to the Committee on _____

A BILL

To discourage domestic corporations from establishing foreign manufacturing subsidiaries in order to avoid Federal taxes by including in gross income of United States shareholders in foreign corporations the retained earnings of any such subsidiary which are attributable to manufacturing operations in runaway plants or tax havens.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Foreign Subsidiary
5 Tax Equity Act".

1 **SEC. 2. INCOME FROM RUNAWAY PLANTS OR FROM MANU-**
2 **FACTURING OPERATIONS LOCATED IN A**
3 **COUNTRY WHICH PROVIDES A TAX HOLIDAY**
4 **INCLUDED IN SUBPART F INCOME.**

5 (a) FOREIGN BASE COMPANY MANUFACTURING RE-
6 LATED INCOME ADDED TO CURRENTLY TAXED
7 AMOUNTS.—Subsection (a) of section 954 of the Internal
8 Revenue Code of 1986 (defining foreign base company in-
9 come) is amended by striking "and" at the end of para-
10 graph (4), by striking the period at the end of paragraph
11 (5) and inserting ", and", and by adding at the end there-
12 of the following new paragraph:

13 "(6) the foreign base company manufacturing
14 related income for the taxable year (determined
15 under subsection (h) and reduced as provided in
16 subsection (b)(5))."

17 (b) DEFINITION OF FOREIGN BASE COMPANY MANU-
18 FACTURING RELATED INCOME.—Section 954 of such
19 Code is amended by adding at the end thereof the follow-
20 ing new subsection:

21 "(h) FOREIGN BASE COMPANY MANUFACTURING
22 RELATED INCOME.—

23 "(1) IN GENERAL.—For purposes of this sec-
24 tion, the term 'foreign base company manufacturing
25 related income' means income (whether in the form
26 of profits, commissions, fees, or otherwise) derived in

1 connection with the manufacture for or sale to any
2 person of personal property by the controlled foreign
3 corporation where the property sold was manufac-
4 tured by the controlled foreign corporation in any
5 country other than the United States if such prop-
6 erty or any component of such property was manu-
7 factured—
8 "(A) in a tax holiday plant, or
9 "(B) in a runaway plant.
10 "(2) OTHER DEFINITIONS; SPECIAL RULES.—
11 For purposes of this subsection—
12 "(A) TAX HOLIDAY PLANT DEFINED.—The
13 term 'tax holiday plant' means any facility—
14 "(i) operated by the controlled foreign
15 corporation in connection with the manu-
16 facture of personal property, and
17 "(ii) with respect to which any eco-
18 nomic benefit under any tax law of the
19 country in which such facility is located ac-
20 crued—
21 "(I) to such corporation,
22 "(II) for the purpose of providing
23 an incentive to such corporation to es-
24 tablish, maintain, or expand such fa-
25 cility, and

"(III) for the taxable year of such corporation during which the personal property referred to in paragraph (1) was manufactured.

"(B) RUNAWAY PLANT DEFINED.—The term 'runaway plant' means any facility—

"(i) for the manufacture of personal property of which not less than 10 percent is used, consumed, or otherwise disposed of in the United States, and

"(ii) which is established or maintained by the controlled foreign corporation in a country in which the effective tax rate imposed by such country on the corporation is less than 90 percent of the effective tax rate which would be imposed on such corporation under this title.

"(C) ECONOMIC BENEFIT UNDER ANY TAX LAW DEFINED.—The term 'economic benefit under any tax law' includes—

"(i) any exclusion or deduction of any amount from gross income derived in connection with—

"(I) the operation of any manufacturing facility, or

"(II) the manufacture or sale of any personal property,

which would otherwise be subject to tax under the law of such country;

"(ii) any reduction in the rate of any tax which would otherwise be imposed under the laws of such country with respect to any facility or property referred to in clause (i) (including any ad valorem tax or excise tax with respect to such property);

"(iii) any credit against any tax which would otherwise be assessed against any such facility or property or any income derived in connection with the operation of any such facility or the manufacture or sale of any such property; and

"(iv) any abatement of any amount of tax otherwise due and any other reduction in the actual amount of tax paid to such country.

"(D) MANUFACTURE DEFINED.—The term 'manufacture' or 'manufacturing' includes any production, processing, assembling, or finishing of any personal property or any component of

1 property not yet assembled and any packaging,
2 handling, or other activity incidental to the
3 shipment or delivery of such property to any
4 buyer.

5 "(E) CORPORATION INCLUDES ANY RELAT-
6 ED PERSON.—The term 'controlled foreign cor-
7 poration' includes any related person with re-
8 spect to such corporation.

9 "(F) SPECIAL RULE FOR DETERMINING
10 WHICH TAXABLE YEAR AN ECONOMIC BENEFIT
11 WAS OBTAINED.—An economic benefit under
12 any tax law shall be treated as having accrued
13 in the taxable year of the controlled foreign cor-
14 poration in which such corporation actually ob-
15 tained the benefit, notwithstanding the fact that
16 such benefit may have been allowable for any
17 preceding or succeeding taxable year and was
18 carried forward or back, for any reason, to the
19 taxable year.

20 "(3) LIMITATION ON APPLICATION OF PARA-
21 GRAPH (1) IN CERTAIN CASES.—For purposes of this
22 section—

23 "(A) IN GENERAL.—The term 'foreign
24 base company manufacturing related income'
25 shall not include any income of a controlled for-

1 eign corporation from the manufacture or sale
2 of personal property if—
3 "(i) such corporation is not a corpora-
4 tion significantly engaged in manufactur-
5 ing,
6 "(ii) the investment in the expansion
7 of an existing facility which gave rise to a
8 tax holiday for such facility was not a sub-
9 stantial investment, or
10 "(iii) the personal property was used,
11 consumed, or otherwise disposed of in the
12 country in which such property was manu-
13 factured.
14 "(B) CORPORATION SIGNIFICANTLY EN-
15 GAGED IN MANUFACTURING DEFINED.—
16 "(i) GENERAL RULE.—A corporation
17 shall be deemed to be significantly engaged
18 in manufacturing if the value of real prop-
19 erty and other capital assets owned or con-
20 trolled by the corporation and dedicated to
21 manufacturing operations is more than 10
22 percent of the total value of all real prop-
23 erty and other capital assets owned or con-
24 trolled by such corporation.

1 "(ii) SPECIAL RULE FOR ASSESSING
2 PROPERTY VALUE.—The value of any
3 property owned by the corporation is the
4 basis of such corporation in such property.
5 The basis of the corporation in any prop-
6 erty which was acquired other than by pur-
7 chase shall be the fair market value of
8 such property at the time of such acquisi-
9 tion. Any property controlled but not
10 owned by such corporation under any lease
11 (or any other instrument which gives such
12 corporation any right of use or occupancy
13 with respect to such property) shall be
14 treated as property acquired other than by
15 purchase in the manner provided in the
16 preceding sentence.
17 "(C) SUBSTANTIAL INVESTMENT DE-
18 FINED.—The term 'substantial investment'
19 means any amount which—
20 "(i) was added to the capital account
21 for an existing facility during the 3-year
22 period ending on the last day of any tax-
23 able year with respect to which such facil-
24 ity is a tax holiday plant, and

"(ii) caused the sum of all amounts added to such account during such period to exceed 20 percent of the total value of such facility (determined in the manner provided in subparagraph (B)(ii)) on the first day of such period."

(c) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) The last sentence of subsection (b)(4) of such section 954 is amended by striking out "subsection (a)(5)." and by inserting in lieu thereof "subsection (a)(5) or foreign base company manufacturing related income described in subsection (a)(6)."

(2) Subsection (b)(5) of such section 954 is amended by striking out "and the foreign base company oil related income" and by inserting in lieu thereof "the foreign base company oil related income, and the foreign base company manufacturing related income".

(3) Subsection (b) of such section 954 is amended by inserting at the end thereof the following new paragraph:

"(9) FOREIGN BASE COMPANY MANUFACTURING RELATED INCOME NOT TREATED AS ANOTHER KIND OF BASE COMPANY INCOME.—Income of a corpora-

1 tion which is foreign base company manufacturing
2 related income shall not be treated as foreign base
3 company income of such corporation under any
4 paragraph of subsection (a) other than paragraph
5 (6)."
6 (d) EFFECTIVE DATES.—
7 (1) IN GENERAL.—The amendments made by
8 this section shall apply to taxable years of foreign
9 corporations beginning after December 31, 1988,
10 and to taxable years of United States shareholders
11 in which, or with which, such taxable years of for-
12 eign corporations end.
13 (2) INVESTMENTS BEFORE THE DATE OF EN-
14 ACTMENT NOT TAKEN INTO ACCOUNT.—No facility
15 of a foreign controlled corporation shall be treated
16 as a tax holiday plant (within the meaning of section
17 954(h)(2)(A) of such Code, as amended by this sec-
18 tion) or as a runaway plant (within the meaning of
19 section 954(h)(2)(B) of such Code, as amended by
20 this section) on the basis of any amount paid or in-
21 curred with respect to such facility and added to the
22 capital account for such facility before the date of
23 the enactment of this Act.

104TH CONGRESS
1ST SESSION

H. R. 392

IN THE HOUSE OF REPRESENTATIVES

Mr. TRAFICANT introduced the following bill; which was referred to the Committee on _____

A BILL

To amend the Internal Revenue Code of 1986 to reinstate a 10-percent domestic investment tax credit, to provide a credit for the purchase of domestic durable goods, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Investment for Amer-
5 ica Act".

1 SEC. 2. REINSTATEMENT OF 10-PERCENT DOMESTIC IN-
2 VESTMENT TAX CREDIT.

3 (a) ALLOWANCE OF CREDIT.—Section 46 of the In-
4 ternal Revenue Code of 1986 (relating to amount of in-
5 vestment credit) is amended by striking "and" at the end
6 of paragraph (2), by striking the period at the end of para-
7 graph (3) and inserting ", and", and by adding at the
8 end thereof the following new paragraph:

9 "(4) the domestic investment credit."

10 (b) AMOUNT OF CREDIT.—Section 48 of such Code
11 is amended by adding at the end thereof the following new
12 subsection:

13 "(c) DOMESTIC INVESTMENT CREDIT.—

14 "(1) IN GENERAL.—For purposes of section 46,
15 the domestic investment credit for any taxable year
16 is an amount equal to 10 percent of the qualified in-
17 vestment for such taxable year.

18 "(2) QUALIFIED INVESTMENT.—

19 "(A) IN GENERAL.—For purposes of para-
20 graph (1), the qualified investment for any tax-
21 able year is the aggregate of—

22 "(i) the applicable percentage of the
23 basis of each new domestic section 38
24 property placed in service by the taxpayer
25 during such taxable year, plus

1 "(ii) the applicable percentage of the
2 cost of each used domestic section 38 prop-
3 erty placed in service by the taxpayer dur-
4 ing such taxable year.
5 "(B) APPLICABLE PERCENTAGE.—For
6 purposes of subparagraph (A), the applicable
7 percentage for any property shall be determined
8 under paragraphs (2) and (7) of section 46(c)
9 (as in effect on the day before the date of the
10 enactment of the Revenue Reconciliation Act of
11 1990).
12 "(C) CERTAIN RULES MADE APPLICA-
13 BLE.—The provisions of subsections (b) and (c)
14 of section 48 (as in effect on the day before the
15 date of the enactment of the Revenue Reconcili-
16 ation Act of 1990) shall apply for purposes of
17 this paragraph.
18 "(3) DOMESTIC SECTION 38 PROPERTY.—For
19 purposes of this subsection, the term 'domestic sec-
20 tion 38 property' means any section 38 property if—
21 "(A) the property was completed in the
22 United States, and
23 "(B) at least 60 percent of the basis of the
24 property is attributable to value added within
25 the United States.

1 For purposes of the preceding sentence, the term
2 'United States' includes the Commonwealth of Puer-
3 to Rico and the possessions of the United States.
4 "(4) SECTION 38 PROPERTY.—For purposes of
5 this subsection, the term 'section 38 property'
6 means—
7 "(A) tangible personal property (other
8 than an air conditioning or heating unit), or
9 "(B) other tangible property (not including
10 a building and its structural components) but
11 only if such property—
12 "(i) is used as an integral part of
13 manufacturing, production, or extraction
14 or of furnishing transportation, commu-
15 nications, electrical energy, gas, water, or
16 sewage disposal services, or
17 "(ii) constitutes a research facility
18 used in connection with any of the activi-
19 ties referred to in clause (i), or
20 "(iii) constitutes a facility used in
21 connection with any of the activities re-
22 ferred to in clause (i) for the bulk storage
23 of fungible commodities (including com-
24 modities in a liquid or gaseous state), or
25 "(C) elevators and escalators, but only if—

"(i) the construction, reconstruction, or erection of the elevator or escalator is completed by the taxpayer, or

"(ii) the original use of such elevator or escalator commences with the taxpayer, or

"(D) single purpose agricultural or horticultural structures; or

"(E) a storage facility (not including a building and its structural components) used in connection with the distribution of petroleum or any primary product of petroleum.

Such term includes only property to which section 168 applies without regard to any useful life and any other property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 3 years or more.

"(5) COORDINATION WITH OTHER CREDITS.—This subsection shall not apply to any property to which the energy credit or rehabilitation credit would apply unless the taxpayer elects to waive the application of such credits to such property.

1 "(6) CERTAIN PROGRESS EXPENDITURE RULES
2 MADE APPLICABLE.—Rules similar to rules of sub-
3 section (c)(4) and (d) of section 46 (as in effect on
4 the day before the date of the enactment of the Rev-
5 enue Reconciliation Act of 1990) shall apply for pur-
6 poses of this subsection."
7 (c) TECHNICAL AMENDMENTS.—
8 (1) Subparagraph (C) of section 49(a)(1) of
9 such Code is amended by striking "and" at the end
10 of clause (ii), by striking the period at the end of
11 clause (iii) and inserting ", and", and by adding at
12 the end thereof the following new clause:
13 "(iv) the basis of any new domestic
14 section 38 property and the cost of any
15 used domestic section 38 property."
16 (2) Subparagraph (E) of section 50(a)(2) of
17 such Code is amended by inserting "or 48(c)(6)" be-
18 fore the period at the end thereof.
19 (3) Paragraph (5) of section 50(a) of such Code
20 is amended by adding at the end thereof the follow-
21 ing new subparagraph:
22 "(D) SPECIAL RULES FOR CERTAIN PROP-
23 ERTY.—In the case of any domestic section 38
24 property which is 3-year property (within the
25 meaning of section 168(e))—

1 "(i) the percentage set forth in clause
2 (ii) of the table contained in paragraph
3 (1)(B) shall be 66 percent,
4 "(ii) the percentage set forth in clause
5 (iii) of such table shall be 33 percent, and
6 "(iii) clauses (iv) and (v) of such table
7 shall not apply."
8 (4)(A) The section heading for section 48 of
9 such Code is amended to read as follows:
10 "SEC. 48. OTHER CREDITS."
11 (B) The table of sections for subpart E of part
12 IV of subchapter A of chapter 1 of such Code is
13 amended by striking the item relating to section 48
14 and inserting the following:
"Sec. 48. Other credits."
15 (d) EFFECTIVE DATE.—The amendments made by
16 this section shall apply to periods after December 31,
17 1994, under rules similar to the rules of section 48(m)
18 of the Internal Revenue Code of 1986 (as in effect on the
19 day before the date of the enactment of the Revenue Rec-
20 onciliation Act of 1990).
21 SEC. 3. CREDIT FOR PURCHASES OF DOMESTIC DURABLE
22 GOODS.
23 (a) IN GENERAL.—Subpart A of part IV of sub-
24 chapter A of chapter 1 of the Internal Revenue Code of
25 1986 (relating to nonrefundable personal credits) is

1 amended by inserting after section 22 the following new
2 section:

3 **"SEC. 23. PURCHASES OF DOMESTIC DURABLE GOODS.**

4 "(a) GENERAL RULE.—In the case of an individual,
5 there shall be allowed as a credit against the tax imposed
6 by this chapter for the taxable year an amount equal to
7 7 percent of the aggregate amount paid during the taxable
8 year for the purchase of domestic durable goods.

9 "(b) DOMESTIC DURABLE GOODS.—For purposes of
10 this section—

11 "(1) IN GENERAL.—The term 'domestic durable
12 good' means any durable good if—

13 "(A) the property was completed in the
14 United States, and

15 "(B) at least 60 percent of the basis of the
16 property is attributable to value added within
17 the United States.

18 "(2) UNITED STATES.—The term 'United
19 States' includes the Commonwealth of Puerto Rico
20 and the possessions of the United States.

21 "(c) LIMITATION.—The amount of the credit allowed
22 under subsection (a) for any taxable year shall not exceed
23 $1,000."

1 (b) CONFORMING AMENDMENT.—The table of sec-
2 tions for such subpart A is amended by inserting after
3 the item relating to section 22 the following new item:

"Sec. 23. Purchases of domestic durable goods."

4 (c) EFFECTIVE DATE.—The amendments made by
5 this section shall apply to taxable years beginning after
6 December 31, 1994.

7 SEC. 4. CREDIT FOR CERTAIN COSTS INCURRED IN PUR-
8 CHASING AN AMERICAN-MADE PASSENGER
9 VEHICLE.

10 (a) IN GENERAL.—Subpart A of part IV of sub-
11 chapter A of chapter 1 of the Internal Revenue Code of
12 1986 (relating to nonrefundable personal credits) is
13 amended by inserting after section 23 (as added by section
14 3 of this Act) the following new section:

15 "SEC. 24. CERTAIN COSTS INCURRED IN PURCHASING AN
16 AMERICAN-MADE PASSENGER VEHICLE.

17 "(a) IN GENERAL.—In the case of an individual,
18 there shall be allowed as a credit against the tax imposed
19 by this chapter for the taxable year an amount equal to
20 the qualified payments made by the taxpayer during such
21 year.

22 "(b) QUALIFIED PAYMENTS.—For purposes of this
23 section, the term 'qualified payments' means any payment
24 of—

1 "(1) any State or local sales tax imposed on the
2 purchase by the taxpayer of any qualified auto-
3 mobile, and
4 "(2) any interest on any loan which is secured
5 by a qualified automobile and which was incurred by
6 the taxpayer to purchase such automobile.
7 "(c) QUALIFIED AUTOMOBILE.—For purposes of this
8 section, the term 'qualified automobile' means any auto-
9 mobile (as defined in section 4064(b))—
10 "(1) which is purchased after December 31,
11 1994,
12 "(2) which is domestically produced,
13 "(3) the original use of which begins with the
14 taxpayer, and
15 "(4) substantially all of the use of which is for
16 personal, nonbusiness purposes.
17 For purposes of the preceding sentence, an automobile is
18 domestically produced if more than 60 percent of the auto-
19 mobile is produced in the United States and its final as-
20 sembly occurs in the United States.
21 "(d) DENIAL OF DOUBLE BENEFIT.—No deduction
22 or credit shall be allowed under any other provision of this
23 title for any payment for which a credit is allowable under
24 this section."

1 (b) CLERICAL AMENDMENT.—The table of sections
2 for such subpart A is amended by inserting after the item
3 relating to section 23 the following new item:

"Sec. 24. Certain costs incurred in purchasing an American-made passenger vehicle."

4 (c) EFFECTIVE DATE.—The amendments made by
5 this section shall apply to taxable years ending after De-
6 cember 31, 1994.

7 SEC. 5. PLACEMENT OF MADE IN AMERICA LABELS ON
8 PRODUCTS.

9 (a) REQUIREMENTS FOR USE OF LABELS.—No prod-
10 uct may bear a label which states or suggests that the
11 product was made in America unless—
12 (1) the product has been registered with the
13 Department of Commerce under subsection (b); and
14 (2) the Secretary of Commerce has determined
15 that—
16 (A) 60 percent of the product was manu-
17 factured in the United States; and
18 (B) final assembly of the product took
19 place in the United States.
20 (b) REGISTRY OF AMERICAN-MADE PRODUCTS.—
21 Not later than 12 months after the Secretary has promul-
22 gated regulations regarding the registration of products
23 with the Department of Commerce under this section, a
24 person shall register with the Department of Commerce

1 any product on which there is or will be affixed a label
2 which states or suggests that the product was made in
3 America.

4 (c) PENALTIES FOR FRAUDULENT USE OF LA-
5 BELS.—

6 (1) CIVIL FINE.—Any person who, with an in-
7 tent to defraud or mislead, places on a product a
8 label which states or suggests that the product was
9 "made in America" in violation of this section may
10 be assessed a civil penalty by the Secretary of not
11 more than $100,000. The Secretary may issue an
12 order assessing such civil penalty only after notice
13 and an opportunity for an agency hearing on the
14 record. The validity of such order may not be re-
15 viewed in an action to collect such civil penalty.

16 (2) INJUNCTIVE RELIEF.—The Secretary may
17 bring an action to enjoin the violation of, or to com-
18 pel compliance with, this section, whenever the Sec-
19 retary believes that such a violation has occurred or
20 is about to occur.

21 (d) REGULATIONS.—Not later than 12 months after
22 the date of the enactment of this Act, the Secretary shall
23 promulgate regulations establishing procedures under
24 which a person shall register a product under this section.

25 (e) DEFINITIONS.—For purposes of this section:

1 (1) LABEL.—The term "label" means any writ-
2 ten, printed, or graphic matter on, or attached to,
3 a product or any of its containers or wrappers.
4 (2) SECRETARY.—The term "Secretary" means
5 the Secretary of Commerce.

103D CONGRESS
2D SESSION

H. R. 390

IN THE HOUSE OF REPRESENTATIVES

Mr. TRAFICANT introduced the following bill; which was referred to the Committee on _____

A BILL

To amend the Internal Revenue Code of 1986 to provide that the burden of proof shall be on the Secretary of the Treasury in all tax cases, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 **SECTION 1. BURDEN OF PROOF.**
4 (a) GENERAL RULE.—Chapter 77 of the Internal
5 Revenue Code of 1986 (relating to miscellaneous provi-
6 sions) is amended by adding at the end thereof the follow-
7 ing new section:

1 "SEC. 7524. BURDEN OF PROOF.

2 "Notwithstanding any other provision of this title, in
3 the case of any court proceeding, the burden of proof with
4 respect to all issues shall be upon the Secretary."

5 (b) CLERICAL AMENDMENT.—The table of sections
6 for chapter 77 of such Code is amended by adding at the
7 end thereof the following new item:

"Sec. 7524. Burden of proof."

8 (c) EFFECTIVE DATE.—The amendments made by
9 this section shall take effect on the date of the enactment
10 of this Act.

11 SEC. 2. SECRETARY OF THE TREASURY REQUIRED TO
12 SPECIFY, ON REQUEST, REGULATIONS IMPLE-
13 MENTING SPECIFIC TAXES.

14 (a) IN GENERAL.—Section 6001 of the Internal Rev-
15 enue Code of 1986 (relating to notice or regulations re-
16 quiring records, statements, and specific returns) is
17 amended by inserting "(a) IN GENERAL.—" at the begin-
18 ning of the first sentence and by adding at the end the
19 following new subsection:

20 "(b) REQUESTS FOR IDENTIFICATION OF IMPLE-
21 MENTING REGULATIONS.—The Secretary shall identify in
22 writing the specific kind or type of tax, and its specific
23 implementing regulations within 14 days, upon the written
24 request from any person made liable for the payment of
25 any tax under this title."

1 (b) CONFORMING AMENDMENT.—Subsection (a) of
2 section 6001 of such Code, as redesignated by subsection
3 (a), is amended—
4 (1) by striking "any tax" in the first sentence
5 and inserting "any kind or type of tax", and
6 (2) by striking "he may require" in the second
7 sentence and inserting "he shall require".

8 **SEC. 3. INCREASE IN LIMIT ON RECOVERY OF CIVIL DAM-**
9 **AGES FOR UNAUTHORIZED COLLECTION AC-**
10 **TIONS; EXCLUSION OF SUCH DAMAGES FROM**
11 **INCOME.**

12 (a) INCREASE IN LIMIT.—Subsection (b) of section
13 7433 of the Internal Revenue Code of 1986 (relating to
14 damages) is amended by striking "$100,000" and insert-
15 ing "$1,000,000".
16 (b) EXCLUSION FROM INCOME.—Section 7433 of
17 such Code is amended by adding at the end the following
18 new subsection:
19 "(e) EXCLUSION OF DAMAGES FROM INCOME.—
20 Damages awarded under this section shall be excluded
21 from gross income under this title."
22 (c) EFFECTIVE DATE.—The amendments made by
23 this section shall apply to actions by officers or employees
24 of the Internal Revenue Service after the date of the en-
25 actment of this Act.

104TH CONGRESS
1ST SESSION

H. R. 391

IN THE HOUSE OF REPRESENTATIVES

Mr. TRAFICANT introduced the following bill; which was referred to the Committee on _____

A BILL

To amend the Internal Revenue Code of 1986 to deny the foreign tax credit and deduction for taxes paid in lieu of income taxes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DENIAL OF FOREIGN TAX CREDIT AND DEDUCTION FOR TAXES PAID IN LIEU OF INCOME TAXES.

(a) IN GENERAL.—Section 903 of the Internal Revenue Code of 1986 (relating to credit for taxes in lieu of income, etc., taxes) is hereby repealed.

1 (b) CLERICAL AMENDMENT.—The table of sections
2 for subpart A of part III of subchapter N of chapter 1
3 of such Code is amended by striking the item relating to
4 section 903.

5 (c) EFFECTIVE DATE.—The amendments made by
6 this section shall apply to taxable years beginning after
7 December 31, 1994.

Mr. CRANE. I thank the gentleman for his testimony.
Mr. Nadler.

STATEMENT OF HON. JERROLD NADLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. NADLER. Thank you, Mr. Chairman. First, let me express my appreciation to the committee for its willingness in hearing my testimony this morning, and I have two subjects of testimony.

First, in 1993, many of us worked to stop a proposal which many of us found to be extremely troubling and discriminatory to seniors nationwide, and I refer, of course, to the proposal to increase the proportion of Social Security subject to taxation from 50 to 85 percent above certain income levels.

Congresswoman Carolyn Maloney, Nita Lowey, Bernie Sanders, and I introduced an amendment to remove this provision in the Omnibus Reconciliation Act. Unfortunately, the Rules Committee did not make this amendment in order. This provision was passed and adopted into law as part of the Omnibus Reconciliation Act, and it provides that single Social Security recipients with taxable incomes over $34,000 and married recipients with joint taxable incomes over $44,000 will now find 85 percent of their benefits subject to income tax rather than the 50 percent of benefits previously subject to taxation.

There is agreement on this issue that goes beyond the bounds of partisan politics. There is agreement on both sides of the aisle that this tax increase is grossly unfair. Shortly after the passage of the Omnibus Reconciliation Act, Congresswoman Nita Lowey and I and several other Members introduced H.R. 2987, which would have repealed this unfair tax immediately. This week we are reintroducing legislation to accomplish this goal.

Our plan differs from H.R. 8 in one significant way. First, our legislation would repeal this tax increase immediately. I believe that it is unjust to force a senior citizen to wait for 5 years until Congress figures out how to balance the budget. If we do.

It was wrong to focus a tax increase only on older Americans. They have been paying this unjust increase and we should not compound the injustice by asking them to continue to pay any part of this increase beyond this year.

Additionally, while we agree on the fundamental principles underlying this legislation, H.R. 8 does not address the question of offsetting revenue. I believe we should deal honestly and openly with the question of how we should pay for this revenue.

This issue is one of particular concern to my constituents in New York where, because of a very high cost of living, an income of $34,000 is very, very far from wealthy. The application of this tax increase has been especially unfair and burdensome to my neighbors living on Social Security. I urge the committee to repeal it now, not in 5 years.

The second subject I wanted to mention is section 277 of the Tax Code, which as long as we are dealing with the taxes, we should pay attention to now. This provision is a rather obscure provision originally enacted with the intention of closing a loophole by which country clubs and golf clubs were making sums of money on interest and other income and were escaping taxation.

The IRS ruled a few years ago retroactive to 1986, that co-ops and condos were subject to this tax on income in their reserve funds. Now, many States require co-ops, not condos, or sometimes condos but mostly co-ops, require a co-op to have a reserve fund to provide for funds if the roof needs repair or some other major capital improvement must be done. And so these co-ops and condos maintain the reserve funds. They keep them in a bank and earn interest. And suddenly they now find that with 8 years of retroactivity the IRS is giving interpretation to section 277 that no one ever anticipated, and large sums are being demanded, such that in many cases will throw these co-ops into bankruptcy and upset the entire situation.

I don't remember the exact figure that it would cost to repeal this. It is a small figure for the country. Congressman Rangel and Congressman Schumer both have legislation introduced in prior years, Senator Moynihan also, to change this egregious misinterpretation of the statute to impose a tax never anticipated by Congress, which was done by the IRS and done retroactively, as I said, and I hope that you will take this opportunity to eliminate this provision retroactive to 1986, to adopt Congressman Rangel's bill on the subject and incorporate it into whatever else is done this year so that we can eliminate this threat to the financial stability of many co-ops and condos throughout the country.

We all say that we want homeownership, especially middle-class homeownership. We want to encourage co-ops and condos middle-class homeownership. This is a direct threat to hundreds of thousands of units in New York and elsewhere. So I hope you will give it every consideration, and I thank you for your courtesy and members of the committee.

Mr. CRANE. Thank you, Mr. Nadler.

And next, Mr. Goss.

STATEMENT OF HON. PORTER J. GOSS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. GOSS. Thank you very much, Mr. Chairman. I congratulate you on these hearings and you and your members of this committee for taking the time. It is critically important and I know the people of America are fascinated with what is going on here and looking for a good outcome.

I want to submit an amended updated statement for the record in addition to the one I have given you for your packets, which has some new information in it, and let that stand as my statement and make a few remarks, if that is permissible.

Mr. CRANE. Absolutely.

Mr. GOSS. Thank you, Mr. Chairman.

Mr. Chairman, I come from a part of the country in southwest Florida, which is a wonderful place to live and a great place to retire. As a result I represent an awfully large number of senior citizens. I can tell you that the Senior Citizens' Equity Act is being watched very closely by the people in my district because they believe it corrects some serious problems and some great unfairness that exists with regard to our senior citizens in this country.

I have just completed a term of serving on the Bipartisan Entitlement and Tax Reform Commission, known also as the Kerrey

Commission, and I think we all understand there are some serious problems facing us out there that we are going to have to deal with. They are generational they are so large. We have years ahead to plan for these.

But before we get to those big, big issues of entitlements and how we handle them, there are some short-term fixes that we can make. And in the Senior Citizens' Equity Act, I think there are several that we should get on with immediately. The first, of course, is the earnings test limitation.

Coming from where I do, the earnings test has about equal billing with the notch as a subject when I go to a town meeting. And I think that that probably gives you an idea of the amount of interest there and the amount of correspondence I get on it.

I think that phasing out the earnings limitation test as quickly as possible is a great idea. It is hard for people to imagine, I guess, that once you have retired you may not have enough money. But, in fact, life goes on and events happen. Sickness comes, unforeseen expenses come, inflation comes, and suddenly you do not have enough dollars to meet your needs. Then you discover if you go back to work that you are penalized for working, you are paying a prohibitive tax rate, more than anybody else in the country, and the bargain that was made with regard to your Social Security is, in fact, being reneged on because you are not getting the Social Security payment that you are entitled to from the withholding of all those payroll taxes throughout your productive years. You find you have to go back to work and you are working at a disadvantage. Revising the earnings limit seems to me to be a question of common sense and fair play, and one, as I have heard other testimony just sitting at this table today, that we know that there is a body of influence that wants to correct rather quickly.

The second area, the repeals of what we call the new tax on Social Security concerns the taxation of that part of Social Security above 50 percent up to 85 percent of benefits that has been referred to frequently in testimony and much discussed. I think that it is very imperative that we get on with that repeal. Again, it is a question of fair play on this, and I do not see how we get away with justifying taxing the seniors. If we are going to have taxes across the board because we need revenues in this country, that is one thing, but why are we picking only on seniors?

I would suggest, as I have many times previously, Mr. Chairman, as you know, and I have been very specific about it with specific lists of spending cuts that I have submitted to this committee and to others over the years, that I think we should focus on spending cuts first. But I also feel that the tax relief in this package for our senior citizens is important, because we have unfairly picked on them.

The part of my testimony that has been amended is the part that has to deal with what happens to the revenues that come in from the Social Security tax. I understand that those revenues in fact, now go to the Medicare Trust Fund. But in effect, they come out of the Social Security Trust Fund system and go into another system, which is not the same part. It is not the same system. They are not going into the General Treasury, which would be worse, but they still are not part of the bargain that was made with the peo-

ple paying the payroll tax under Social Security. I think that is an area that needs correction.

The final area that comes under the jurisdiction of this committee that is in the packet has to do with long-term care insurance. Obviously, we have taken a good deal of time trying to find out what people's druthers are in the area of health insurance, having gone through the debate last year. I find that perhaps 80 percent of our senior citizens who have health care problems would rather have them taken care of in a home style atmosphere. They would like to minimize expenses.

There are a number of ways that these things can be done through the incentives and the changes in the tax programs that we have outlined here under the long-term care insurance provisions. They will benefit seniors, and will certainly help them get on with dealing with their health care costs. Certainly health reform is an unfinished piece of business for the U.S. Congress, and I think these long-term care provisions will provide welcome relief in the short term.

The other area, the Fair Housing Act, is not in your jurisdiction, but I think it is equally worthy and a much welcomed provision in that act. Mr. Chairman, I would ask that this committee move as rapidly as it prudently can in the areas that are within your jurisdiction because I know our country is waiting eagerly for these changes. I thank you for the opportunity to present this testimony.

[The prepared statement follows:]

PORTER GOSS
14TH DISTRICT, FLORIDA

330 CANNON BUILDING
WASHINGTON, DC 20515-0913
(202) 225-2536

COMMITTEES
RULES
STANDARDS OF OFFICIAL CONDUCT

Congress of the United States
House of Representatives
Washington, DC 20515-0914

DISTRICT OFFICES
2000 MAIN STREET
SUITE 303
FT. MYERS, FL 33901
(813) 332-4677

3301 TAMIAMI TRAIL EAST
BUILDING F, SUITE 212
NAPLES, FL 33962
(813) 774-8060

PUNTA GORDA
(813) 639-0051

STATEMENT OF CONGRESSMAN PORTER J. GOSS
BEFORE
THE HOUSE WAYS & MEANS COMMITTEE
CONCERNING
"THE SENIOR CITIZENS' EQUITY ACT"

January 10, 1995

THANK YOU MR. CHAIRMAN. I GREATLY APPRECIATE THE OPPORTUNITY TO TESTIFY BEFORE THIS DISTINGUISHED PANEL TODAY. FIRST, LET ME CONGRATULATE YOU ON ASSUMING THE CHAIR AND FOR MOVING SO QUICKLY ON THESE HEARINGS. AND LET ME ALSO CONGRATULATE AND WELCOME ALL THE NEW MEMBERS OF YOUR COMMITTEE. WITH THAT SAID, MR. CHAIRMAN, I'D LIKE TO ADDRESS ONE ITEM IN THE "CONTRACT WITH AMERICA" THAT IS VERY CLOSE TO MY HEART -- "THE SENIOR CITIZENS' EQUITY ACT."

AS YOU KNOW MR. CHAIRMAN, BECAUSE OF THE LARGE NUMBER OF RETIREES WHO RESIDE IN MY DISTRICT, I HAVE WORKED TIRELESSLY ON MANY SENIORS' ISSUES SINCE COMING TO THE CONGRESS. LAST YEAR I WAS ONE OF SEVERAL MEMBERS WHO HELPED DEVELOP "THE SENIOR CITIZENS' EQUITY ACT" AND FOUGHT FOR ITS INCLUSION IN THE CONTRACT. NEEDLESS TO SAY, I AM THRILLED THAT NOW, WE WILL FINALLY BE GIVEN THE CHANCE TO REEXAMINE, LEGISLATIVELY, IMPORTANT ISSUES LIKE THE SOCIAL SECURITY EARNINGS LIMIT AND THE REPEAL OF THE CLINTON SOCIAL SECURITY TAX. I HOPE MY TESTIMONY CAN HELP THE PANEL BETTER APPRECIATE THE HUMAN CONSEQUENCES OF SOME OF THESE CURRENT POLICIES -- AND ULTIMATELY HELP CONVINCE THE HOUSE THAT RAPID ENACTMENT OF THE "SENIOR CITIZENS' EQUITY ACT" IS IN **AMERICA'S** BEST INTEREST.

THE "SENIOR CITIZENS' EQUITY ACT" CONSISTS OF FOUR PRIMARY PROVISIONS -- RAISING OF THE SOCIAL SECURITY EARNINGS LIMIT, REPEAL OF THE NEW TAX ON SOCIAL SECURITY BENEFITS LEVIED AS A PART OF PRESIDENT CLINTON'S 1993 RECONCILIATION BILL, CREATION OF NEW TAX INCENTIVES FOR THE PURCHASE OF PRIVATE LONG-TERM CARE INSURANCE, AND A STATUTORY CLARIFICATION OF THE FAIR HOUSING ACT'S SENIOR COMMUNITY EXEMPTION. THE FIRST THREE FALL WITHIN THIS COMMITTEE'S JURISDICTION. AS ONE WHO HAS SEEN FIRSTHAND THE ILL-EFFECTS ON OUR CURRENT POLICIES IN THESE AREAS, I URGE YOU TO TAKE THIS OPPORTUNITY TO IMPROVE UPON THE STATUS QUO.

FIRST, I WOULD CONTEND THAT REPEALING THE SOCIAL SECURITY EARNINGS LIMITATION IS AMONG THE MOST IMPORTANT ITEMS IN THE ENTIRE CONTRACT. THE CURRENT POLICY DISCOURAGES AND PENALIZES **WORK**, AND HURTS THOSE SENIORS WHO STRUGGLE TO LIVE ON MODEST FIXED INCOMES THE MOST. IN SHORT, THE CURRENT POLICY IS A CRUEL CATCH-22. BECAUSE THE POLICY ONLY WITHHOLDS SOCIAL SECURITY BENEFITS AS **EARNED** INCOME EXCEEDS THE ALLOWABLE MAXIMUM, WEALTHIER RECIPIENTS WHO MAY DRAW UPON PRIVATE PENSIONS OR INVESTMENT INCOME ARE NOT EFFECTED. INSTEAD, IT'S THOSE SENIORS WHO RETIRE AND THEN FIND (FOR WHATEVER REASON) THAT THEIR FIXED RETIREMENT INCOME IS INADEQUATE TO MEET THEIR DAILY NEEDS WHO ARE SUBJECTED TO THE EARNINGS LIMIT. WHEN THEY TRY TO TAKE RESPONSIBILITY FOR THEIR OWN NEEDS, AND RETURN TO WORK, THEY SOON REALIZE THAT EVERY DOLLAR THEY EARN ABOVE THE LIMIT IS TAXED AT AN EFFECTIVE MARGINAL TAX RATE OF NEARLY 60%! NOT ONLY DOES THIS POLICY SERVE AS A DISINCENTIVE TO WORK, IT DEVALUES THE DIGNITY OF INDEPENDENCE.

I FEEL STRONGLY THAT REPEALING THE EARNINGS LIMIT WOULD BE GOOD FOR ALL AMERICANS. NOT ONLY WOULD IT ENABLE WORKING CLASS SENIORS TO REGAIN THE DIGNITY THAT ACCOMPANIES SELF-RELIANCE, THE ENTIRE AMERICAN ECONOMY WOULD BENEFIT FROM THE CONTINUED PRODUCTIVITY OF OLDER AMERICANS. AMERICA WAS BUILT ON THE PRINCIPLES OF INDIVIDUAL FREEDOM AND RESPONSIBILITY. AS WE SEEK TO ROLL BACK THE CULTURE OF DEPENDENCY THAT SEEMS TO HAVE SURROUNDED SO MANY OF OUR FEDERAL PROGRAMS, WE SHOULD ENCOURAGE AND REWARD PRODUCTIVITY AND PERSONAL RESPONSIBILITY FROM ALL AMERICANS. REPEALING THE EARNINGS LIMIT IS A GOOD PLACE TO START.

THE SECOND TAX-RELATED PROVISION IN THE "SENIOR CITIZENS' EQUITY ACT" IS THE REPEAL OF THE ADDITIONAL TAX ON SOCIAL SECURITY BENEFITS. THIS

TAX HAS BEEN VIGOROUSLY DEFENDED BY PRESIDENT CLINTON AND OTHERS IN THE DEMOCRATIC LEADERSHIP AS A NECESSARY AND JUSTIFIED SACRIFICE, IMPOSED ONLY ON THE RICH. IN MY VIEW THIS POLICY IS JUST ANOTHER VESTIGE OF THE OLD TAX AND SPEND MENTALITY. IF WE ARE TRULY GOING TO REINVIGORATE AMERICA, AND MAKE THE SYSTEM WORK FOR THOSE WHO WORK HARD AND PLAY BY THE RULES, THIS IS THE VERY KIND OF POLICY THAT WE MUST RETHINK.

THIS NEW $30 BILLION TAX IS NOT A LEVY ON THE RICH, BUT SIMPLY ANOTHER OF THE GROWING TAXES ON MIDDLE-INCOME AMERICANS WHICH ARE ESSENTIAL TO THE FINANCING OF THE OLD BLOATED FEDERAL BUREAUCRACY. THE POLICY, WHICH MAKES 85% OF SOCIAL SECURITY BENEFITS TAXABLE INCOME, EFFECTS THOSE SENIORS WITH INCOMES OF $34,000 OR MORE A YEAR. I WOULD CONTEND THAT $34,000 A YEAR IS HARDLY RICH BY MOST AMERICANS' STANDARDS -- ESPECIALLY WHEN YOU CONSIDER THE HIGH COSTS OF LIVING SENIORS FACE WITH TODAY'S HEALTH SYSTEM. BY DESIGN, THIS THRESHOLD IS NOT INDEXED FOR INFLATION -- IT WILL BE RATCHETED DOWN IN REAL TERMS OVER THE YEARS.

NOW THAT WE KNOW WHAT IT IS, I'D LIKE TO SUGGEST TWO REASONS WHY IT SHOULD BE REPEALED. FIRST, THIS POLICY CAN BE SEEN AS DOUBLE TAXATION. RECIPIENTS PAYING INTO THE SOCIAL SECURITY SYSTEM HAVE ALREADY PAID INCOME TAX ON THEIR CONTRIBUTIONS. THE OLD POLICY OF TAXING 50% OF BENEFITS RECOGNIZED THIS FACT IN THAT ONLY THE PORTION OF BENEFITS ATTRIBUTABLE TO EMPLOYER CONTRIBUTIONS WAS TAXABLE. SECONDLY, AND MORE IMPORTANTLY, I THINK SPECIFICALLY TAXING SENIORS WHO HAVE RESPONSIBLY PREPARED FOR THEIR OWN RETIREMENTS TO MAKE UP FOR CONGRESS' OWN LACK FISCAL RESPONSIBILITY, IS BOTH MORALLY SUSPECT AND ECONOMICALLY DESTRUCTIVE.

AGAIN, THIS POLICY PENALIZES PRIVATE SAVINGS AND PERSONAL RESPONSIBILITY, ALL TO HELP FUND THE IRREPRESSIBLE GROWTH OF OUR INCREASINGLY INEFFECTIVE FEDERAL BUREAUCRACY. CONTRARY TO SOME BELIEFS, REVENUES GENERATED FROM THIS POLICY WERE NOT DEDICATED TO SHORING UP THE SOCIAL SECURITY TRUST FUND, BUT WERE INSTEAD USED TO HELP FINANCE THE NEW SPENDING INCLUDED IN THE CLINTON BUDGET. THIS UNPRECEDENTED COMMINGLING OF SOCIAL SECURITY RELATED REVENUES WITH GENERAL TREASURY RECEIPTS HAS BEEN WIDELY CRITICIZED. I THINK IT COULD INVITE OTHER FISCALLY INAPPROPRIATE FINANCING ARRANGEMENTS AND FURTHER MUDDLE THE PUBLIC'S UNDERSTANDING AND CONFIDENCE IN OUR ENTITLEMENT PROGRAMS. MOST IMPORTANTLY THOUGH, THIS POLICY AGAIN DISCOUNTS THE PRINCIPLE OF SELF RELIANCE. WE SHOULD ENCOURAGE AND REWARD PEOPLE WHO HAVE HAD THE DISCIPLINE AND FORESIGHT TO SECURE RETIREMENT INCOMES TO SUPPLEMENT SOCIAL SECURITY. THIS SHOULD BE ESPECIALLY TRUE NOW THAT THE FUTURE FINANCING STREAMS OF MANY ENTITLEMENT PROGRAMS THAT SERVE RETIREES ARE IN LONG-TERM IMBALANCE.

FINALLY, I'D ALSO ENCOURAGE YOUR SUPPORT OF THE LONG-TERM CARE TAX INCENTIVES IN TITLE III. AGAIN, THE IDEA HERE IS TO ENCOURAGE AND REWARD INDIVIDUALS TO APPROPRIATELY PREPARE FOR THEIR OWN FUTURES. WHILE THE EVER-INCREASING COST OF LONG-TERM CARE HAS BEEN EQUALLY DIFFICULT FOR GOVERNMENT AND INDIVIDUAL FAMILIES TO MANAGE, EVERYONE AGREES THAT THE MORE WE SAVE NOW, FOR THE VAST DEMANDS THAT OUR NATION'S DEMOGRAPHICS WILL BRING IN THIS AREA IN THE FUTURE, THE BETTER OFF WE'LL BE. THE TAX INCENTIVES IN THIS BILL WOULD SIGNIFICANTLY INCREASE PRIVATE SAVINGS FOR LONG-TERM CARE AND IN TURN BETTER ENABLE US TO MANAGE THE PROJECTED COSTS OF CARING FOR OUR AGING POPULATION. MUCH LIKE HOW THE EMPLOYER DEDUCTION FOR HEALTH INSURANCE HAS CAUSED THE WORK PLACE TO BECOME THE PRIMARY AND MOST LASTING SOURCE OF MAJOR MEDICAL COVERAGE, SIMILAR TAX INCENTIVES ARE NEEDED FOR LONG-TERM CARE. NOT ONLY WILL THIS APPROACH HELP ENCOURAGE THE DEVELOPMENT OF MANY, COMPETING PRIVATE LONG-TERM CARE OPTIONS, BUT BY REWARDING THOSE WHO SELF-INSURE NOW, IT WILL DRAMATICALLY REDUCE THE COST OF OUR ALREADY OVERBURDENED PUBLIC LONG-TERM CARE PROGRAMS IN THE FUTURE.

FOR ALL OF THESE REASONS, I URGE THIS COMMITTEE TO MAKE ADOPTION OF THE "SENIOR CITIZENS EQUITY ACT" A VERY HIGH PRIORITY FOR THE 104TH CONGRESS. THANK YOU FOR YOUR ATTENTION. AND AGAIN MR. CHAIRMAN, THANK YOU FOR THE INVITATION TO TESTIFY HERE TODAY.

Mr. CRANE. Thank you, Mr. Goss.
And next is Mrs. Lowey.

STATEMENT OF HON. NITA M. LOWEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mrs. LOWEY. Thank you, Mr. Chairman, and I too would like to thank you for giving me the opportunity to testify before you, and I would like to ask permission to revise and extend these remarks and submit them to the committee.

Before I focus on the specific bill which I have already introduced in this term, I want to share my colleague, Porter Goss' comments, with regard to the earnings limitation and long-term care, and, in fact, I have had a couple of very specific incidents in my district where I have joined constituents in their outrage, people on Social Security who find that they have to earn a few more dollars and they find that the inspectors are out there chasing them down like common thieves because they want to earn dollars above what they were appropriately supposed to be doing. I think it is urgent that we revise those limitations.

Congressman Nadler and I are here today to encourage you to move forward quickly on your pledge to repeal the increase in the portion of Social Security benefits subjected to taxation from 50 to 85 percent. As you well know, 50 percent was the threshold before passage of the Revenue Reconciliation Act of 1993.

We introduced legislation, referred to by my colleague, H.R. 2987, to repeal this tax increase before the ink was even dry on the enacting legislation. Therefore, we call on you to repeal this onerous tax increase now, eliminating your proposal to phase out the tax over 5 years. The senior citizens who are bearing this burden deserve no less.

The increased taxation of Social Security benefits on those individuals whose incomes are above $34,000 and couples with incomes above $44,000 was wrong when it was enacted and it remains wrong today. There is absolutely no reason to delay its repeal, especially since there are numerous places where cuts can be made in appropriations. In fact, in our bill, which was introduced on August 6, 1993, we explicitly included, in title II of the bill, 10 specific spending cuts totaling $32 billion over 5 years that would have fully offset the revenue loss from repealing this onerous and unfair tax increase. As a member of the Committee on Appropriations, I am prepared to work with you and others long and hard to ensure that we have a serious contribution to deficit reduction through specific spending reductions. The first installment of these reductions should be used to offset repeal of this particular tax increase.

In closing, let me make one point, which I know Congressman Nadler shares and that has to do with the general issue of relative impact of tax laws on residents of high-cost areas, like those we represent in metropolitan New York City. I know in some parts of America, $44,000, at which point retired couples are subjected to this high percentage of Social Security income being taxed, seems like relative affluence. But—let me tell you in the New York metropolitan area, where the average rent on a one bedroom apartment is $1,032 per month, and other costs are also higher than in many

parts of the country, people with incomes at these levels hardly feel wealthy, and they do need tax relief.

As my colleague, Porter Goss, referred to his constituents, I hear about this all the time, be it on Queens Boulevard or other parts of my district. People do not feel rich at those income levels.

So, again, we are here today to encourage you to move forward quickly to repeal this tax increase and to make the necessary offsets so as not to increase the Federal deficit. It can be done, it should be done. A phaseout is not good enough and the new tax was imposed without a phase-in. It can and should be repealed without a phaseout. And I thank you very much for your time.

Mr. CRANE. I thank you for your testimony, all of you, and would like at this point, before we start the next panel, to ask members here, do any of you have questions for the preceding witnesses?

Mr. RANGEL. Mr. Chairman, I would like to take this time to thank this panel, and also to ask them to constantly assist us as we attempt to end up with some type of bipartisan agreement on this committee.

I think what you have said, Mrs. Lowey, is very important, and that is that the Appropriations Committee will have to guide the taxwriting committee as to what we end up with, what priorities we place on the savings.

I don't know, but I am inclined to believe a lot of those savings will have to do with the formulas we adopt as relates to pricing out the tax cuts. So it is very important that we continue to work together to see what we can salvage out of this Contract. Thank you.

Mrs. LOWEY. Thank you.

Mr. CRANE. Mr. Ford.

Mr. FORD. Mr. Chairman, I want to thank all my colleagues for their testimony before the committee today, and I guess echo what my friend and colleague on the committee, Mr. Rangel, has said to the Members, is that we are going to be looking forward to working with all of you as we go through this process.

Mr. CRANE. Well, again, I thank all of you who testified thus far, and I appreciate your input. At this point I would like to invite our other colleagues to come on up to the dais so we can start with the next panel.

Well, we have an unwritten rule here on the committee and that is ladies first. So Ms. Norton, you might proceed initially and then we will go to Ms. Woolsey.

STATEMENT OF HON. ELEANOR HOLMES NORTON, A DELEGATE IN CONGRESS FROM THE DISTRICT OF COLUMBIA

Ms. NORTON. Thank you very much, Mr. Chairman, I am here to testify on the aspect of the Contract that has to do with welfare reform. I am here to make constructive suggestions that I hope will improve where we are, rather than to make counterproposals.

I recognize that the Speaker yesterday seemed to wash his hands of the entire business, indicating that perhaps all these things should go back to the States and, therefore, we are done with it. If, however, one-size-fits-all welfare is wrong, so, surely, is the total collapse of all Federal standards that throw defenseless children to be buttressed by whatever State whims come along.

I would like to simply suggest some propositions with the view in mind that these notions can help welfare reform to survive a reality test. First of all, let me indicate where I am coming from. I don't think the State has an obligation to support able-bodied adults, period. We only have welfare because of the State's in loco parentis role in its responsibility for children. Even the majority of welfare recipients say that welfare recipients ought to work, even if they do not like their job. I think we have broad consensus in the country on that.

The predicate of the Contract bill is, of course, jobs. Indeed, that is the be-all, end-all of the bill. I invite the committee to look at the job situation in the parts of the country which have given the greatest concern and perhaps produced this bill: Rural communities and inner cities.

What you have there, Mr. Chairman, is a situation where jobs simply do not exist. And my challenge to the committee is to describe how we are going to have welfare reform in those sections if there are no jobs. I cite the big city unemployment rates for the last 5 years. I cite the tragic black unemployment rates for the last 5 years. I cite the rates for African-American women, who have taken a decline in wages that is horrendous. And I have to ask myself, as I ask you, where is a living wage going to come from after 2 years of looking for a job if you cannot find one?

Look for one and have a public service job, you must, but my question to the committee is, then what? I have looked everywhere in Anacostia. I have looked everywhere in Harlem and I have looked everywhere on the South Side, and I still can't find a job because the welfare rates in my community are 30 and 40 percent. What then is your answer?

My recommendation to you is to listen to your Governors. They said that one-size-fits-all welfare is no good for the States. I say to you, one-size-fits-all welfare is no good for welfare recipients because they range from college graduates to people who are functionally illiterate.

I say to you also that there are different wage and unemployment rates across the country and your 2-year limit has to take into account that factor or else this is not about welfare reform remedied by jobs but is about simply throwing people off welfare who are doing the best they can.

Finally, let me suggest where we might look. The job growth in this country over the past several years has been in temporary jobs and part-time jobs. I believe that the committee might well want to look at part-time jobs. A quarter of the recent growth has been in part-time jobs. In a real sense, if you think about it, part-time work fits with the needs of many welfare recipients. They have young children. They have poor skills. Even if it were necessary to supplement them in a part-time job, it means that they have a job, they are getting a work history. And this is the only way that you can get to permanent employment.

The way most people learn or are trained is on the job. So I say, get these people into the work force. If you have to give part of the grant so that they keep the part-time job, do that.

I leave you finally with the notion that I think there are two very important tests if any welfare reform bill is to survive, and one is

minimum national standards. I don't see how anybody can disagree that there ought to be minimum standards. We can fight about how minimum they ought to be but surely there should be some minimum standards. And finally, if the reform bill does not survive the test of practicality, in light of job availability, then, of course, it is not a reform bill at all. It is a tragic ruse.

I thank you very kindly.

[The prepared statement and attachments follow:]

TESTIMONY OF CONGRESSWOMAN ELEANOR HOLMES NORTON BEFORE THE COMMITTEE ON WAYS AND MEANS ON THE CONTRACT WITH AMERICA

JANUARY 10, 1995

I appreciate the opportunity to appear here today to testify on perhaps the only part of the Republican contract that is widely familiar to Americans and broadly endorsed by them. Welfare reform as an idea is endorsed by the American public and was the number one concern in exit polls on election day. At the same time, Americans also favor training and work for welfare recipients rather than total cut off of children and mothers working in public service jobs or in compliance with the appropriate rules -- positions directly at odds with the Contract proposals.

Welfare reform has displaced other domestic issues, often because of misconceptions, such as the perception of many Americans that welfare accounts for at least half of federal spending (instead of only 1.1%) or the view of some on the ideological right that destroying welfare as a concept and a program is the answer to illegitimacy. Whatever one's reasons, or party, or social class or racial background, however, welfare belongs at the center of our country's concerns.

Welfare is now and has long been the government mission that has defied reform largely because it is not a single problem. Its content includes a virtual line-up of the country's most serious social and economic problems. Among the most severe are the decline of low-skill, high-wage jobs; the growth in the percentage of children of divorced and out-of-wedlock parents; and the isolation and decline of inner cities and rural communities accompanied by joblessness and social disintegration. The complexity of welfare reform will not yield to the now-you-see-it- now-you-don't - solutions tossed about by many who endorse the Contract proposals.

For the purpose of simplicity, I would like to make my points by offering three sets of propositions. The value of this approach for those in search of bipartisan, practical solutions is that it will allow us to see the points of departure and what I believe are many points of agreement.

First, I lay out my underlying assumptions about welfare reform; second, a set of propositions that point up existing barriers that I believe most Americans would agree must be overcome for welfare reform to succeed; and third, a set of recommendations designed to overcome the barriers in a way that is not inconsistent with the Contract goal of reducing the welfare rolls.

I

First, my underlying assumptions:

1. Parents have the obligation to support their own children.

2. The government does not have a responsibility to support able-bodied people and offers stipends to parents only as a safety-net until they find work and only because of the states's *in loco parentis* obligation to see to the welfare of minor children.

3. Able-bodied parents without the means of support, like other parents, have the obligation to take available jobs, even if they are not the jobs they prefer.

4. A poll of welfare clients in representative cities found that in percentages that ranged from 57.5% to 69.6%, welfare clients believe that "it is wrong to stay on welfare if you can get a job, even a job you don't like."

5. The government has an obligation to convert from its passive welfare check

role, and become an active participant in assisting clients to locate jobs, as it does with people who have unemployment insurance.

6. Because of its ultimate responsibility for minor children, the government must not abandon the safety net when the reason the parent cannot support her child is the absence of jobs and not an unwillingness to work.

7. It is less expensive in actual dollars and less costly to society to require a parent to work for welfare until a permanent job can be found than to leave her destitute without a job.

8. Since without help, 70% of recipients leave welfare in less than two years, the causes for the return to the rolls must be determined, or today's attempt at reform will fail as previous attempts have.

9. If it is impossible for a poor parent on welfare to work without childcare, support must be provided, but if provided only long enough to get the person safely off the rolls, the primary job mission of welfare reform will be undone.

10. Since the least expensive way to provide for the welfare of poor children is the present method of providing a minimal welfare check, it follows that any other approach to welfare reform will increase costs for some years.

11. Aggressive pregnancy prevention, especially for teenagers, is an indispensable element of welfare reform.

II

My second set of propositions points up some of the barriers inherent in the Contract approach to welfare that must be overcome if we are serious and have any hope of reaching those who have invited the most concern, particularly recipients who reside in inner cities and in rural communities, where often the majority of children are growing up on welfare.

1. The most serious economic change affecting the workforce of the 80's and 90's has been a severe and rapid decline in wages and employment among the 75% who are non-college educated men and women.

2. The deterioration in the labor market status of non-college educated Americans has been marked, especially among men and younger workers, despite the economic growth of much of the 1980's as well as the present recovery.

3. Labor market trends for non-college educated men and women in the work force operate profoundly against those who, like many welfare recipients and inner city men, have never been in the work force.

4. Unemployment rates and wage reductions are even greater for young males than for young females, a major factor in the growth of fatherless families.

5. Taken as a group across all income lines, women's wages have fallen deeply since 1970, a situation which forecasts little opportunity for untrained welfare recipients to earn a living wage.

6. Young women with a high school education or less have experienced a steep decline in wages, African American women the most serious of all, with a wage fall of 20%

7. The unemployment rates in large cities establish the great difficulty welfare recipients will have entering the labor force inasmuch as city residents who have a

work history are now and for many years have had high unemployment rates, even without counting welfare recipients, most of whom do not have an attachment to the labor force. See Appendix.

8. The unemployment rate of blacks who were in the workforce between 1990 and 1994 has ranged between 11.3% and 14.1%.

9. Typical of large cities where many welfare recipients reside, the District of Columbia unemployment rate rose in November while the national and Washington Metropolitan rates fell.

10. Because blacks, at 38%, are disproportionately recipients of welfare, the persistently high unemployment rates among blacks who have a work history establish the great difficulty that black welfare recipients will have entering the labor force.

11. Typical of the mismatch between the desire of welfare recipients to work and the availability of jobs is the recent report that more than 900 public housing residents in the District, almost all of them women, applied for 75 trainee constructions jobs.

III

My third set of propositions consists not of a counter proposal to the Contract, but of suggestions designed to make the Contract proposals more than temporary or failed measures.

1. If one accepts the notion that one-size-fits-all welfare does not work for the states, it follows that one-size-fits-all welfare solutions will not work for 10 million women on welfare.

2. To be workable, welfare reform must take account of critical differences among recipients, including whether they live in high or low unemployment areas, high or low wage areas, and whether they are well or poorly educated.

3. To be workable, the two-year-time limit for recipients in compliance with their own "contract" must leave room for adjustments based on the availability of jobs.

4. The most important goals of welfare reform are: (a) for those who are at risk, to prevent and discourage welfare dependency, and (b) for those who are receiving welfare, (i) to encourage and require the goal of self support; (ii) to encourage family stability and continuity; and (iii) to break the present cycle whereby recipients, have been able, without help, to find their own routes off the welfare rolls in less than two years only to return because of loss of a job or indispensable support system, or both.

5. In order to encourage family stability and continuity, as well as an appropriate incentive to self-sufficiency, minors who live with a parent, family member or responsible adult should be eligible for all or part of a grant if the minor continues in school and makes satisfactory progress toward obtaining a high school diploma.

6. Since the most valuable training occurs on the job, a primary goal of reform should be to help recipients obtain a job in the private sector, even if part of the welfare grant must be used as a supplement in order for the job to be self supporting.

7. The best hope of matching welfare recipients with private sector jobs is to track where the job growth is - in part time and temporary jobs.

8. Temporary jobs, which accounted for the largest percentage of new jobs in

1991-1993 (27% though they are less than 2% of the total jobs) are better than no job but may not fully meet the goal of permanently reducing the welfare rolls.

9. Part-time jobs, which account for almost as much of the job growth as temporary jobs (25.9%), are more stable than temporary help jobs, more likely to meet the job skills and needs of many welfare recipients, and should be supplemented, if necessary, because they fill the indispensable role of helping the recipient gain work experience and a work history that can lead to permanent independence.

Mr. Chairman, I thank you and this committee for the opportunity to offer my views.

Geographic Profile of Employment and Unemployment, 1993

U.S. Department of Labor
Robert B. Reich, Secretary

Bureau of Labor Statistics
Katharine G. Abraham, Commissioner

September 1994

Bulletin 2446

Table 23. Selected metropolitan areas and cities: Civilian labor force participation rates, employment-population ratios, and unemployment rates by sex, age, race, Hispanic origin, and marital status, 1993 annual averages—Continued

Area and population group	Civilian labor force participation rate	Employment-population ratio	Unemployment	
			Rate	Error range of rate[1]
Cleveland central city				
Total	58.8	50.8	10.9	8.9 - 12.9
Men	66.5	58.2	12.4	9.6 - 15.3
Women	48.4	44.1	8.0	6.2 - 11.8
White	63.5	58.5	8.2	4.1 - 8.3
Men	75.6	70.4	6.8	3.9 - 9.7
Women	58.6	49.7	5.4	2.4 - 8.5
Black	46.9	40.0	18.2	14.4 - 22.0
Men	55.1	42.7	22.5	17.1 - 28.1
Women	43.8	37.8	13.8	8.7 - 18.8
Single (never married)	57.0	48.2	15.4	11.5 - 19.2
Married, spouse present	67.3	61.8	6.5	5.8 - 11.1
Other marital status[2]	40.9	37.0	9.4	5.1 - 13.7
Dallas central city				
Total	73.1	66.1	9.6	8.2 - 11.0
Men	82.9	75.8	8.8	7.0 - 10.6
Women	63.6	57.0	10.6	8.5 - 12.7
White	74.6	70.5	5.5	4.1 - 6.9
Men	84.9	80.2	5.5	3.6 - 7.4
Women	64.6	61.2	5.5	3.4 - 7.6
Black	71.6	59.4	17.1	14.1 - 20.1
Men	78.3	65.3	16.6	12.3 - 20.8
Women	66.1	54.4	17.8	13.4 - 21.8
Hispanic origin	79.3	69.2	8.1	5.5 - 10.6
Men	88.0	83.2	8.5	3.6 - 9.5
Single (never married)	77.6	67.1	13.4	10.9 - 15.9
Married, spouse present	70.3	66.3	5.8	4.0 - 7.6
Other marital status[2]	71.6	64.2	10.2	7.4 - 13.0
Detroit central city				
Total	53.4	46.1	13.7	12.2 - 15.2
Men	62.5	53.5	14.5	12.4 - 16.6
Women	46.1	40.1	12.9	10.8 - 15.0
White	47.3	43.3	8.3	5.2 - 11.5
Men	58.1	55.5	6.2	2.8 - 9.6
Black	54.9	46.7	15.0	13.3 - 16.7
Men	62.7	52.2	16.8	14.3 - 19.3
Women	48.9	42.3	13.2	10.9 - 15.5
Single (never married)	60.0	46.7	22.2	19.7 - 24.7
Married, spouse present	56.5	52.7	5.1	3.3 - 6.8
Other marital status[2]	41.8	37.7	9.8	7.0 - 12.7
District of Columbia				
Total	66.9	61.2	8.5	7.7 - 9.3
Men	73.1	66.9	8.8	7.4 - 8.7
Women	61.6	56.3	8.4	7.3 - 9.6
White	79.2	76.0	4.1	3.2 - 5.0
Men	85.9	82.3	4.2	2.9 - 5.5
Women	72.8	70.0	3.8	2.6 - 5.2
Black	58.2	52.0	12.2	11.0 - 13.5
Men	64.8	56.7	12.5	10.7 - 14.3
Women	54.8	48.2	11.9	10.2 - 13.7
Hispanic origin	79.4	72.7	8.4	5.2 - 11.7
Men	86.8	80.6	8.2	4.5 - 13.9
Women	71.4	66.0	7.6	3.1 - 12.1
Single (never married)	71.1	63.1	11.2	9.9 - 12.5
Married, spouse present	70.4	68.9	4.9	3.8 - 6.1
Other marital status[2]	53.4	49.5	7.2	5.4 - 9.0

See footnotes at end of table.

Table 23. Selected metropolitan areas and cities: Civilian labor force participation rates, employment-population ratios, and unemployment rates by sex, age, race, Hispanic origin, and marital status, 1993 annual averages—Continued

Area and population group	Civilian labor force participation rate	Employment-population ratio	Unemployment	
			Rate	Error range of rate[1]
Houston central city				
Total	69.9	62.6	9.2	8.1 - 10.4
Men	78.3	71.6	8.4	7.0 - 9.9
Women	60.0	53.9	10.2	8.4 - 11.9
White	70.5	66.1	6.3	5.1 - 7.5
Men	81.9	76.9	6.1	4.6 - 7.6
Women	59.0	55.1	6.6	4.8 - 8.5
Black	65.6	53.7	18.1	15.3 - 20.9
Men	67.4	55.3	18.0	14.0 - 22.1
Women	64.0	52.4	18.2	14.3 - 22.0
Hispanic origin	71.4	64.3	9.9	7.5 - 12.4
Men	86.3	81.3	8.0	5.2 - 10.8
Women	52.7	45.6	13.6	8.9 - 18.2
Single (never married)	75.0	64.4	14.1	11.8 - 16.3
Married, spouse present	67.7	63.7	5.8	4.4 - 7.2
Other marital status[2]	63.7	57.5	9.7	7.1 - 12.3
Indianapolis central city				
Total	71.7	67.5	5.8	4.3 - 7.4
Men	76.9	71.7	6.7	4.3 - 9.1
Women	67.5	64.1	5.1	3.0 - 7.1
White	75.5	72.9	3.4	2.0 - 4.9
Men	81.2	78.2	3.6	1.6 - 5.7
Women	70.4	68.2	3.2	1.2 - 5.2
Black	62.1	53.6	13.6	9.1 - 18.1
Single (never married)	68.4	61.1	10.6	6.0 - 14.3
Married, spouse present	75.9	73.7	2.8	1.2 - 4.4
Other marital status[2]	66.5	62.1	6.6	2.9 - 10.6
Los Angeles central city				
Total	64.8	58.4	9.9	9.0 - 10.8
Men	75.4	67.4	10.6	9.4 - 11.8
Women	54.2	49.3	9.0	7.7 - 10.4
Both sexes, 16 to 19 years	36.2	30.3	20.9	14.9 - 26.8
White	66.4	60.1	9.5	8.5 - 10.5
Men	78.0	70.3	9.9	8.6 - 11.2
Women	54.2	49.4	8.8	7.3 - 10.4
Both sexes, 16 to 19 years	41.2	32.8	20.2	13.7 - 26.7
Black	55.1	46.7	15.3	11.9 - 18.6
Men	59.8	48.9	18.3	13.3 - 23.3
Women	51.0	44.8	12.1	7.8 - 16.5
Hispanic origin	65.2	57.9	11.2	9.6 - 12.9
Men	81.4	72.2	11.3	9.3 - 13.3
Women	47.6	42.2	11.2	8.5 - 13.9
Single (never married)	69.5	60.6	12.8	11.2 - 14.5
Married, spouse present	66.0	61.0	7.5	6.4 - 8.7
Other marital status[2]	53.5	47.9	10.4	8.1 - 12.7
Milwaukee central city				
Total	66.9	61.3	8.4	6.6 - 10.2
Men	72.6	65.7	9.8	7.1 - 12.5
Women	61.8	57.5	7.0	4.6 - 9.4
White	71.8	68.2	5.0	3.3 - 6.7
Men	77.1	71.5	7.2	4.5 - 10.0
Women	66.5	64.9	2.4	.6 - 4.2
Black	57.4	46.9	18.2	13.7 - 22.7
Single (never married)	70.6	61.8	12.8	9.7 - 15.9
Married, spouse present	69.3	66.5	4.1	1.9 - 6.2
Other marital status[2]	54.7	50.8	7.1	3.0 - 11.2

See footnotes at end of table.

Table 23. Selected metropolitan areas and cities: Civilian labor force participation rates, employment-population ratios, and unemployment rates by sex, age, race, Hispanic origin, and marital status, 1983 annual averages—Continued

Area and population group	Civilian labor force participation rate	Employment-population ratio	Unemployment	
			Rate	Error range of rate[1]
New York central city				
Total	55.9	50.2	10.2	9.7 - 10.6
Men	66.7	59.1	11.4	10.7 - 12.1
Women	46.8	42.8	8.7	8.0 - 9.3
Both sexes, 16 to 19 years	23.4	14.9	36.4	34.8 - 38.0
White	54.7	49.9	8.8	8.2 - 9.4
Men	66.6	60.3	9.4	8.6 - 10.2
Women	44.6	41.2	8.0	7.2 - 8.9
Both sexes, 16 to 19 years	29.0	19.0	34.2	31.6 - 36.7
Black	56.5	48.9	13.6	12.6 - 14.6
Men	64.9	54.2	16.5	15.0 - 18.0
Women	49.9	44.6	10.6	9.3 - 11.9
Hispanic origin	50.7	43.4	14.3	13.1 - 15.6
Men	65.2	55.2	15.3	13.6 - 17.0
Women	39.1	34.0	13.1	11.2 - 14.9
Single (never married)	57.2	49.3	13.8	13.0 - 14.7
Married, spouse present	61.3	56.9	7.1	6.5 - 7.6
Other marital status[2]	43.1	38.5	10.6	9.4 - 11.8
Philadelphia central city				
Total	55.1	48.8	11.5	10.2 - 12.8
Men	64.6	56.2	13.0	11.1 - 14.8
Women	47.4	42.7	9.8	8.1 - 11.6
White	57.0	51.6	9.3	7.8 - 10.9
Men	67.9	60.6	10.8	8.6 - 12.9
Women	47.5	43.9	7.6	5.5 - 9.7
Black	52.1	44.1	15.3	12.9 - 17.6
Men	59.6	49.6	16.8	13.3 - 20.2
Women	46.4	40.0	13.8	10.6 - 16.9
Single (never married)	61.8	51.8	16.1	13.8 - 18.5
Married, spouse present	59.4	55.6	6.4	4.9 - 7.8
Other marital status[2]	38.7	33.0	14.9	11.5 - 18.2
Phoenix central city				
Total	71.0	65.5	7.8	6.5 - 9.1
Men	79.6	72.4	9.1	7.2 - 10.8
Women	62.8	59.0	6.2	4.4 - 7.9
White	71.8	66.8	7.0	5.7 - 8.3
Men	80.8	73.9	8.5	6.7 - 10.4
Women	63.2	60.0	5.1	3.4 - 6.8
Hispanic origin	71.9	65.3	9.2	5.9 - 12.6
Men	85.0	76.7	9.7	5.4 - 14.0
Single (never married)	80.7	69.4	14.0	10.9 - 17.1
Married, spouse present	70.5	67.2	4.7	3.3 - 6.2
Other marital status[2]	62.7	57.9	7.7	4.8 - 10.5
St. Louis central city				
Total	54.2	45.6	15.8	12.0 - 19.6
Women	50.7	42.5	16.3	10.9 - 21.6
White	63.1	59.1	6.4	2.7 - 10.0
San Antonio central city				
Total	61.2	56.8	7.2	5.7 - 8.8
Men	69.9	65.0	7.0	4.9 - 9.0
Women	53.3	49.2	7.5	5.2 - 9.9
White	60.1	55.5	7.7	6.0 - 9.3
Men	68.4	63.3	7.5	5.2 - 9.7
Women	52.5	48.3	7.9	5.4 - 10.4
Hispanic origin	59.5	54.4	8.7	6.5 - 11.0
Men	67.9	62.0	8.7	5.8 - 11.7
Women	52.1	47.5	8.8	5.5 - 12.1
Single (never married)	71.1	62.4	12.3	9.1 - 15.6
Married, spouse present	58.4	55.5	4.9	2.9 - 6.9

See footnotes at end of table.

Table 23. Selected metropolitan areas and cities: Civilian labor force participation rates, employment-population ratios, and unemployment rates by sex, age, race, Hispanic origin, and marital status, 1983 annual averages—Continued

Area and population group	Civilian labor force participation rate	Employment-population ratio	Unemployment	
			Rate	Error range of rate[1]
San Antonio central city—Continued				
Other marital status[2]	65.6	59.0	4.7	2.0 - 7.4
San Diego central city				
Total	63.9	58.4	8.5	7.1 - 10.0
Men	75.0	66.7	8.4	6.4 - 10.4
Women	54.1	49.4	8.7	6.5 - 11.0
White	65.2	59.7	8.4	6.8 - 10.1
Men	76.2	69.9	8.3	6.1 - 10.5
Women	55.1	50.3	8.8	6.1 - 11.1
Hispanic origin	66.8	57.0	14.6	10.6 - 18.6
Men	80.9	66.3	15.6	10.1 - 21.2
Women	35.0	47.7	13.4	7.6 - 19.1
Single (never married)	72.7	64.2	11.7	8.8 - 14.7
Married, spouse present	62.5	58.8	6.0	4.2 - 7.8
Other marital status[2]	54.2	46.8	10.0	6.0 - 14.0
San Francisco central city				
Total	64.0	58.9	7.9	6.2 - 9.6
Men	71.5	66.4	7.1	5.0 - 9.3
Women	58.1	51.1	8.9	6.2 - 11.7
White	64.5	60.6	6.2	4.1 - 8.2
Men	72.2	68.0	5.8	3.3 - 8.3
Women	55.8	52.1	6.7	3.4 - 9.9
Hispanic origin	67.1	60.8	9.3	4.8 - 13.9
Single (never married)	73.7	67.5	8.5	5.7 - 11.2
Married, spouse present	65.2	61.1	6.2	3.9 - 8.6
Other marital status[2]	44.2	39.2	11.4	6.1 - 16.6

[1] Error ranges are calculated at the 90-percent confidence interval, which means that if repeated samples were drawn from the same population and an error range constructed around each sample estimate, in 9 out of 10 cases the true value based on a complete census of the population would be contained within these error ranges.

[2] "Other marital status" includes divorced, widowed, separated, and married with spouse absent.

[3] Data do not reflect the 1983 official U.S. Office of Management and Budget (OMB) definition of the St. Louis Metropolitan Statistical Area (MSA). See appendix C.

NOTE: Data for demographic groups are not shown when they do not meet BLS publication standards of reliability for the particular area based on the sample in that area. See appendix B.

Mr. CRANE. Thank you.
And Ms. Woolsey now.

STATEMENT OF HON. LYNN C. WOOLSEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. WOOLSEY. Thank you, Mr. Chairman, and I commend you and your committee for holding these hearings on the Contract With America, and I thank you for allowing me to speak.

Today, I will focus on welfare reform because I know firsthand exactly what the faults and merits are of the welfare system. Twenty-7 years ago I was a single, working mother with three small children and I needed to go on welfare so that I could get the health care and the child care that my children needed.

Make no mistake, the welfare system is broken. It does not work for recipients or for taxpayers. The question is: How do we make the system work to get families off welfare for good?

My solution is to invest in innovative job training programs, reinvent the welfare office, and revolutionize child support collection. The Republican proposals, on the other hand, get families off welfare by gutting the system, leaving millions of children without support and possibly on the streets.

Fortunately, the new majority is already hinting that its plan to spend $37 billion a year on government-run orphanages will not be pursued. While I am relieved by this decision, the public should not be fooled into thinking that we can live with the Personal Responsibility Act, an act that cuts off welfare benefits for millions of children who, through no fault of their own, are born to young and poor unmarried women.

The act thwarts our efforts to end childhood hunger by slashing funding for crucial programs such as food stamps and school lunches, and the act's inflexible time limits will cast people off the welfare rolls permanently, regardless of whether there are jobs available. These strict time limits will only result in increased poverty, hunger, and homelessness.

The Republican's block grant proposal will reap similar results. While I support the ability of States to experiment with welfare programs, block grants will harm those least able to defend themselves: Poor children, the elderly, and the disabled. Under this proposal, many poor Americans, including working families, no longer will be eligible for the services they desperately need.

Wisconsin is a good case in point here. While the State's workfare program has reduced the welfare rolls, the number of children living in poverty has doubled. Clearly, cutting benefits and perpetuating the cycle of poverty is not the solution. The key to welfare reform is to reduce the need for assistance, not reduce the availability of assistance.

We can start reducing the need for assistance by collecting the over $5 billion in child support that goes unpaid each year. We can further decrease reliance by implementing comprehensive reform that provides for innovative programs that train for jobs that pay a livable wage. We can pass welfare reform but it will not work unless recipients can find jobs they can afford to live on.

We must also reinvent the welfare office by establishing a single convenient location in the community where individual case-

workers work with recipients to ensure they receive the job training and support services, such as child care and health care, needed in order to permanently move into the work force and off welfare forever.

Mr. Chairman, I thank you and the committee for hearing my testimony and I look forward to working with you on welfare reform. My views are important to this debate because they are based on experience, not theory. So I beg the committee not to use poor children in our country as scapegoats but rather invest in their future.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Representative Lynn Woolsey
Ways and Means Committe Hearing

Chairman Archer, Ranking Member, Mr. Gibbons, I commend you and all of the Members of the Ways and Means Committee for holding these hearings on the Contract with America, and I thank you for allowing me to testify.

Today, I will focus on welfare reform because I know firsthand the faults and merits of our welfare system. You see, 27 years ago, I was a single, working mother who relied on welfare, even though I was employed, so I could give my three small children the health care and child care they needed.

Since it is unclear what the official Republican welfare reform plan is, I will attempt to comment today on both the Contract's Personal Responsibility Act the Majority's latest proposal to terminate crucial poverty programs and replace them with block grants to the states.

Make no mistake, the welfare system is broken. It doesn't work for recipients or for taxpayers. The question is: How do we make the system work to get families off welfare for good?

My solution is to invest in innovative job training programs; reinvent the welfare office; and revolutionize child support collection. The Republican proposals, on the other hand, get families off welfare by gutting the system, leaving millions of children without support and on the streets.

Let's talk about the Personal Responsibility Act first.

Fortunately, the Majority is already hinting that it's plan to spend $37 billion a year on government-run orphanages will not be pursued. While I am relieved by this decision, the public should not be fooled into thinking that it can live with the rest of this legislation, which is equally damaging.

The Personal Responsibility Act cuts off welfare benefits for millions of poor children who, through no fault of their own, are born to young unmarried mothers.

The Act thwarts our efforts to end childhood hunger by slashing funding for crucial programs such as Food Stamps and school lunches.

And, the Act's inflexible time limits will cast people off the welfare rolls permanently, regardless of whether there are jobs available. In my case, despite my job skills, education, and good health, it took me three years to get off welfare. And you know I wasn't lazy. Strict time limits, particularly on individuals that do not have the advantages I had, will only result in increased poverty, hunger, and homelessness.

The Republican's block grant proposal will reap similar results.

While I support the ability of states to experiment with welfare programs, block grants will only harm those least able to defend themselves: poor children, the elderly, and the disabled. Since these block grants will be vulnerable to the Congressional chopping block, pressure to cut them will be strongest in years of recession, a time when more Americans are in need of assistance. Further, under this proposal, poor Americans, including working families, will no longer be automatically eligible for the services they desperately need. Wisconsin is a

good case in point. While the state's workfare program has drastically reduced the welfare rolls, the number of children living in poverty has doubled. Clearly, cutting benefits and perpetuating the cycle of poverty is not the solution to the welfare mess.

The key to welfare reform is to reduce the need for assistance, not to the availability of assistance.

We can start reducing the need for assistance millions of families by collecting the $5.1 billion in child support that goes unpaid each year. Chairman Henry Hyde and I will shortly introduce legislation to revolutionize child support collection by federalizing our ineffective state-by-state child support system.

We can further decrease reliance on welfare by implementing my comprehensive welfare reform package, The Working Off Welfare Act, which I will reintroduce this year.

My bill implements innovative programs that provide recipients with training for jobs that pay a livable wage. We can pass welfare reform until we're blue in the face, but it won't solve anything unless recipients can find jobs that they can afford to live on. We must ensure that training programs give people real skills for jobs that are really out there.

My bill also reinvents the welfare office by establishing a single, convenient location in the community where individual caseworkers can work with recipients. This way, we can ensure that recipients receive the job training and support services, such as child care and health care, that they need in order to permanently move into the workforce.

Mr. Chairman, I thank you and the Committee for hearing my testimony, and I look forward to working with each of you on welfare reform. My views are important to this debate because they are based on experience, not theory. Since we are now considering alternatives to the Personal Responsibility Act, I beg the Committee not to use poor children in our country as scapegoats, but rather to invests in their future. I urge you to consider my realistic proposals for getting families off welfare forever.

Mr. CRANE. Thank you, Mrs. Woolsey.
Mr. Sanders.

STATEMENT OF HON. BERNARD SANDERS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VERMONT

Mr. SANDERS. Thank you, very much, Mr. Chairman, for the opportunity to say a few words about the Contract With America.

Let me put this discussion perhaps in a little bit different context than some others have. We know who won the election on November 8 and we know who lost, but it is also important to point out that in that election 62 percent of the American people did not vote; that we in the United States have the lowest voter turnout in the industrialized world. Therefore, the voices of poor people and low-income people in our democratic institutions in America now are not far removed from what they were for blacks in South Africa just a few years ago. They are irrelevant.

People have the right to vote, but look at the two-party system. The fact is they do not vote. It concerns me very much that as a result of that election in which tens of millions of poor people did not participate, they are going to be victimized by policies developed here by those who won which will cause intense pain and suffering for those people.

In economic terms of what is happening in this country, I think many of us do know what is happening, and that is the people on the top, the very richest people are becoming richer. We see the middle class shrinking and the poor becoming poorer. There are significant increases in poverty at the same time as the richest 1 percent of the people in this country own more wealth than the bottom 90 percent.

As Ms. Norton just mentioned, the new jobs being created are very largely part-time, low-wage jobs which have no benefits whatsoever. So within that context wherein many low-income people and poor people have no power, within the context of economic development in which the rich get richer and most everybody else gets poorer, let us analyze what the Contract With America is about.

What the Contract With America prescribes is that at a time when the rich have already received huge tax breaks over the last 15 years, we are going to reward them with more tax breaks by lowering the capital gains tax—73 percent of whose benefits will go to people making $100,000 a year or more.

So we lower taxes for those people who have already enjoyed huge tax benefits and who are the richest people and, on the other hand what else do we do, we say to children in the State of Vermont, in my State, who are in need of food stamps because maybe their families are hungry that we are going to cut back on food stamps for the hungry. We are going to cut back on the WIC program, which in my State has been a very successful program. We are going to cut back on school breakfast programs and school lunch programs.

So after all the big talk this is what it comes down to. We are going to reward the rich for being rich, and we are going to punish the poor for being poor. I don't think that that is what the American people think this country should be doing.

In terms of crime legislation, we all recognize that there is a serious crime problem. But I talk to many police officials in my State and all over this country who understand that you cannot get to the root cause of crime by simply building more jails. We should wake up and smell the coffee. We already have more people per capita in jail than any other industrialized nation on Earth.

The solution to the crime problem is not simply putting more people in jail. We have got to understand the causation of crime. We have to understand that in communities in America where we have a 40 or 50 percent unemployment rate and where kids are dropping out of high school, that the likelihood of those young people ending up in jail is many times higher than young people in middle-class or upper-middle-class communities.

It is beyond my comprehension that at a time when we need more funding for education, more money for drug rehabilitation, more money for the prevention of crime, more money for counseling, more money to keep an eye on those kids who are falling off the track, and who are going to drift into crime, that any serious person would want to cut back on those crime prevention programs.

Essentially, Mr. Chairman, I think a lot of what is in the Contract With America is moving us precisely in the wrong direction. We need to raise the minimum wage and make sure that everybody who works in this country earns a decent wage. That is the only way you can talk about welfare reform.

We need a jobs program. Right here, 2 miles away from here, and in my own State of Vermont there are enormous public infrastructure needs being unaddressed. We have landfills that need work. When we need to expand rail service, it is crazy to cut Amtrak funding. We need to rebuild our physical and human infrastructure, put people to work and create the opportunity for people on welfare to have decent paying jobs rebuilding their communities.

I thank you very much, Mr. Chairman, for the opportunity to say a few words.

[The prepared statement follows:]

BERNARD SANDERS
MEMBER OF CONGRESS
VERMONT, AT LARGE

213 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-4501
TELEPHONE: 202-225-4115
FAX: 202-225-6790

Congress of the United States
House of Representatives
Washington, DC 20515-4501

COMMITTEES:
BANKING, FINANCE AND URBAN AFFAIRS
GOVERNMENT OPERATIONS

1 CHURCH STREET, SECOND FLOOR
BURLINGTON, VT 05401-4417
TELEPHONE: 802-862-0697
TOLL FREE: 800-339-9834
FAX: 802-860-6370

"Contract with Corporate and Wealthy America"
Representative Bernard Sanders
January 10, 1995

In five minutes I cannot do justice to the Contract with America, but I do want to congratulate the authors of the Contract for their Orwellian titles. I think we can begin to set the record straight by renaming the entire package, the Contract with Corporate and Wealthy America.

On November 8th, in an election in which only 38 percent of the people voted, an election in which low income people barely participated, an election dominated by big money, the Republican Party claimed to have won a mandate for massive change. With that so-called mandate, the Republicans in the House are now proposing legislation which, if enacted, would cause intense pain and suffering for tens of millions of Americans, primarily the weakest and the most vulnerable people in our society.

At a time when the gap between the rich and the poor is growing wider, when the United States has the most unequal distribution of wealth in the industrialized world, when 5 million American children go hungry, the Contract proposes lowering taxes on the wealthy and cutting back severely on programs needed by the poor, the elderly and our children.

The first provision of the Contract, The Fiscal Responsibility Act, would better be called, **The Balanced Budget Bait-and-Switch Act.** That would be a more apt title because it accurately reflects what will happen to middle and low-income Americans when they feel the real pain and suffering in store for them.

Little wonder that so many Americans are so angry and cynical toward the federal government. The first tenet of the Republican Contract with America is the ultimate in "feel good", cop-out legislation. It allows Members of Congress to vote now for a balanced budget without specifying any details on how that goal must be met during the next seven years. The authors of this bill should be ashamed of their con job. Every member of this Congress owes it to talk sense to our constituents and not tell them what they want to hear now, only to stick it to them later.

Immediately after the November elections, newly-elected Republican leaders of this Congress assured all of us that they intend to specify the spending cuts "to put the nation on a glide path to a balanced budget in the next 7 years." That promise was quickly jettisoned. Now we are told vote to amend the Constitution now and that it is impossible to stipulate the spending cuts for the seven-year "glide path" to a balanced budget in 2002. These are classic bait-and-switch tactics, unworthy even of snake oil salesman.

The Republican crime bill, or **The Criminal Creation and Prison Jobs Act** is an effort to take the prevention money out of last year's crime bill, so that we can erect more prisons and expand the use of the death penalty. The new GOP crime bill will reduce the amount spent on crime prevention by $5 billion, taking the prevention spending down from 23 percent of last year's crime bill to 6 percent of the new package.

The Contract's welfare reform act, which I like to call **The Hunger and Homelessness Expansion Act**, cuts back food programs to millions of children, seniors and working Americans, including the Food Stamp, WIC, and the school lunch and breakfast programs. The bill slashes child care, affordable housing and assistance to the blind and disabled. It has been estimated that the Republican contract provision to reform welfare could deny helping hands to 5 million children and 2.5 million adults.

The so-called "Job Creation and Wage Enhancement Act" is really just the **Fat Cats' Reward Act.** The cumulated effect of this bill would be Robin Hood in reverse -- taking from the poor to give to the rich. For example, one of the largest corporate perks

contained in the Contract, is a provision that would allow many major corporations to once again pay little or nothing in federal income taxes. Republicans have said they intend to wipe out taxes on profits from new investments by allowing an immediate tax write-off for capital outlays. In other words, businesses would be able to deduct considerably more than their actual costs. Costs to American taxpayers for this corporate boon would come to $35-40 billion a year.

This legislation would make about two-thirds of all capital gains tax-exempt. The Joint Committee on Taxation estimates the added costs of these capital gains tax breaks to be $25 billion a year -- mostly for the very rich. The Joint Committee on Taxation has estimated the cost in the second 5-year period of enactment could exceed $160 billion. Almost half of the benefits from the capital gains provisions would go to the wealthiest one percent of the population!

These half-baked revenue proposals will cause both a worsening of the deficit and deep reductions in discretionary social programs. While the deficit has been halved as a share of Gross Domestic Product since 1992, large potential budget savings would have to go to paying for tax cuts rather than continuing to make progress on deficit reduction. Combined with the Contract's proposal to balance the budget, enormous cuts will have to be made in Medicare, Medicaid, and veterans programs. Since the Republican Leadership has said they plan on taking Social Security, interest on the federal debt, and defense spending off the chopping block, we can expect to see even deeper cuts in the other social programs designed to help our most vulnerable citizens.

In short, the Contract with Corporate and Wealthy America will further increase the disparity between the rich and the poor. During the period from 1977 to 1990, the average after-tax income of the richest one percent of American households doubled, while the income of the average American household in the middle fifth rose only three percent. Meanwhile the lowest fifth's income dropped 12 percent. Key tax proposals in the Contract go to those Americans that have seen their wealth double just in the past 15 years. Meanwhile, the main spending cuts specified in the Contract are $40 billion over five years from reductions in AFDC, public housing, nutrition programs and programs that assist the blind, disabled and impoverished.

As Republican strategist, Kevin Phillips has noted about the growing gap between the rich and poor in America, "This stratifying starts to make us into a different country. It goes to the American notion of fairness."

Americans are an intelligent people and a hardworking people. But what has gone on for a number of years is that the power and wealth has gone away from ordinary people and is now in the hands of the very few, and the few are using that power and wealth to enrich themselves, ignoring the needs of the vast majority of ordinary people. That is why so few Americans came out to vote in the last election -- because they no longer feel that government works for them, but rather, for the interests of the wealthy and the powerful. I urge you not to carry out this unfair Contract and to reconsider the needs of ordinary Americans. I and other Progressives intend to bring forth real alternative solutions to the real problems confronting the vast majority of Americans.

Mr. CRANE. Thank you, Mr. Sanders.
Mr. Filner.

STATEMENT OF HON. BOB FILNER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. FILNER. Thank you, Mr. Chairman. My name is Bob Filner. I am in my second term representing San Diego, Calif. I thank you for allowing me to have the opportunity to bring forward a proposal that I think will help ensure tax fairness, restore the American dream, and assure fiscal responsibility.

As a Democrat, I support several of the items in the Contract With America. I am especially enthusiastic about the repeal of the taxes on Social Security benefits contained in the Senior Citizens' Equity Act. But, while others will testify in the coming days in support of middle-class tax cuts and repealing taxes on Social Security benefits, most will not offer any concrete way to pay for these cuts. Mr. Chairman, I am here to offer the committee at least a partial solution, one way to pay for these proposals.

My plan would bring $2 billion annually in new revenue to the U.S. Treasury and would not require a general tax increase. Let me repeat: That is $2 billion per year without a tax increase! All that is required is a technical correction to existing tax laws affecting life insurance companies.

Soon I will reintroduce legislation that I originally wrote in the 103d Congress that would repeal section 809 of the U.S. Federal Tax Code. This provision has failed to achieve the purpose intended by the Ways and Means Committee in 1984—and needs to be corrected. As a result, the U.S. Treasury is losing revenues estimated to be as high as $2 billion per year.

My legislation is simple, and based on a careful examination of previous congressional efforts that have failed to produce the intended results. It will achieve the revenue which Congress and the Treasury intended to be paid by the mutual life insurance industry. If action is not taken, Congress will again forgo collecting this $2 billion in taxes from a few mutual life insurance powerhouses that have familiar household names. Until now, no one seemed to want to examine this glaring loophole in section 809 of the Tax Code due to both its technical and political complexity.

This $2 billion annual windfall dates back to when Congress attempted to correct the taxation of mutual life insurance companies. The corrective action was intended to provide income to the U.S. Treasury based on equity among life insurance companies, whether they be stock or mutual. After a short-term increase in taxes was realized, the revenue actually began to decrease. Four years later, the Treasury and the General Accounting Office admitted something was wrong. The intended revenues were not being generated.

In fact, certain large insurance companies had been paying no taxes on earnings for business activity since 1986. By being able to regulate their sale of assets, the few giant mutual insurance companies were able to increase or decrease their taxes on business activities under the terms of section 809. Obviously, this is contrary to congressional intent.

According to several experts, including those used by the IRS, section 809 should have been generating between $1.5 and $2 bil-

lion per year in taxes from these large mutual insurance companies. Since this was not happening, Congress again attempted corrective action. Many of you were here for those hearings in 1989. No results were achieved. The life insurance industry itself was then asked to develop a proposal and bring it to Congress. Six years have passed and Congress is still waiting for that report.

I don't have to tell you that the Nation is in a dire financial situation. We cannot afford to wait any longer. Of all the difficult choices Congress faces, none are more agonizing than those involving taxpayer dollars. The loss of $2 billion in annual revenue makes the choices between military spending, middle-class tax cuts, welfare reform, veterans' programs, and social services even more difficult than they need to be. Closing the section 809 loophole makes a lot of sense, but it is a difficult political decision. Closing it would send a message to the insurance industry that the special interest gravy train has run out of tracks. It would show the Nation that Congress has its priorities back in order.

I thank you, Mr. Chairman, and colleagues, for the opportunity to present this proposal. I hope this committee will hold hearings to discuss this loophole, and I look forward to working together with you to pass this legislation and to helping restore the American dream.

Mr. CRANE. Thank you, very much, for your testimony.

And next is Mr. Franks.

STATEMENT OF HON. BOB FRANKS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. FRANKS. Mr. Chairman, I appreciate the opportunity to testify today in support of a targeted capital gains tax reduction.

Congressman Meehan and I would want to make the members of the committee aware of our modified version of a capital gains tax reduction which tends to focus capital where our economy needs it most, the manufacturing sector.

When I joined Congress in January 1993, I began looking for ways to assist this vital sector of our economy. I was fortunate back then to meet up with Congressman Meehan, who was also a freshman at that time, and together, with the help of the Northeast/Midwest Congressional Coalition, we formed the first-ever bipartisan task force on manufacturing.

During the past 2 years, the task force met with scores of experts, visited literally dozens of manufacturing facilities, and held public forums on the future of manufacturing in Washington, Trenton, Boston, Cleveland, and Detroit. In July, we released our findings and recommendations which were designed to remove the shackles from manufacturers that are currently inhibiting growth, innovation, and job creation.

Although it has been a long recognized fact that a nation's rate of investment is critical to its economic growth, the United States has consistently lagged behind its international competitors in the share of its national output devoted to productive investments in the private sector.

Our current system lacks a crucial component—one that our industrial competitors have long used to gain a competitive edge—incentives to invest.

A change in the Tax Code is essential to encourage investment in America's manufacturing enterprises. Federal law should assist, and not discourage, businesses in raising equity capital to fund growth and expansion.

Repeatedly, during our meetings with manufacturers, especially the small and midsized firms, we were told that these companies often cannot obtain the capital they need to modernize their equipment or expand their production.

In many cases, prospective investors demand a short-term return on their capital, which underscores the fact that there is little patience in capital markets. Most manufacturing operations cannot satisfy a short-term timeframe with any degree of assurance. Because of these conditions, creating greater access to capital has emerged as one of the most pressing goals of our manufacturing task force.

To achieve this objective, our task force recommends a targeted capital gains tax rate reduction to 10 percent for productive assets held for 6 years or longer. The terms of our legislation would fix the rate at 23.5 percent for assets held for at least 3 years.

Our proposal was carefully crafted to avoid abuse. The tax break would be limited to those companies that are classified as domestic producers of manufactured goods and would apply only to those assets that contribute to a manufacturing company's productive output. These assets would have to be held for a minimum of 5 years in order to qualify for any tax break.

The benefits of this tax reduction would be substantial. It would enable entrepreneurs and small manufacturers to raise more equity and to reduce the cost of attracting capital. Also, preferential treatment of capital gains creates incentives for industry and investors to focus on long-term expansion.

With the cold war behind us and the lifting of trade barriers, our Nation faces an enormous new challenge, to become the undisputed economic superpower of the world. It is a race that we can and must win, but some of us in Congress believe that success will come only if we unleash our most potent weapon, our industrial base.

Mr. Chairman, thank you for your consideration of my remarks, and I look forward to working with you and the members of this committee to create a more rational Tax Code, one designed to help and not hinder our Nation's manufacturers.

Mr. CRANE. Thank you, Mr. Franks.

And now, Mr. Meehan.

STATEMENT OF HON. MARTY T. MEEHAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. MEEHAN. Mr. Chairman, thank you for the opportunity to testify before the committee today.

Two years ago Mr. Franks and I launched a Northeast/Midwest Congressional Coalition manufacturing task force because we believed that the United States and global economies are experiencing rapid and fundamental economic change. To effectively compete in this new global economy, we believe that the U.S. workers and companies must have the necessary training and resources avail-

able if they are to thrive in the ever-changing economic environment.

Mr. Chairman, there are three actions that Congress can take to increase the chances of success of our workers, managers, and companies in this new technology-driven knowledge intensive world.

First, we need to achieve a balanced budget by continuing to reduce the Federal budget deficit. The Federal Government's continued heavy demands in the global credit market makes it more expensive for private-sector borrowers to raise the capital needed for future growth.

Second, we need to encourage households and businesses to increase their savings so as to expand the funds available for investment in companies and jobs for the future. Most economists believe that 80 percent of a country's investment funds come from its own savings.

Third, if the technologies of the future are to be successfully developed, we need to encourage our workers and companies to take on increased but prudent levels of risk.

Mr. Franks and I believe that to achieve these policy objectives Congress needs to consider making substantial changes in the current tax law. As it is written today, many provisions in the current tax law not only do not encourage savings, investment and risk taking but, in fact, discourage those activities which have resulted in reduced levels of high-wage jobs and slower economic growth.

During the last 2 years we held field hearings to look at several options for what would be the most efficient ways of spurring long-term investment in capital formation. Based on those hearings we concluded that a targeted, carefully crafted capital gains tax rate reduction was the most efficient and that it will result in increased savings, increased investment and increased risk taking and has the potential to increase revenue over the long term.

Our proposal is aimed at investments in manufacturing. We believe this proposal offers several key advantages.

First, a conditioned rate cut based on patient investment will discourage short-term speculative buying and selling of assets, a pattern that runs counter to the capital needs of manufacturers. Such a cut provides an incentive for manufacturers to carry out long-range planning and investments—essential if they are to modernize, develop new product lines or expand production.

Second, it only provides favorable treatment to productive assets. It excludes assets such as art collections, rare antiques, rare coin collections. Tax policy should only be favorable to taxpayers who make an explicit contribution to economic growth and employment.

Finally, the revenue impact. In order to be fiscally responsible we must estimate that all tax cuts carry a cost in terms of forgone revenues and the need to be paid up front. Failure to do so would be irresponsible, and that would certainly balloon the Federal budget deficit.

With that in mind, our proposal is carefully crafted to give a maximum bang for the buck. By targeting the cut to investment in American manufacturing, the legislation provides tax relief to those investors who are willing to make an explicit contribution to increase economic growth and employment. This significantly reduces

the fiscal impact of the cut while still achieving the desired objective.

In short, our capital gains tax cut will address the problems of long-term capital availability that the manufacturing sector faces. Targeting the cut to manufacturing investment reduces the cost to the Federal Treasury and will give manufacturers the ability to better plan for and carry out modernization activities which ultimately increase U.S. competitiveness and job creation. Our proposal is also crafted to address the issue of tax fairness by generating and saving jobs, and encouraging spinoff of economic activity.

Thank you, Mr. Chairman, for the opportunity to testify today. I look forward as well to working with members of the committee.

[The prepared statement follows:]

Statement of the Honorable Marty Meehan
5th District of Massachusetts
U.S. House of Representatives

Before the House Ways and Means Committee
January 10, 1995

Mr. Chairman, thank you for the opportunity to testify before the committee today.

Two years ago, Mr. Franks and I launched the Northeast-Midwest Congressional Coalition Manufacturing Task Force because we believe the U.S. and global economies are experiencing rapid and fundamental economic change. To effectively compete in this new global economy, we believe U.S. workers and companies must have the necessary training and resources available if they are to thrive in the ever changing economic environment.

The Fifth District in Massachusetts, my district, is an excellent example of the type of rapid economic change the U.S. economy faces. The Massachusetts Miracle was, in many ways, the result of tremendous worldwide demand for mid-range computer systems that were at the leading edge of technology from the mid-1970s until the mid-1980s. These systems were developed and produced in Massachusetts by such companies as Digital Equipment Corporation, Wang Laboratories and Data General Corporation. However, in the 1990's, these large global systems companies have experienced great difficulty because their products have become technologically obsolete. The result has been the loss of tens of thousands of jobs, tremendous pain for workers and their families and real problems for the Massachusetts economy.

Much of the new technology that made the mid-range computers outdated, is the result of tremendous advances in semiconductor technology that has given us much smaller personal computers. Interestingly enough, large numbers of these small computers are now linked together via local area and wide area networks. Many key components for these networks have been developed and produced by many Massachusetts companies that have risen out of the ashes of the fallen industry leaders. Companies such as Bay Networks, Chipcom and Powersoft are leading the worldwide effort to develop networking technology from their home offices in Massachusetts' Fifth Congressional District. This development activity is a key part of worldwide information technology, including the development of the so-called "information superhighway."

This revival of the Massachusetts economy has been driven by the entrepreneurial spirit and risk-taking attitudes of the worker, managers and owners of a new class of companies. Federal policy should do all that is necessary to create an economic environment in which such companies can adapt, thrive, grow and continue to successfully create new jobs. If the "information superhighway" is to become a reality -- and it is by no means certain -- two ingredients are required; a tremendous capital investment and a desire to take on a high degree of risk.

Mr. Chairman, there are three actions that Congress can take to increase the chances of success of our workers, managers and companies in this new technology driven, knowledge intensive world.

* First, we need to achieve a balanced federal budget by continuing to reduce the

deficit. The federal government's continued heavy demands in the global credit market makes it more expensive for private sector borrowers to raise the capital needed for future growth.

* Second, we need to encourage households and businesses to increase their savings so as to expand the funds available for investment in companies and jobs of the future. Most economists believe that 80% of a country's investment funds comes from its own savings.

* Third, if the technologies of the future are to be successfully developed, we need to encourage our workers and companies to take on increased, but prudent, levels of risk.

Mr. Franks and I believe that to achieve these policy objectives, Congress needs to consider making substantial changes to current tax law. As it is written today, many provisions in current tax law not only do not encourage savings, investment and risk-taking but, in fact, may discourage those activities which have resulted in reduced levels of employment and slower economic growth.

Closing tax loopholes that unfairly enrich one group at the expense of another -- usually lower income groups -- is a worthwhile policy objective. However, as a result of the Tax Reform Act of 1986, current tax law fails to distinguish between those economic activities that are productive and to be encouraged and those that are unproductive and only benefit a wealthy few. It is the productive activity, such as investment in the manufacturing sector, that tax law should encourage.

By shifting the tax burden toward business income and away from personal income, the 1986 act implicitly created incentives in favor of consumption and away from investment. In other words, the act created incentives, ironically, away from building for the future and toward consumption today. In an imperfect world of second best solutions, tax policy that favors investments in productive capital may be a necessary incentive for the manufacturing sector.

During the last two years, the Manufacturing Task Force held field hearings to look at several options for what would be the most efficient means of spurring long term capital formation. Based on those hearings, we concluded that a carefully crafted capital gains rate reduction, was most efficient in that it will result in increases in savings, investment and risk taking and has the potential to increase revenue in the long term.

The Task Force's proposal calls for the establishment of a targeted long term capital gains tax rate cut: to 23.5 percent for productive assets held for three years or longer; for assets held six years or more, the rate would drop to 19 percent. The cut would be aimed at investments in manufacturing. We believe this proposal offers several key advantages.

First, a conditioned rate cut based on patient investment will discourage short-term speculative buying and selling of assets, a pattern that runs counter to the capital needs of manufacturers. Such a cut provides an incentive for manufacturers to carry out long-range planning and investments -- essential if they are to modernize, develop new product lines, or expand production.

Second, it only provides favorable treatment to productive assets, and excludes assets such as art and antiquities. Tax policy should only be more favorable for taxpayers who make an explicit contribution to economic growth and employment.

Third, the two-tiered approach serves as a good middle ground, able to capture the advantages that a capital gains rate cut would have for both spurring investment and encouraging patient capital.

Finally, the revenue impact. In order to be fiscally responsible, it is important to estimate that all tax cuts carry a cost, in terms of foregone revenues, and need to be paid for up front.

Failure to do so would be irresponsible, and would almost certainly balloon the deficit.

With that in mind, the Task Force's proposal is carefully crafted to give a maximum bang for the buck. By targeting the cut to investment in manufacturing, the legislation provides tax relief to those investors that make an explicit contribution to increases in economic growth and employment. This significantly reduces the fiscal impact of the cut while still achieving the desired objective.

In short, the Task Force's capital gains tax proposal will help address the problems of long-term capital availability that the manufacturing sector faces. Targeting the cut to manufacturing investment reduces the cost to the federal Treasury, and will give manufacturers the ability to better plan for and carry out modernization activities, which ultimately increases U.S. competitiveness and job creation. The Task Force proposal is also crafted to address the issue of tax fairness by generating and saving jobs and encouraging the spin-off of economic activity.

Thank you, Mr. Chairman for the opportunity to testify today. I look forward to working with you and the Committee.

Mr. CRANE. Thank you for your testimony, Mr. Meehan.

Are there any members of the committee who have questions or comments to direct to this panel?

Mr. RANGEL. Mr. Chairman.

Mr. CRANE. Yes.

Mr. RANGEL. Ms. Woolsey and Ms. Norton, I am sorry that Representative Sanders has left, but clearly we don't have the votes to make any substantial changes in what the majority is attempting to do with the welfare bill. And clearly popular opinion appears to be on their side because of the frustration that people feel about a system that is not working.

I do think that we have a wonderful opportunity to bring more equity, more job opportunity, more investment in human beings to the board because it is not inconsistent with anything that they believe, even though it is not stressed in the Contract.

Congressman Ford has agreed to head up an ad hoc committee to see whether Members such as yourselves, Mr. Sanders, and others might want to bring their ideas to the table since he doesn't enjoy the luxury of subpoena and holding hearings any longer.

But my question is, am I missing something when I speak about the silence of the churches and the synagogues and the temples on this issue? It just seems to me that there is no spiritual theory that does not concern itself with one's obligation to help those who can least help themselves.

And in New York Cardinal O'Connor spoke out against the mayor cutting off the soup lines, an initiative I might add that was started, and continues, by the nuns as opposed to the priests, but that was headlines in the New York papers, that my cardinal has spoken out to maintain soup lines.

Am I missing something, Congresswoman Norton? Are the churches far more vocal than I think they are?

Ms. NORTON. Mr. Chairman, to its great credit, the Catholic church has spoken out in opposition to major aspects of the bill that is before you. For example, the church is against putting people off welfare who are doing all they can in terms of working, even if it is a public service job.

Mr. RANGEL. It is interesting that you would say that because it is clear that the social service parts of Catholic charity have and continue to do a fantastic job in all of our legislative bodies, especially here in Washington, but they never seem to set the moral tone for fellow Catholics. It seems as though we deal with the mechanics, we deal with the legislation and try to improve it, but where public opinion is involved, I just don't hear the voices of the cardinals throughout this country. I don't mean to single out my church, of course. I am talking about the Board of Rabbis, the Protestant Council and whatever religions are there.

Ms. NORTON. Mr. Chairman, I do believe that this criticism comes from the bishops themselves and not simply from Catholic charities. I believe this is the position of the church.

I believe what we are going to experience is a terrible delayed reaction. When the fallout occurs, everybody is going to come running to the Congress saying, "How could you let this happen"?

That is why my approach has been not to offer a counterproposal, and not to say do it our way. I certainly accept what you have said,

that we don't have the votes to do that, but to challenge the committee to make its own proposals work. And I don't think you make your proposals work if you think you are going to get people in Harlem off the welfare rolls in 2 years if there are no jobs.

So you have to think just a little deeper, and one of the ways to do so—and I offered a concrete suggestion—is to allow part-time jobs to serve as supplements to those jobs, for example. But if all you say is you are on your own after 2 years, you are going to have a giant catastrophe and you will have the Catholic church, all the rabbis, every church and lots of Americans coming in and berating us for not having seen in advance that there would be these vast, unintended consequences.

Mr. RANGEL. But—no one challenges the hard work that you are doing, but it is clear that the majority has a contract, they have something. And it is clear that President Clinton at this point has nothing. And you and I are trying to see whether or not we can bring some equity out of what they declare as a mandate.

It would seem to me that if we could meet and to bring public opinion—I mean, one of the solutions offered by the Speaker is Boys Town. Well, you know, I would like to know, who is running Boys Town today? It was a Catholic institution. Do they think it makes any sense at all?

Ms. WOOLSEY. Mr. Rangel.

Mr. RANGEL. But we are going to meet and we would hope that you would entertain meeting because we are going to need more than concrete ideas to shift this program from where it is located today, and we are going to need a lot of help. And I don't think we can wait until there is maximum pain because they are sending enough signals now that they are not taking any prisoners, that popular opinion is with them, and they are going to go ahead and move forward.

So the least we can do is to bring in as many moral forces as we can to do what you are saying, and that is let's take a look at this. Let's see whether it is going to work. And if it can't work, let us make some solutions to reform the system with you.

Thank you so much, both of you, and all of you, of course, but especially in this area.

Mr. CRANE. Are there any other questions by members of the committee?

If not, we thank you all for your testimony.

And at this point I would like to invite up to the dais Mr. Smith of Michigan, Mr. Largent of Oklahoma and Mrs. Roukema from New Jersey. It is our procedure for ladies to go first.

STATEMENT OF HON. MARGE ROUKEMA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mrs. ROUKEMA. Oh, thank you. I accept, Mr. Chairman.

Certainly I wanted to congratulate you and certainly Mr. Archer, the chairman of the full committee, for your well-deserved promotion to the positions that you hold today. As a fellow Republican, I congratulate you and must acknowledge that we in the party and the Congress as a whole have a historic opportunity to demonstrate our commitment to the constructive change that we have pledged. And certainly we are all wanting to work together for a more effec-

tive and efficient government, and I certainly thank you for having these hearings and holding them so promptly.

Mr. RANGEL. Mr. Chairman, you should know that she said the same thing to me when I was chairman.

Mrs. ROUKEMA. Did I, Mr. Rangel? You see how right I was. I was right then, and I am right now. Thank you.

Mr. CRANE. Thank you.

Mrs. ROUKEMA. Mr. Chairman, I would suggest that as we are going in this overview on the Contract With America I would like to concentrate my remarks today on the welfare system and that particular part of it as well that deals with child support enforcement.

Unfortunately, this debate has focused, at least in the popular press, almost exclusively on the single issue of orphanages or settlement houses or group homes, youth hostels, whatever you choose to call them, but I suggest that we have to resolve to end this war of words today and that we—Conservatives, Moderates and Liberals alike—must acknowledge that our welfare system is out of control and needs essential reform.

Clearly, what outrages the American taxpayers most completely is the conviction that the welfare system is a failure. Not only is it wasting hard-earned taxpayers' dollars, but it has created and is fostering, in my opinion, unhealthy, unproductive and dysfunctional families that sentence children to a lifetime of extreme economic, social and emotional deprivation.

Clearly, the children are the victims here. In reinventing the welfare system we must address both the short-term and the long-term problems of these children. Youth hostels and group homes—orphanages, if you will—should be an element of reform. But the costs will be significant whether we absorb them at the Federal or at the State level.

Ultimately, however, the Americans and the Congress will not countenance children being raised in abusive, drug-infested households or going hungry in the streets. Therefore, we must begin a serious debate now, not an unproductive war of words.

One aspect of our current welfare system that has attracted a lot of controversy is the fact that welfare recipients can automatically receive additional, higher benefits when they have more children. In some cases, this amounts to a perverse incentive for beneficiaries to remain on welfare and have more children, instead of taking responsibility for them and their families getting off welfare.

A few years ago, the New Jersey State Legislature under the then Democratic Governor and with the cooperation of Republican legislature concluded that the welfare program was simply subsidizing unwed mothers and out-of-wedlock births and that strong corrective action was necessary. The State began denying AFDC benefits for new children in August 1993. The preliminary results for this new initiative during its first 12 months indicate that births to AFDC recipients have been reduced by more than 10 percent. It is too early to precisely determine what caused this reduction, but it is an encouraging sign nonetheless.

On the Federal level, I feel that we must follow this example and prohibit any automatic increase in AFDC benefits to mothers already in the program who have additional children. At the same

time, the committee should ensure that women on AFDC who have additional children can earn higher amounts of AFDC benefits by working without jeopardizing their current benefits. I am sure that will be a central part of the ongoing debate.

For decades, States have required that children entering the school system be properly immunized and vaccinated. Mr. Chairman, I am not going to spend time on this. In the interest of time I am just going to point out that I believe that as preventive medicine it is essential that we put it as a requirement for continuing AFDC benefits that families have their children immunized, using the medical protocol which is within the first 2 years. It is done for school entrance. It has been for generations. I think we should now apply it as a condition for welfare qualifications.

I won't go into the expansion of the JOBS program. It is in my written statement. But I would like to go on to the question of block granting welfare and giving the States more flexibility since that has been in the press lately with respect to the Republican Governors' Conference.

Mr. Chairman, am I already out of time? I haven't gotten to my point on child support enforcement.

Mr. CRANE. Well, continue with your point on child support. And anything in anyone's comments that is not presented, if it is in writing it will become a part of the record, too.

Mrs. ROUKEMA. Let me just summarize the child support enforcement portion of this since that is, I feel, the essential component of any welfare reform bill, and it is one that the U.S. Commission on Child Support, on which I served, their report formed the basis of my recommendations.

I think Congress has been working for more than 10 years on this subject, and it has finally come time for us to enforce and close any existing loopholes that Congress never intended, including the national system, including going in for direct service into States where a willful child support avoider is employed in another State. Now we would like to circumvent that State bureaucracy since they are not being as cooperative as they should be and go direct—with direct service to garnish the wages of the willful violator in the next State.

I believe we have already made a good start on the subject of criminal penalties. We have already established that interstate, and we should now apply it within the State. For willful child support avoidance there should be criminal penalties.

The one area where there has been some discussion and probably not as much controversy as you might have thought was the requirement to establish paternity at the hospital at the time of birth. This was not something that I necessarily would have concluded, but the Commission has concluded that it is an essential component, and that is that if the woman does not cooperate in establishing paternity at birth in the hospital, then she will not qualify for cash support.

I think this is an essential element. It has been shown by the Commission studies that in areas where there have been demonstration projects that it has worked very well. In some cases up to 80 percent of nonmarried parents have been identified as with fathers, and the fathers have been made to accept the personal re-

sponsibility for those children, and it has a direct impact on reducing the numbers of families on welfare. Women who do not cooperate under this program would not qualify for welfare.

On the subject of willful child support avoidance, we have the example of a State like Maine where in our legislation we have followed what Maine has done and made withholding of drivers' licenses and other professional licenses a penalty for willful avoidance of child support.

The State of Maine has had a remarkable experience in proving the fact that as soon as there is a penalty involved the money strangely appears, so in this legislation I am recommending that we include that penalty for occupational licenses and withholding drivers' licenses as one of them. It will greatly enhance the collection.

Mr. Chairman, I know we are out of time now, but I want to suggest to you that while we are talking about the Contract With America we recognize that this Contract is well on its way to being accepted. This problem of child support enforcement has long been festering, and there is no need for us to delay any longer. We should take this opportunity for the historic change, the saving of taxpayers' dollars, more efficiency, and by all means we are caring for the children who have suffered the greatest disadvantage. The Contract With America should be the vehicle for this comprehensive child support enforcement reform. No more talk. Now we need action.

[The prepared statement follows:]

Statement of
The Honorable Marge Roukema
before the
House Ways and Means Committee
January 10, 1995

Before starting my testimony, I would first like to congratulate my distinguished colleague from Texas -- Bill Archer -- on his well-deserved promotion to the chair of the House Ways and Means Committee.

Mr. Chairman, you have waited many years for this exciting opportunity and we are all supremely confident that you are up to the task of leading the Committee during the 104th Congress.

Also, I want to thank you, Mr. Chairman, for so quickly organizing the Committee and holding hearings on those legislative measures found in the our "Contract with America".

The people of the United States have given the Republican Party a historic opportunity to demonstrate our commitment to constructive change -- a change to more effective and efficient governance. These hearings represent the first step in what is sure to be a long and difficult process of fulfilling this commitment. I, for one, welcome the challenge.

This hearing has been designated as an "overview" on the "Contract with America." I'd like to begin my testimony by focusing on the urgent need to reform our nation's welfare system.

DSYFUNCTIONAL SYSTEM

Unfortunately, this debate recently has focused almost exclusively on a single issue -- "orphanages" or "settlement houses" or "group homes" or "youth hostels". Whatever you want to call them -- we must resolve to end this "war of words" today. We (conservatives, moderates and liberals alike) must acknowledge that our welfare system is out of control.

Clearly, what outrages American taxpayers most completely is the conviction that the welfare system is an unmitigated failure. Not only is it wasting hard-earned taxpayers dollars, but it has created -- and is fostering -- unhealthy, unproductive dysfunctional families that sentence children to a lifetime of extreme economic, social and emotional deprivation.

Clearly, the children are the victims!!! In re-inventing the welfare system, we must address the short-term and long-term problems of the children. Youth hostels and group homes (orphanages if you will) should be an element of reform. But the costs will be significant whether absorbed at the federal or the state level.

Ultimately, however, Americans and the Congress will not countenance children being raised is abusive, drug-infested households or going hungry in the streets. We must begin a serious debate -- not a unproductive "war of words!!"

Denial of Higher AFDC Benefits for Additional Children

One aspect of our current welfare system that has attracted a lot of controversy is the fact that welfare recipients can automatically receive additional, higher benefits

when they have more children. In some cases, this amounts to a perverse incentive for beneficiaries to remain on welfare and have more children, instead of taking responsibility for themselves and their families and getting off welfare.

A few years ago, the New Jersey State Legislature and then Governor Florio concluded that the welfare program back then was simply subsidizing unwed mothers and out-of-wedlock births, and that strong, corrective action was necessary. The State began denying AFDC recipients higher benefits for new children in August of 1993, and the preliminary results for this new initiative during its first twelve months indicate that births to AFDC recipients have been reduced by a little more than 10 percent. It is too early to precisely determine what caused this reduction, but the fact remains that this is an encouraging signal nonetheless.

On the federal level, we must follow this example and prohibit any automatic increase in AFDC benefits to mothers, already in the program, who have additional children. At the same time, the Committee should ensure that women on AFDC, who have additional children, can earn a higher amount of AFDC benefits by working without jeopardizing their current benefits. This second provision balances the desire to encourage AFDC recipients to earn their way off of welfare with the intent of not simply rewarding beneficiaries when they have more children by giving them more money.

Preventive Health Care and Immunization Requirements

For decades, States have required that children entering the school system be properly immunized and vaccinated. The record is clear: when we require immunization and vaccination as a condition of attending school, and tell parents that their children can't start classes without them, they do the right thing: they children make sure that kids get their shots!

Regrettably, either through ignorance or apathy, many parents in the welfare program today are failing to get their children immunized and vaccinated, making these children the real victims.

We must require parents to have their children properly immunized and up-to-date on their vaccinations in order to qualify for AFDC, WIC or Food Stamp benefits. State compliance with this requirement should be mandatory, not optional. Also, any day care and child care center that receives federal monies must be required to certify that these same immunization and vaccination standards have been met before enrolling any given child.

In 1992, six children died in New Jersey from an outbreak of the measles. It's a national disgrace that today -- just five years from the 21st century -- the United States (the world's most advanced country with the best medical care available) ranks down there with many Third World bloc countries when it comes to immunization and vaccination standards.

Immunizations and vaccinations are preventive medicine. Extensive medical and scientific evidence demonstrates that every dollar invested in childhood immunization saves ten dollars in future health care costs. There is no reason why AFDC, WIC or Food Stamp recipients should not have their children properly immunized, particularly when free -- or discounted -- immunizations and vaccinations are widely available in many communities.

Expand the JOBS workfare Program

There is widespread agreement amongst those who have studied the welfare system that we must significantly improve our efforts to assist and encourage AFDC recipients earning their way off of welfare and becoming productive, self-sufficient members of society.

We could establish mandatory, enhanced levels of participation in the JOBS workfare program for the States. For example, States could be required to have at least 25-30 percent of their AFDC recipients participating in the JOBS workfare program in the short-term, with these requirements gradually increasing up to 90-100 percent participation in the long-term.

In order to encourage States to meet these requirements, the federal government could reduce the amount of its contribution to a State's AFDC program by a certain amount, say 5 or 10% initially, with higher penalties being levied against States that repeatedly fail to meet these new federal requirements.

Block Granting Welfare Can Give States More Flexibility:

In recent days, there has been considerable speculation in the news media about ongoing negotiations between Republican Governors and Members of Congress about making welfare a block grant program. Essentially, these discussions revolve around the idea of taking many different federal programs, with their myriad of conflicting rules and regulations, and instead simply giving States a block grant of funds with some basic federal guidelines, and allowing States the flexibility to implement the welfare program they think suits their needs.

While I believe that this idea has considerable merit, I want to be clear about my thoughts on a related topic. Some have suggested that welfare programs should be changed from the entitlement segment of the federal budget to the discretionary portion.

I have very strong reservations about proposals of this nature. I state categorically: Children must not go hungry! If ensuring that children do not go hungry means welfare remains an entitlement program, so be it.

Strong Child Support Enforcement Reform is Welfare Prevention:

The second topic I would like to testify about is one which many members of this Committee have heard me talk about repeatedly in recent years: Effective reform of our Child Support Enforcement laws must be an integral component of any welfare reform proposal that the 104th Congress sends to President Clinton.

Both Republicans and Democrats may have vastly different ideas as to how we should be reforming welfare system, but most readily agree that Child Support Enforcement reform must be a critical component of any successful welfare reform proposal.

Make no mistake about it: effective Child Support Enforcement is welfare prevention. And a tough, comprehensive Child Support Enforcement title is a central and critical element to any effective welfare reform proposal. Non-support of children by their parents is one of the primary reasons that so many families end up on the welfare rolls in the first place.

Children who are deprived of the support to which they are entitled face a lifetime

of economic, social and emotional deprivation. It's a national disgrace that our child support enforcement system continues to allow so many parents who can afford to pay for their children's support to shirk these obligations.

Finally, we must be clear. Failure to pay court-ordered child support is not a "victimless crime". The children going without these payments are the first victims. But American taxpayers are the ultimate victim, when they have to pick up the welfare tab for the deadbeat parents who evade their financial obligations.

As many members of the Committee recall, in 1994 I worked with a bi-partisan coalition of House members who tried to decouple Child Support Enforcement reform legislation from the Clinton Welfare Reform plan. Last summer, the Caucus on Women's Issues developed an omnibus package of Child Support Enforcement reforms (H.R. 4570), which we asked the bi-partisan leadership of the House to move separately from more controversial welfare reform legislation. Regrettably, the majority leadership of the 103rd Congress was unable to uphold their end of the agreement, and the Congress adjourned without acting on this serious problem. Child Support Enforcement reform legislation died without ever having even been brought to the floor of the House for a vote.

I am very, very pleased to see that new House leadership, both Speaker Gingrich and Majority Leader Armey, have made both welfare reform and Child Support Enforcement reform legislation items that **will receive action in the U.S. House of Representatives within our first 100 Days of session.** While there are a few modest Child Support Enforcement provisions in the Contract's Family Reinforcement Act, I support a much more comprehensive legislative solution to this serious problem. I look forward to being a part of the coalition that fulfills this solemn promise to the American people as this legislation moves through the 104th Congress.

The Caucus's legislation, (H.R. 4570, the Child Support Responsibility Act of 1994) represented a comprehensive reform of our child support enforcement system based largely on legislation I previously introduced, H.R. 1600, which in turn was drawn from the recommendations of the U.S. Commission on Interstate Child Support Enforcement.

U.S. Commission on Interstate Child Support:

As the Ways and Means Committee examines these recommendations, it may be useful to provide some background as to the nature, membership and report of the Commission.

I have long been a leading voice in this debate, on both the Child Support Enforcement Amendments of 1984, and the Family Support Act of 1988. Along with my colleague Mrs. Kennelly, and Senator Bill Bradley, I served as a member of the U.S. Commission on Interstate Child Support Enforcement.

The Commission was composed of experts in all areas of child support enforcement: family law judges and attorneys, state and local officials, caseworkers, and of course, parents and child support advocates. Our Commission was charged with a comprehensive review and report of recommendations for reform of our interstate child support system, which was completed in August of 1992.

Perhaps the most important fact revealed in the Commission's report was that our interstate child support system is only as good as its weakest link. States that have

made child support a priority, and adopted aggressive reforms, are penalized by those states which have failed to reciprocate.

Or, as one of my county sheriffs told me, we will never be able to get parents to meet their child support obligations when they can "skip across" the Delaware or Hudson river into a neighboring state (PA or NY) to avoid payment.

That is precisely why we need comprehensive federal reform of our child support system -- to ensure that all states come up to the HIGHEST common denominator, not sink to the LOWEST common denominator as has happened all to frequently in the past.

Among the most important and effective "get tough" reforms that I have endorsed, and which must be included in either the Personal Responsibility Act, or the Family Reinforcement Act include:

Enhanced Hospital-based Paternity Establishment Programs:

Although the Clinton tax package of 1993 contained some provisions mandating comprehensive hospital-based paternity establishment programs, we may need to take further action. The alarming rise in single-parent families should give every one of us reason to act now. The most recent studies demonstrate the shocking rise in out-of-wedlock births, most prevalent in low-income populations, and across all ethnic groups. Without fail, every report we have seen on this subject documents the social and economic consequences to children raised without the support of both parents. It is well-documented and well-known.

This fact alone makes clear that the most crucial element for the establishment and collection of court-ordered child support must be paternity establishment.

The U.S. Commission in its report indicated that the one time when we are most able to obtain fathers' acknowledgment of paternity is at birth, in the hospital. The Commission estimated that more than **80%** of non-married parents are in contact with one another at the time of the child's birth. States that have emphasized outreach at hospitals and birthing centers have been particularly successful in increasing parentage determinations.

Comprehensive, hospital-based paternity establishment programs should build on that premise, and require all hospitals to have clear, simple and uniform procedures for parents to acknowledge paternity at birth. Moreover, we need to shift the burden of proof so that parents who have acknowledged paternity at birth cannot turn around when a support order comes and say "prove it".

Require States to Criminalize Failure to Pay Child Support

We must require all States to make it a crime to willfully fail to pay child support, and provide criminal penalties for 'deadbeat parents'. The federal government has wisely adopted federal criminal penalties for those who cross interstate lines to avoid child support. States should be held to the same standard, and use criminal penalties for those who choose not to pay.

Withhold Drivers' & Occupational Licenses for Deadbeat Parents

In our efforts to address some of the important gaps in our present system: require States to withhold drivers' and occupational licenses from "deadbeat parents". This

has already shown very promising results in those states which have adopted it. For example, the State of Maine reports that in the first year of its program, more than $11 million in back child support were collected under these sanctions. By applying such proven methods on a federal level, we ensure that all States rise to the level of the best, rather than sink to the worst.

Increase Credit Reporting Efforts and Wage Garnishment

Increases the use of credit reporting and garnishment; and require uniform, national subpoenas to simplify burdensome paperwork requirements. We must improve and expand the national reporting of all support orders, and the computer data base of outstanding child support obligations.

The importance of this federal locator network cannot be understated. In fact, my own State of New Jersey, is using its computerized database of automobile registration to take aggressive action against auto scofflaws, intercepting tax refunds and garnishing paychecks.

Frankly, if we can find the resources and find a way to crack down on automobile fines, I would hope we would find the same resources to help parents get their court-ordered child support! In the past we have been told that problems in child support collection are a function of overwhelming caseloads and limited resources. Well, if we can find a way to put a lien on someone's house for a parking ticket, we ought to be able to use the same sanctions when they fail to pay child support.

Improving the federal data network on child support arrearage gives us the tool to put these tax intercepts, rebate refunds, and property liens to their fullest use!

Allow States to Serve Child Support Orders on Out-of-State Employers

We must change the law to definitively allow States to serve child support orders on out-of-state employers. This was clearly the intent of Congress when we adopted mandatory wage withholding for new child support orders. Unfortunately, the various levels of state bureacracy still make wage withholding unnecessarily complex and cumbersome. We must streamlines this process, and removes levels of bureaucracy from the child support collection process in order to allow wage withholding to work simply and effectively.

As the U.S. Commission noted, this "direct service" is one of the most successful methods of child support enforcement available, with success rates of 80% and more when used.

Prohibit the Federal Government from Aiding & Abetting Deadbeat Parents

Finally, we must adopt a pioneering reform that addresses the role of the federal government as an employer. We should prohibit the federal government from employing, paying benefits, or making loans to "deadbeat" parents!

We need to prohibit the federal government from "aiding and abetting" deadbeat parents who have failed to make court-ordered payments. The federal government should refrain from providing assistance to a "deadbeat parent" who owes more than $1,000 in back child support, and is making no court-arranged effort to repay the arrearage.

That we would refuse to subsidize the behavior of deadbeats would seem simple logic. Unfortunately, under current law, no such arrangement exists. Without such a safeguard, the government can and will continue to provide financial assistance and loans to a parent, without corresponding responsibility for court-ordered payment.

So "the left hand" of government can be paying taxpayer dollars in welfare to a single parent trying to raise children without court-ordered child support, while the "right hand" is providing deadbeats with a college loan or a government-backed mortgage! This may be the most classic example of "waste, fraud, and abuse" we find in the welfare debate, and we must end it here and now.

Establish a National Child Support Withholding Form for New Employees

One final point: as of January 1, 1994, all new child support orders are being delivered through employer-based wage withholding. We should create a national child support "withholding form" for new hires, and improve the computerized federal database for tracking child support orders. In short, our system makes employers a pivotal part of the child support collection process -- it is only right that the federal government, in its role as employer to millions, meet its responsibilities in this important area just as private employers must now do.

Again, I thank Chairman Archer and the Committee for providing me with this opportunity to share with you my thoughts about the need to reform our welfare system, as well as improve the nature of our Child Support Enforcement problem, and the solutions that I believe we must enact.

At this point in time, I'd be more than happy to answer any questions that the Committee's members might have.

Mr. CRANE. Thank you, Mrs. Roukema.
Now Mr. Smith.

STATEMENT OF HON. NICK SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. SMITH OF MICHIGAN. Mr. Chairman, thank you very much.

Two years ago, during rescission, I was here suggesting that we need some way to stimulate business investment in this country, and I am here to encourage your consideration of what has been called neutral cost recovery that stimulates investment.

Business investment creates jobs and increases wages for American workers by raising our Nation's productivity. Simply put, it encourages businesses to put tools in the hands of our workers so that they can increase their efficiency.

It seems to me that the way we are going to put the tools in the hands of workers is not to penalize those businesses that decide to make investments in that machinery and equipment and have a tax policy that fairly taxes the real return on capital, in this case a return that neutralizes the loss from inflation and the time value of money.

In order to encourage businesses to invest in machinery and equipment, we need to stop penalizing businesses that make that investment. In other words, we should allow businesses to deduct the cost of equipment in the year of purchase or deduct an equivalent value in the outyears through depreciation.

It seems that we need to increase equipment purchases because by doing that, we will ultimately increase the productivity of labor, and raise wages. If we in this Congress can't figure out a way to leave a strong economy with good jobs to our kids and grandkids, then probably we should be going home and finding somebody who can.

Indexing depreciation, like capital gains indexing, makes sense and will increase the Nation's capital stock and add to the long-run growth of gross domestic product. While a capital gains tax cut will increase economic growth, it is not the only solution to encouraging business investment in new machinery and equipment that is going to increase our productivity and our competitiveness with a very strong world market.

Neutral cost recovery, which I introduced 2 years ago as H.R. 539 with 80 bipartisan cosponsors, was introduced on the first day of session this year as H.R. 199. This proposal has been endorsed by leading business organizations: The U.S. Chamber of Commerce, the NFIB, the National Federation of Independent Businesses, and the National Business Owners Association. These groups, I think, understand that we need to change our tax law to be fair and to have a tax law that is competitive with other countries of the world that now treat their businesses more favorably to encourage investment in machinery and equipment and facilities.

Mr. Chairman, members of the committee, we discourage capital investment in this country because we penalize those businesses that make that investment. We penalize them by not allowing them to consider that purchase of a machine or that equipment or facility as a business expense.

Under this bill, businesses would be allowed to expense or deduct the first $25,000 of capital investment. That is $17,500 now. This would raise it to $25,000. It would also index other depreciation to inflation and the time value of money. Neutral cost recovery would be an optional depreciation method. Existing forms of depreciation would remain available. By passing this legislation and reducing the cost of machinery and equipment, businesses would be encouraged to purchase more capital, and we would increase economic activity.

I just left a hearing in our Budget Committee with Alan Greenspan. We asked Mr. Greenspan, if you have a proposal like neutral cost recovery, that the Treasury later today is going to say costs tens of billions of dollars, and you have other estimators that say it is going to increase economic activity, how do you evaluate that proposal?

His reaction was, maybe it is not going to be that easy to change how we score these different tax proposals, but if it is fair and if it is going to increase economic growth and the potential for jobs, then we should pass it.

I would just like to say that, in contrast to what I expect Treasury to claim on the cost of this specific proposal, according to an independent study by Gary Robbins, who is a former Treasury estimator, neutral cost recovery would have several benefits.

It would reduce the cost of equipment by 16 percent. The guess is—and I have charts in my written testimony that show this—it is going to create an additional 2.7 million new jobs, and increase annual take-home pay by $3,300 over the next 5 years.

Robbins also estimated an additional $3.5 trillion in economic activity, bringing in billions of dollars to the U.S. Treasury. That is in contrast to static scoring which would suggest that it is actually going to cost the government less.

Mr. Chairman, I think it is important to note that over the last 20 years the United States has trailed most of our industrialized competitors in capital investment per worker, in part because they have more favorable tax policies. In our post cold war economy, other countries are doing everything they can to attract business investment. Obviously, the United States no longer has a monopoly attracting investment.

Countries with tax laws that encourage investment give themselves an advantage in attracting capital. For example, over the last 20 years U.S. investment growth in plants and equipment has been only half that of Japan and Canada.

We must recognize that we have to compete for capital investment. A study done by the American Council on Capital Formation found that U.S. corporate tax depreciation rules put us at a strong disadvantage because our competitors in other countries have much more favorable tax treatment.

In conclusion, I think it is important that we investigate this, not only because it is fair but because other countries are doing a better job of encouraging business investment. If we believe that investment in new machinery and equipment is going to increase our productivity and our competitiveness in the world market, then it seems important that we move ahead.

[The prepared statement and attachment follow:]

NICK SMITH, MEMBER OF CONGRESS
Testimony on Neutral Cost Recovery before the House Ways and Means Committee
January 10, 1995

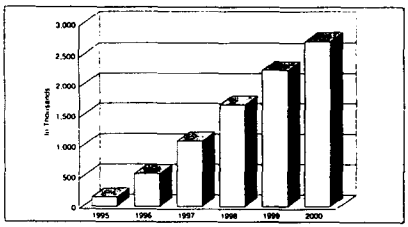
MR. CHAIRMAN...MEMBERS OF THE WAYS AND MEANS COMMITTEE, I AM HERE TODAY TO TESTIFY IN SUPPORT OF THE NEUTRAL COST RECOVERY ACT WHICH IS PART OF THE JOB CREATION AND WAGE ENHANCEMENT ACT IN THE CONTRACT WITH AMERICA.

INVESTMENT CREATES JOBS AND INCREASES WAGES FOR AMERICAN WORKERS BY RAISING OUR NATION'S PRODUCTIVITY GROWTH. WE CAN ACCOMPLISH THIS BY ENCOURAGING SAVINGS AND INVESTMENT THROUGH A TAX POLICY THAT TAXES THE REAL RETURN TO CAPITAL, THAT IS THE RETURN IN EXCESS OF INFLATION. IN ORDER TO ENCOURAGE BUSINESSES TO INVEST IN MACHINERY AND EQUIPMENT, WE NEED TO ALLOW BUSINESSES TO TREAT THEIR CAPITAL ACQUISITIONS AS BUSINESS EXPENSES. IN OTHER WORDS, WE SHOULD ALLOW BUSINESSES TO DEDUCT THE COST OF EQUIPMENT AS AN EXPENSE WHEN DETERMINING TAXABLE INCOME. THIS WILL INCREASE THE PRODUCTIVITY OF LABOR AND RAISE WAGES, AS WELL AS INCREASE OUR INTERNATIONAL COMPETITIVENESS. INDEXING DEPRECIATION, LIKE CAPITAL GAINS INDEXATION, MAKES SENSE AND WILL INCREASE THE NATION'S CAPITAL STOCK AND ADD TO THE LONG RUN GROWTH OF GROSS DOMESTIC PRODUCT.

NEUTRAL COST RECOVERY, WHICH I INTRODUCED IN THE LAST CONGRESS AS H.R. 539, AND IN THE 104TH CONGRESS, AS H.R. 199, HAS BEEN ENDORSED BY LEADING BUSINESS ORGANIZATIONS: THE U.S. CHAMBER OF COMMERCE, THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS, AND BY THE NATIONAL BUSINESS OWNERS' ASSOCIATION. THESE GROUPS UNDERSTAND THAT OUR CURRENT TAX TREATMENT FOR EQUIPMENT, MACHINERY, AND FACILITIES IS NOT FAIR AND PUTS OUR BUSINESSES AT A COMPETITIVE DISADVANTAGE WITH OTHER COUNTRIES. MOST ECONOMISTS AGREE THAT ENCOURAGING CAPITAL INVESTMENT IS KEY TO ECONOMIC AND JOB EXPANSION. MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, WE DISCOURAGE BUSINESS CAPITAL INVESTMENT BECAUSE WE DON'T ALLOW THOSE PURCHASES TO BE CONSIDERED A BUSINESS EXPENSE. IN OTHER WORDS, BY REQUIRING BUSINESSES TO WAIT 5, 10, 15, OR 20 YEARS BEFORE DEDUCTING THE PURCHASE PRICE, INFLATION ERODES THE VALUE OF THE DEDUCTION.

UNDER NEUTRAL COST RECOVERY, BUSINESSES WOULD BE ALLOWED TO INDEX DEPRECIATION FOR INFLATION. THE DECISION TO USE NEUTRAL COST RECOVERY WOULD BE OPTIONAL FOR ANY BUSINESS. WHILE NOT EQUIVALENT TO EXPENSING, THIS PROPOSAL WOULD REDUCE THE COST OF EQUIPMENT AND ENCOURAGE BUSINESSES TO PURCHASE MORE OF IT.

ACCORDING TO AN INDEPENDENT STUDY BY GARY ROBBINS, A FORMER REVENUE ESTIMATOR FOR THE DEPARTMENT OF TREASURY, NEUTRAL COST RECOVERY WOULD HAVE SEVERAL BENEFITS. FIRST, IT WOULD REDUCE THE ECONOMY-WIDE MARGINAL TAX RATE ON CAPITAL BY 24%, RESULTING IN A 16% LOWER COST OF CAPITAL. SECOND, IT WOULD CREATE 2.7 MILLION NEW JOBS. THIRD, IT WOULD INCREASE WAGES BY $4,826 PER WORKER OVER THE NEXT FIVE YEARS. FOURTH, IT WOULD PRODUCE AN ADDITIONAL $3.5 TRILLION IN ECONOMIC ACTIVITY BY THE YEAR 2000, INCREASING GDP BY ONE TRILLION DOLLARS PER YEAR, A 1.8 PERCENT INCREASE ANNUALLY.

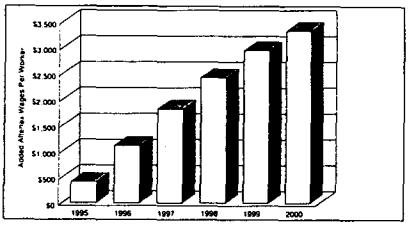


New Jobs From H.R. 539

Neutral Cost Recovery: Investing for Growth, Not Planning for Taxes

By:
Gary Robbins
Aldona Robbins

Taxation Action Analysis™
The Tax Policy Arm of the Institute for Policy Innovation
250 South Stemmons, Suite 306 · Lewisville, Texas 75067 · (214) 219-0811



Increase in Take Home Pay From HR 539

MR. CHAIRMAN, IT IS IMPORTANT TO NOTE THAT OVER THE LAST 20 YEARS, THE UNITED STATES HAS TRAILED MOST OF OUR INDUSTRIALIZED COMPETITORS IN CAPITAL INVESTMENT PER WORKER, IN PART BECAUSE THEY HAVE MORE FAVORABLE TAX POLICIES. IN OUR POST COLD WAR ECONOMY, OTHER COUNTRIES ARE DOING EVERYTHING THEY CAN TO ATTRACT INVESTMENT. THE U.S. NO LONGER HAS A MONOPOLY ATTRACTING INVESTMENT. THE COUNTRIES THAT HAVE TAX LAWS THAT ENCOURAGE INVESTMENT WILL HAVE AN ADVANTAGE IN ATTRACTING CAPITAL. OVER THE LAST 20 YEARS, U.S. INVESTMENT GROWTH IN PLANTS AND EQUIPMENT HAS BEEN ONLY HALF THAT OF JAPAN AND CANADA. WE MUST RECOGNIZE THAT WE HAVE TO COMPETE FOR CAPITAL INVESTMENT.

A STUDY BY THE AMERICAN COUNCIL ON CAPITAL FORMATION FOUND THAT U.S. CORPORATE TAX DEPRECIATION RULES PUT US AT A STRONG DISADVANTAGE WITH OUR COMPETITORS. MR. CHAIRMAN, AND MEMBERS OF THE COMMITTEE, WE HAVE A CHANCE TO ATTRACT MORE CAPITAL INVESTMENT, INCREASE PRODUCTIVITY, AND EXPAND JOB OPPORTUNITIES BY ADJUSTING DEPRECIATION FOR INFLATION AND THE TIME VALUE OF MONEY. MR. CHAIRMAN, I WOULD LIKE TO THANK YOU AND THE COMMITTEE FOR YOUR EFFORTS. THROUGH THE CONTRACT WITH AMERICA, WE HAVE THE OPPORTUNITY TO STRENGTHEN THIS NATION'S ECONOMY. LET'S IMPLEMENT NEUTRAL COST RECOVERY, INDEX CAPITAL GAINS FOR INFLATION, SUPPORT SMALL BUSINESS GROWTH BY INCREASING THE EXPENSING LIMIT TO $25,000, AND ENCOURAGE SAVINGS THROUGH INCREASED IRA'S. THE NET EFFECT WILL BE A NATION WITH MORE AND BETTER JOBS.

###

WESLEY PRUDEN, *Editor in Chief*
JOSETTE SHINER, *Managing Editor*

TOD LINDBERG, *Editor of the Editorial Page*
MARY LOU FORBES, *Commentary Editor*
WOODY WEST, *Associate Editor*
ARNAUD DE BORCHGRAVE, *Editor at Large*

PRESTON E. INNERST, *Deputy Managing Editor*
TED AGRES BARBARA TAYLOR
JOSEPH W. SCOPIN FRANCIS B. COOMBS JR.
Assistant Managing Editors

The Washington Times
Founded 1982
America's Newspaper

GEOFFREY H. EDWARDS, *Vice President, General Manager*
RONALD S. GODWIN, *Vice President*
KEITH COOPERRIDER, *Chief Financial Officer*
MICHAEL R. MAHR, *Advertising Director*

CRAIG SIMMERS, *Circulation Director*
PETER COURTRIGHT, *Marketing Director*
CHRIS AMBROSINI, *Production Director*
PAULA GRAY HUNKER, *Facilities Director*
SARA COOPERRIDER, *Computer Services Director*

If we want to be competitive, we must stop penalizing investment

As the sponsor of the neutral cost recovery legislation in the "Contract with America," I commend John Goodman's Dec. 22 Op-Ed article, "Want to 'grow' the economy? Here's how to do it."

Mr. Goodman's analysis demonstrates that there is a relationship between corporate taxes and economic growth. The current tax treatment of corporations in this country places many of our companies at a competitive disadvantage to businesses in other countries. This disadvantage ultimately results in fewer jobs and a lower standard of living for American workers.

The primary way a society raises the standard of living is by increasing its stock of physical capital. This is evident to anyone who has used a new machine at work to increase productivity. Neutral cost recovery, by offsetting some of the bias against capital in the tax code, will increase the capital stock and lead to higher incomes for American workers. A recent study by Tax-Action (the tax policy division of the Institute for Policy Innovation) estimates that the average worker will receive in excess of $3,300 in additional take-home pay within five years of the implementation of the legislation.

Neutral cost recovery would be available to all firms that pay tax on their income, from the Fortune 500 down to the one-person barber shop on the corner. Depreciation allows a business to account for the wearing-out of machinery or tools in the course of production, and subtract this cost of business from income. In order to measure depreciation properly, neutral cost recovery adjusts depreciation schedules in two ways. It takes inflation into account to reflect the falling value of the currency, and it makes an additional 3.5 percent adjustment corresponding to the time value of money.

Further, the deduction under neutral cost recovery remains the same, regardless of how machinery is financed. If a firm gets a deduction for interest paid on the loan under another section of the tax code, then the lender will pay taxes on the interest that was deducted by the firm. Thus, neutral cost recovery is not a debt-financed tax subsidy as some opponents have claimed.

The real issue with neutral cost recovery is how to create more and better jobs. Between 1972 and 1991, the United States ranked next to last among the G-7 industrialized countries in the growth of investment. Other industrialized countries such as Italy, Germany and Japan all have more favorable tax policies to encourage capital investment.

If we want to increase productivity and our competitive position in world markets, it is important to stop penalizing investment. Neutral cost recovery is simple and fair, makes the tax code more economically efficient and will result in higher wages and incomes for working Americans.

NICK SMITH
U.S. House of Representatives
Washington

Mr. CRANE. Thank you, Mr. Smith.
Next is Mr. Largent.

STATEMENT OF HON. STEVE LARGENT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Mr. LARGENT. Thank you, Mr. Chairman. I would like to thank you and the remaining, persevering members of this distinguished panel for the opportunity to appear before this committee to discuss the Contract With America and its implications for the American family.

I appear here today not only as a Member of Congress but more importantly as a husband and a father of four young children. I know firsthand what it costs to raise a family in middle America. I am glad that the Republicans have promised tax relief for families and have embraced other policies in the Contract that advance and promote strong families. Remember, as families go, so goes the Nation.

The family is the cornerstone of society. It is the campaign that I led for the last 6 months for this seat. As we have watched the breakdown of the American family we have increasingly seen the degradation of our society.

The failure of the welfare state has proven that the rebuilding of our society cannot be done at the direction of Washington. It must come through the restoration of the institutions that are vital to our civilization, and at the most fundamental level that means the renewal of the family.

The family is the cornerstone of society. Washington cannot renew the family, but we, as policymakers, can remove some of the burdens that press down on the formation and the well-being of the family. That is why we need to enact policies like those embodied by the Contract With America and its implementing legislation.

For example, the Contract With America provides tax relief for parents raising children. Marriage is rewarded, not penalized, through the Tax Code. To stabilize lifetime income for families, IRAs are expanded and improved. The Contract also provides tax credits for families who care for an elderly parent or grandparent or who adopt children.

I believe Congress must act now to relieve the unfair tax burden on families with children. We should do everything in our power to make it easier to form families and to keep them strong.

Raising children requires resourcefulness and a serious commitment to their emotional, physical and financial well-being. Today, parents must be willing to dedicate as much of their time and resources as they can in order to ensure the well-being of their children.

One study shows that in 1960 the average parent spent 30 hours a week in close, intimate contact with their children, and yet by 1990 that number had declined to 17 hours per week that they spent with their children. Why? In great part to relieve the tax burden on their families.

For too long, families with children have been overtaxed. When Harry Truman was president in 1948, the average American family with children sent only 3 percent of its income to Uncle Sam. Today, that same family sends 24.5 percent to Washington.

I was surprised to learn that in Washington "budget speak," a $500 tax credit is considered a "cost to government" because it is a revenue loser. Tax relief for families should not be looked at as a "cost to government." Instead, we should consider it as a way to keep money in the hands of those to whom it belongs in the first place: America's working families.

According to the Heritage Foundation, the $500-per-child tax credit would allow $55 million to stay in the household budgets of families from the First District of Oklahoma. I am infinitely more confident that these hard-working families of my home State will use their own money much more wisely than the government ever could, no matter which party is controlling the Federal budget.

Not only should we enact the $500-per-child tax credit, but reform of the marriage penalty is long overdue. Formation of families ought to be promoted, not penalized. Marriage should be a commitment to love and to cherish, not to pay higher taxes.

The American dream savings accounts will help all Americans to save for retirement, encouraging families to be self-reliant and less dependent on the whims of government policies. These special IRAs promote long-term prosperity through the growth of capital to invest in America. Stay-at-home moms and dads can participate in this unique savings plan as well.

The savings in American dream accounts can be withdrawn for retirement income, a first-time home purchase, for postsecondary education expenses or toward medical expenses. This flexibility encourages even more savings than at the present time by allowing families to make decisions that are best for them and their changing circumstances without the danger of locking away too much money in an account they can't get to without paying a substantial penalty.

Family tax relief is crucial. Nevertheless, we must simultaneously work toward another daunting task—a balanced Federal budget. I hear many of my colleagues in Washington, D.C., these days say that we are not going to pass the balanced budget amendment unless we first explain how we are going to do it.

I have to say that I disagree with that logic. I think we need to put those golden handcuffs on the hands that are writing the rubber checks here in Washington, D.C.

In conclusion, Mr. Chairman, I promise you and the members of this committee that I will work faithfully on the Budget Committee to ensure that we cut spending first in order to pass along the savings to American families and children.

Once again, thank you for this opportunity to testify.

[The prepared statement follows:]

Congress of the United States
House of Representatives
Washington, DC 20515-3601

Testimony
of
Rep. Steve Largent

Before the
Committee on Ways and Means

Fairness for Families First

January 10, 1995

Thank you, Mr. Chairman and members of this distinguished panel, for the opportunity to appear before this Committee to discuss the Contract with America and its implications for the American family.

I appear here today as a Member of Congress, but more importantly, I speak as the father of four young children. I know first-hand what it costs to raise a family in middle America. I'm glad that Republicans have promised tax relief for families and have embraced other policies in the Contract that advance and promote strong families. Remember: as the family goes, so goes the nation

The family is the cornerstone of society. As we have watched the breakdown of the American family, we have increasingly seen the degradation of our society. The failure of the welfare state has proven that the rebuilding of our society cannot be done at the direction of Washington. It must come through the restoration of the institutions vital to our civilization -- at the most fundamental level, that means the renewal of the family. The family is the cornerstone of society. Washington cannot renew the family, but we, as policy makers, can remove some of the burdens that press down on the formation and well-being of the family. That is why we need to enact policies like those embodied by the Contract with America and its implementing legislation.

For example, the Contract with America provides tax relief for parents raising children. Marriage is rewarded -- not penalized through the tax code. To stabilize life-time income for families, IRAs are expanded and improved. The Contract also provides tax credits for families who care for an elderly parent or grandparent, or who adopt children.

Family Tax Relief

I believe Congress must act now to relieve the unfair tax burden on families with children. We should do everything in our power to make it easier to form families and keep them strong.

Raising children requires resourcefulness and a serious commitment to their emotional, physical and financial well-being. Today, parents must be willing to dedicate as much of their time and resources as they can in order to ensure the well-being of their children.

For too long, families with children have been overtaxed. When Harry Truman was President in 1948, the average American family with children sent only 3 percent of its income to Uncle Sam. Today, that same family sends 24.5 percent to Washington.

I was surprised to learn that in Washington "budget-speak," a $500 tax credit is considered a "cost to government" because it is a "revenue loser." Tax relief for families should not be looked at as a "cost to government." Instead, we should consider it as a way to keep money in the hands of those to whom it belongs in the first place: America's working families.

According to the Heritage Foundation, the $500 per-child tax credit would allow $55 million to stay in the household budgets of families from the First District of Oklahoma. I am infinitely more confident that these hard-working families of my home state will use their own money much more wisely than the government ever could -- no matter which party is controlling the federal budget.

Promoting Marriage and Family Savings

Not only should we enact a $500 child tax credit, but reform of the marriage penalty is long overdue. Formation of families ought to be promoted, not penalized. Marriage should be a commitment to love and to cherish, not to pay higher taxes.

Amefican Dream Savings Accounts will help all Americans to save for retirement -- encouraging families to be self-reliant and less dependent on the whims of government policies. These special IRAs promote long-term prosperity through the growth of capital to invest in America. Stay-at-home moms and dads can participate in this unique savings plan as well.

The savings in American Dream Accounts can be withdrawn for retirement income, a first-time home purchase, for postsecondary education expenses, or towards medical expenses. This flexibility encourages even more savings than at present by allowing families to make decisions that are best for them and their changing circumstances, without the danger of locking away too much money in an account they can't get to without paying a substantial penalty.

Balanced Budget Amendment

Family tax relief is crucial; nevertheless, we must simultaneously work towards another daunting task -- a balanced federal budget.

Mr. Chairman, I want you to know that I plan to work diligently with this Committee and the Budget Committee on which I serve to cut spending, cut taxes for families and balance the budget. The task before us is not easy; however, I believe it can and must be done.

In President Reagan's first inaugural address, he stated,

> "We are a nation that has a government -- not the other way around. And this makes us special among the nations of the Earth. Our government has no power except that granted by the people. It is time to check and reverse the growth of government which shows signs of having grown beyond the consent of the governed. It is my intention to curb the size and influence of the Federal establishment and to demand recognition of the distinction between powers granted to the Federal Government and those reserved to the States or to the people. All of us need to be reminded that the Federal Government did not create the States; the States created the Federal Government... Now, so that there will be no misunderstanding, it is not my intention to do away with government. It is, rather, to make it work -- work with us, not over us; to stand by our side, not ride on our back."

It's time to look at every federal program, examine every appropriation, and take a microscope to each line-item in the budget and ask if the Framers of our Constitution would allow the federal government to spend money in this way. As each check goes out, drawing on the Federal Treasury, we must ask if the federal government should be spending hard-earned tax dollars on this item in the first place.

We cannot simply trim government spending -- the task is too large. We must go the core of every program and question its very existence. Yes, the task is enormous -- the Congressional Budget Office projects a deficit for 1995 at $176 billion and a national debt of $3.6 trillion. However, I believe it can and must be done.

This is where Congress can learn directly from families.

In my family, if we don't have the money, we cut back on our expenses. It's that simple. After looking over the books of the federal government and learning that 14 percent of the budget goes just to pay the interest on the national debt, I think my family's straightforward budgeting technique must be a strange and foreign concept here in Washington.

The Fiscal Responsibility Act embraces the Balanced Budget Amendment and the Line-Item Veto. A balanced federal budget will ensure that our children are not saddled with the ever-mounting debt Washington has accrued. The Balanced Budget Amendment takes away the threat that our children will pay enormous rates of taxation to pay for the spending incurred by today's special interests. The line-item veto is one additional tool to help trim shameless porkbarrel spending.

In closing, Mr. Chairman, I promise you and the members of this committee that I will work faithfully on the Budget Committee to ensure we cut spending first in order to pass along the savings to American families and children. Once again, thank you for this opportunity to testify.

Mr. CRANE. Thank you, Mr. Largent.
Next is Mr. Foley from Florida.

STATEMENT OF HON. MARK FOLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. FOLEY. Thank you, Mr. Chairman. I again would like to thank you for the opportunity as a freshman joining the 104th Congress to testify before this important committee.

We have signed a Contract, and it spells out a few things to me. One is accountability. On the first day, we dealt with accountability, and we will have a further opportunity to deal with the accountability of elected officials when we bring up term limits.

Personal responsibility is also a key provision in reforming welfare, in reforming the legal system, to restore greater personal responsibility of every individual of our society toward their country.

What I would like to focus on today, in testimony is on economic opportunity, specifically the capital gains tax cut and the debt buydown. Let me relate to you just simply as a small businessman from Lake Worth, Fla., how the capital gains tax affected myself and my family.

I had an opportunity to sell a piece of real estate that I had owned since 1975. After considering the purchase offer I had to look very closely at the tax implications on the sale. The tax liability that I would have incurred and my family would have incurred—being my parents and my sisters that own the property with me—would have been over $36,000 in cash.

I had to look at that very carefully because my net takeout after the Contract would have been significantly, significantly decreased because of that tax obligation. So I passed on that opportunity to sell the real estate. We are putting it back on the market for rent, fixing up the property slightly, but it will basically go back as a rental income property.

Who lost in that transaction? Well, certainly I did. I lost a little bit of an opportunity to get some cash in my pocket. Certainly the government lost because they don't get the $36,000 that I have chosen not to give them.

But let's look at the other beneficiaries of a capital gains tax cut. Let's look at local and State and county government that share in the rewards of a sale of that piece of real estate. The State of Florida alone on documentary stamp tax on the transfer of that deed would have had over $1,300 of tax income to the people of the State of Florida due to that sale.

But it is not just the beneficiaries of government. County tax collectors would have gotten their piece of the pie, recording officers of the clerk's office. The courts would have gotten recording fees.

But let's talk about the average American that is working in my community. The title insurance company that would have written the title policy lost over $1,200 to their company. And that didn't just include the executive. That included the title inspector. That included the secretaries within that office.

And let's talk about the pest control company that would have come out and done an inspection on that property. Small fee maybe of $50, but, again, their income has been depleted.

Let's talk about the roof and structural inspectors, the environmental auditors that we require in government to get on with radon testing and all the other things that government has mandated over the last several years. That income is gone, no longer in their pockets, no longer will show up in the Treasury as earned income for those individuals. So they in fact have lost due to my decision not to sell the property.

If we will reduce the capital gains tax cut, I think many middle-class people much like myself would benefit from it.

Now, it has been charged that a capital gains tax cut is merely for the rich. Well, I got here and certainly my net worth statement was published in many publications, particularly by my opponent, but it has gone down about $250,000 since I joined the ranks of elected officials back in 1990. I certainly am not rich. I am like every other American working for a living.

So I think it is incumbent upon this Congress to work seriously on a capital gains tax cut not only to spur the investment opportunities of every American but also to increase the opportunities of the working Floridians and Americans around this country who are looking for opportunities.

Let me spend a moment on the debt buydown because I think that is critically important if we are to get our fiscal house in order. Payment on interest alone this year will exceed 14 percent of our budget, and it will continue to grow. If we give our citizens the opportunity to check off a debt buydown provision that they would like 10 percent of their tax obligations to go toward reducing the Federal budget deficit, I think we will have restored a faith in this government and a faith in this Congress.

Why is the debt growing out of control of concern to myself? When we talk about every issue that faces us today—Social Security, crime, welfare, education—those dollars that could be going to vital programs within our communities' boundaries are now going to pay a debt, a debt of this government that has been increasing over the last several decades and that will continue to grow unless we affirmatively, as a Congress, urge our citizenry to participate in the debt buydown.

Just like a Christmas club account, just like a savings account for vacations, just like every American saves in an account for their future, just as every American saves for their children's education, the debt buydown gives the citizenry a chance to say, yes, I believe the Federal budget deficit is of serious concern to us, and we have to address that. I think it is an important step for this Congress.

I thank the Chairman and the members of the committee for their diligence, their pursuit of the goals of the Contract, and I urge them to work diligently on these reforms. I think it will make a tremendous difference, and I thank the Chairman for the time.

[The prepared statement follows:]

Testimony of the Honorable Mark Foley
of Florida
Before the House Committee on Ways and Means
January 11, 1995
The Contract With America

Mr. Chairman, I would like to thank you for allowing me the opportunity to testify before the Committee on aspects of the Contract With America. On behalf of myself and all of the members of this year's historic freshman class, I would also like to thank you for your leadership in holding these important hearings which will certainly lead to fundamental changes in the way government does business and enhance the economic opportunity of Americans for generations to come.

My testimony today will focus on two aspects of the Contract contained within the Job Creation and Wage Enhancement Act which I believe are of utmost importance for the economic viability of this country. First, I would like to discuss the proposed cut in the Capital Gains Tax rate contained within the bill, and secondly, I would like to discuss the taxpayer debt buydown provision. However, before I begin on these specific provisions, I would like to briefly discuss some of the core principles underlying the Contract with America from the perspective of a freshman Member of Congress.

As a signatory of the contact, I couldn't agree more with the three core principles of the Contract - accountability, responsibility, and opportunity. The historic opening day of the 104th Congress ushered in fundamental changes in the way Congress does business, making the people's House more accountable to the people who have sent us here. The fundamental changes in the way the House of Representatives does business, including the unanimous vote to apply laws to Congress were just the beginning of increased era of Congressional accountability. I believe that an upcoming vote on Congressional term limits will truly give this institution back to the people.

Personal responsibility is one of the foundations of American liberty; however, recent years have seen an erosion of personal responsibility and reliance on big government. This in turn has led to skyrocketing budget deficits, an astronomical public debt and a seemingly unbreakable cycle of poverty due to an over reliance on the welfare state. It is my hope that the provision contained within the Contract to reform the welfare as well as the legal system will promote greater personal responsibility and end the dependence on big government which has emerged in recent years.

But the core principle I want to focus on today is increasing opportunity, especially future economic opportunity in this country. The United States has always been considered the land of opportunity, yet burdensome federal regulations, enormous tax burdens on individuals and small businesses have resulted in a loss of vision, of hope, and of opportunity around this nation. I believe that one of the first steps to increasing economic opportunity in this country would be a cut in the capital gains tax rate.

Capital Gains Tax Cut

As a small businessman, I applaud the provisions of the Job Creation and Wage Enhancement Act which effectively halves the capital gain tax rate, as I believe this provision will spur economic growth and opportunity around the country, not just to investors but to wage earners alike.

Let me relate a personal experience to the Committee, as the owner of a piece of real estate in Palm Beach County, I was recently precluded from selling this piece of land due to an enormous capital gains tax obligation of approximately $36,000 I would have incurred had I sold the property. Had the rate been halved, I would have been much more likely to sell the property, which in turn would have expanded economic opportunity for the various people who would have been involved in the transaction, including the title insurance company, the surveyors, the environmental auditors, and various building inspectors. As you can clearly see, the net effect of a cut in the capital gains tax rate would have been expanded economic opportunity to many involved in the process of selling the property, and not just the investor. In response to those who claim this tax cut will inflate the budget deficit, it is my belief expanded economic activity due to decrease in the capital gains tax rate will in turn lead to greater income throughout the American economy, more than making up for the direct loss to the Treasury from a decrease in the tax rate.

Opponents to the cut in the capital gains tax rate view it as a tax cut for the rich; yet, in the instance I just described to the Committee, it is clear that those who would benefit the most from this tax cut would be those on the periphery involved in the sale. Furthermore, I don't believe that you can look at this aspect of the Contract alone, it must be taken it context of the overall picture of what is being done in the Contract to bring tax relief to the already overburdened small businesses and individuals in this country.

Debt Buydown

Without a doubt, this country has entered a fiscal crisis of an stifling national debt. Payment on interest alone takes up a disproportionate share of the federal budget each year resulting in lost opportunities for potential uses of taxpayer money and increasing the burden on future generations. I have seen that in the past, each time the federal budget is announced, interest on the debt is taking up a larger and larger portion of the pie chart accompanying the budget.

The time has come to end the cycle of huge budget deficits and exponentially expanding the public debt - the time has come to reduce the principle on the money owed by the federal government. One tool that should be considered is the debt buydown provision contained within this bill. By empowering taxpayers to designate up to 10% of their tax liability to a public debt reduction fund we will be giving the power back to the people who are fed up with Congress and the Executive Branch continually bickering on who is responsible for the four trillion dollar debt. The time has come to act and give the taxpayers a say in reducing the public debt.

While detractors from this idea may say that giving taxpayers the power to designate what use their tax dollars should go for is not a good idea because it detracts from the power of the government to fulfill necessary obligations. I would say that the future of this county is by far the most important issue facing this country, and right now the future is in serious jeopardy because of the present debt crisis. It has become clear that the government is not taking advantage of the best uses of the American taxpayers money, as our debt obligations grow. Instead of money being sent to the states to help reduce crime by hiring more police officers or building new prisons, more money is being spent to pay for the interest alone on the debt. Instead of money being allocated to enhancing border patrols, these type of assets are being cut back in order for more money to go to pay the interest on the debt. Instead of money going to programs that work and make a difference in a child's life like Head Start, a bigger slice of the pie is going to interest payments. The increasing costs of paying the interest alone on our debt is clearly being felt in the lost opportunities, and the American taxpayer getting less and less out of their hard earned tax dollars. The debt reduction buydown is an experiment which we must try, our future is far too important.

Thank you, Mr. Chairman, for this opportunity to testify before your distinguished Committee, and I would be happy to answer any question you or members of the Committee may have.

Mr. CRANE. Thank you for your testimony.

Now Mr. Souder.

STATEMENT OF HON. MARK E. SOUDER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. SOUDER. Thank you, Mr. Chairman and members of the committee. I appreciate the opportunity to be here today.

You have my statement, so if I could just make a few summary comments and add an additional few comments.

I had the privilege of being the Republican Staff Director for 4 years at the House Select Committee on Children, Youth, and Families, and have worked over in the Senate on social issues.

Bob Woodson challenged me early on and said: "Do not be a typical guy who just pronounces what is wrong, but go out and meet people at the grassroots level. See what is working. Because all across America, in the middle of the worst places, there are programs and individuals who are making an impact."

And I did that. I blew two engines on my car. I was in Philadelphia, South Bronx, Brooklyn, Harlem, Chicago, into Watts multiple times, Miami, Fla., and met people in the middle of the most desperate places in America who are making a difference. And I can guarantee you it was predominantly not the welfare system.

I am proud of what we are attempting to do in a number of the reforms before Congress. I think it is important that in Congress we look at these problems in a holistic way and not individualized in the sense of capital gains. Tax reform is needed. You cannot do it without child support reform.

But one of the things I just wanted to raise today—it may not be in the first part of the Contract, but I hope that we will look at it soon—is a supplemental way to look at the welfare question. In every State in the country, regardless of whether it is a Republican or a Democratic Governor, social welfare spending is frozen or declining in real terms, yet the problems are increasing. And we have to figure out how to make it work and how we are going to deal with this burgeoning problem in America.

I have a three-part proposal to do what Peter Drucker calls the nonprofitization of the social service sector, and that is, first off, to increase the charitable deduction to $1.10 on the dollar; second, to allow nonitemizers to take a charitable deduction; and third, to let corporations take a charitable deduction of up to 15 percent. Quite frankly, the major urban areas will be where big dollars come in for the major projects, because they are in a higher tax bracket. I believe that's the type of movement of dollars that Marvin Olasky, who has an excellent book that has been quoted a number of times in the last week, talks about. Olasky maintains that government programs cannot produce the faith, the hope, the love, the personal care that the private sector does, nor can it foster the accountability that the private sector does.

Woodson and William Raspberry and others have also pointed out that 85 percent of the social programs in the African-American and the Hispanic communities that are effective are religion-based. I don't want the government telling me what to do with my money. I don't desire to fund religious groups that disagree with me. Nor do I want the government telling my church what to do. The chari-

table deduction is a way for individuals to choose where to put their money without the regulation that would result from the separation of church and State questions. I believe that we need to look at this very carefully.

I personally oppose wiping out all welfare expenditures and transferring the charitable programs totally to the private sector because I don't think it will work in the major urban areas, but I think it is a process that we need to begin, just like privatization.

I appreciate the opportunity to raise that today. I don't know whether it can be in this first round, but I hope that we will look at that in the long term.

[The prepared statement follows:]

STATEMENT OF THE HONORABLE MARK E. SCUDER
BEFORE THE COMMITTEE ON WAYS AND MEANS

TUESDAY, JANUARY 10, 1995

Mr. Chairman, I want to thank you and the members of the Committee for allowing me to testify before you today. This session of Congress promises to be a historic one, and this committee will take up a large portion of this year's landmark legislation. I appreciate the opportunity to present my views to you this afternoon.

The guiding principles behind the Republican "Contract with America" can be summed up in three statements: One, many government programs are too big, too expensive, and too intrusive; two, not only do these programs waste taxpayers' money, but they often hurt the very people they are intended to help; and, three, private organizations and individuals can do a better job than federal bureaucracies if the government will just get out of their way.

The present welfare system is a case in point. Since 1965, the federal government has spent $5 trillion on means-tested welfare. In doing so, we have elbowed out of the way numerous private groups that had been addressing America's social ills for generations, and replaced them with Washington bureaucracies. America's poor lost out in the bargain: today's statistics point to worsening conditions for the underprivileged, at skyrocketing costs for taxpayers.

Getting back to a rational and workable social welfare policy will not merely be a matter of cutting programmatic costs and establishing tougher eligibility requirements for Washington's largesse. Righting the policy wrongs of the last few decades must entail a significant devolution to the private sector of both the responsibility and the means to care for our society's less fortunate.

For these reasons, I want to urge the Committee to carefully consider -- either as part of the "Contract" legislation on welfare reform or in a subsequent tax bill -- my proposal to expand the tax deduction for charitable donations for both individuals and corporations.

I will soon be introducing legislation to effect the following changes in tax policy:

1) Allow individuals to deduct 110% of the value of their charitable donations

2) Allow non-itemizers to deduct the value of their charitable donations

3) Raise to 15% the current 10% charitable donation limitation on corporations.

These changes will begin to shift the burden of caring for those in need from government programs that have succeeded chiefly in wasting taxpayers' money, to philanthropic organizations, charities, and other private groups that over the years have compiled much better track records at a fraction of the cost.

Certainly many other reforms are needed, but they are unlikely to take root if we are not successful in revitalizing America's proud tradition of volunteerism. This tradition has been increasingly crowded out by an ever-expanding government. By encouraging Americans to give generously of their time, talent and treasure, we will allow the existing voluntary sector to stretch dollars farther and more effectively than Washington, D.C., ever could.

Author and scholar Marvin Olasky has observed: "The major flaw of the modern welfare state is not that it's extravagant with money, but that it's stingy with the help that only a person can give: love, time, care, and hope." Raising the charitable deduction is a good start in re-creating the societal bonds and affiliations that have been so drastically weakened by years of well-intentioned but wrong-headed government policies.

Thank you very much for your time this afternoon.

Mr. CRANE. I thank you for your testimony.

At this point I know Mr. Camp has questions. Are there any others that want to be recognized?

All right, Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman. I will just be brief.

I want to thank all the Members for their excellent testimony but particularly my colleague from Michigan for the Neutral Cost Recovery Act. That is the first step in recognizing that we are not as competitive as our neighboring countries are when it comes to capital, and I want to compliment you in taking the lead in trying to increase our efficiency, our productivity and our competitiveness. Thank you for your testimony.

Mr. CRANE. Thank you.

Mr. Jacobs.

Mr. JACOBS. Mr. Chairman, I don't have a question, but I did want to say for the record that I particularly appreciated Mr. Smith's testimony. I believe he is one of the most thoughtful Members of the Congress. I guess we are all sincere, but he is very sincere in his proposals.

Mr. SMITH OF MICHIGAN. Thank you.

Mr. CRANE. Thank you.

And Mr. Houghton.

Mr. HOUGHTON. I would like to follow up with what Mr. Jacobs said because I think it is a good issue that you are talking about here in terms of neutral cost recovery.

I always remember the story of Russell Long saying that I voted for investment tax credits to come in four times and I voted for them to go out four times and I am sure they will come back in again.

What have you got to suggest in addition to the excellent idea for us to glue on to this thing for awhile? Because it comes in and it goes out, and we are uncompetitive and we are competitive. And it never seems to hold, and that is our problem. So if it comes in again there is going to be an attraction to cut this thing off at a later time unless somehow we find a way to make it more meaningful to the Members of Congress.

Mr. SMITH OF MICHIGAN. My brief reaction would be that the investment tax credit was an arbitrary proposal that led to some firms being able to actually make a profit and depreciate more than they would otherwise be allowed to depreciate so taxpayers financed increased income.

This proposal is not arbitrary but absolute. It simply says to a business, if you purchase this equipment we are going to either allow you to expense or deduct the full cost in the year of purchase or we are going to allow you to depreciate in future an equivalent value.

Number one, it seems fair. Number two, what we really need to look at is what the rest of the world is doing. I see in the Wall Street Journal yesterday that Japan is increasing its productivity, so it seems to me that if it is fair, we should do it in such a way that nobody has excessive benefits. We should rule out the possibility of excessive leasing benefits, which this does, then we will be on the track to a solid, stable, fair treatment of that for that investment.

Mr. HOUGHTON. OK. Well, I have got another question for Mr. Largent.

Mr. Largent, your testimony is impressive, and I relate to it very much because I come from a rural area, and family values are very, very important there. Not that they aren't in the metropolitan areas, but I particularly identify with them up there.

But, you know, we are not talking about, I don't think, the types of families that you are talking about. We are talking about dysfunctional families. We are talking about families who really are in need, can't get together, dependent upon a variety of different things that the normal sort of classic family isn't. What do you do about these people? How do we handle them? This is the issue.

Mr. LARGENT. I think I can speak to that because I come from a dysfunctional family. I was raised in a single parent family, and I can tell you that I can fully appreciate the struggles that many families like that in our country and in my district are faced with, and it is a challenge.

I would just say that having four children myself—and I don't mean this to sound cold or callous—children are expensive, no matter where they are. It is one of the situations you can't live with them and you can't live without them.

But I would just say that the $500 tax credit, which is what I came to speak to in particular, addresses all these children. We don't discriminate against children on a $500 tax credit. So, you know, I can appreciate the problem, having, as I said, been a product of a single parent family myself.

Mr. HOUGHTON. OK. One other question. Mr. Foley, you know you talk about a couple of areas. One was the debt buydown. And I mean, I can understand how it is an attractive thought to have 10 percent of your taxable income designated as a debt buydown, but the problem is not with the citizens. The problem is with Congress. So where I pay a tax of $100 and 10 percent of that is dedicated to a debt buydown, at the same time I am borrowing as a Member of Congress $5 or $6. There is something missing there. I don't quite understand what the thrust is.

Mr. FOLEY. Well, obviously, that is the problem in Congress. We are spending more than we take in. We believe we have an unlimited gold Visa card, and we continue to charge on behalf of the American taxpayer. They are no longer willing to sign the voucher. I think they want to participate in the debt reduction. And we are going to have to constrain ourselves on spending. We are going to have to get serious about downsizing agencies.

We have gone through this exercise in the State of Florida when we had a tremendous budget crisis. We discharged a lot of people from the Department of Education, from HRS. We had to show fiscal restraint because we had to have a balanced budget.

We couldn't go past the margins and say, well, we will keep everybody in place and hope the economy gets better, borrow until it does, then pay it back. That is not the way the State was allowed to operate.

And I think by having the debt buydown again it gives the citizens a chance to participate in where they want this government to head. It will cause greater fiscal restraint on the part of Congress. That 10 percent will be off the table, so it will further exac-

erbate the spending difficulties and spending cuts we will be faced with.

We did it in Florida. We had a tremendous budget deficit of two some billion dollars to face that first year, not a deficit in the actual budget, but spending estimates versus anticipated income. We brought the numbers together. We balanced the budget. It worked fine, and nobody has had extreme difficulties in Florida as a result.

Mr. HOUGHTON. Thank you, Mr. Chairman.

Mr. CRANE. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman. I would like to thank the individual members of the panel for coming forward with what I think are a very solid set of ideas.

I would particularly like to comment, first of all, on Mr. Smith's proposal with regard to neutral cost recovery. As I campaigned around my district and got to know a lot of the small manufacturers who are internationally competitive, I became aware of how many resources they have to put in annually to stay ahead of the game by investing in capital equipment.

The only way that small, internationally competitive manufacturers in this country can remain competitive in this trade climate is through this kind of critical investment, and I think your bill would address that, and I think it is absolutely essential that we have a provision like this in the tax bill we do this year.

I appreciate Mr. Foley's comments amplifying on the debt buydown. I strongly support this proposal since it was introduced in the past by our colleague from Pennsylvania, Mr. Walker. I think you have done a very good job today of outlining some of the reasons why we need to empower the taxpayers to force us to reduce our spending, and I think this is a very powerful tool to do that, and I think it also needs to be very strongly considered as the part of any final tax package we do.

And, finally, I would like to particularly congratulate Mr. Souder, who has come forward with a set of ideas on how we can use the Tax Code to encourage charitable deductions, which are going to, in my view, provide some resources for social needs that are very critical and in a way that they will be very effectively delivered, far more effectively than they can in the welfare state.

I would like to say, sir, when you do introduce these bills, I would be welcome—happy to join you as a sponsor, and thank you very much.

Mr. CRANE. Are there any other members that have questions for the panel? Yes, Mr. Christensen.

Mr. CHRISTENSEN. I also wanted to thank this panel for their time. It has been very enjoyable to listen to positive things that we have heard today about the family, restoring the family, as Congressman Largent talked about.

But also, Congresswoman Roukema, as someone who has Boys Town in their district, the main Boys Town campus, it was very enjoyable to hear you set the record straight on this war of words that we have been hearing from a lot of people. And I just really appreciate your viewpoints toward that because whether you call it a youth hostel or a group home or orphanages, if you will, they have provided positive results—especially Boys Town—incredible,

positive things that Father Val Peters has done. I would like to hear your comments on that a little bit more.

Mrs. ROUKEMA. I would like to point out and say what I tried to say in my opening statement that what we are really talking about here are generations of children under the present system that are growing up with such deprivation that many of us don't really want to acknowledge it, whether it is living in families of drug abuse or whether it is living in families with extreme economic deprivation and extreme poverty. We have to look at this issue from the perspective of what is happening to the children and what can we best do to serve those children.

I think it was unfortunate for anyone to fashion it as though we were tearing children out of the arms of loving mothers. That was not at all what the statement was meant to mean.

And certainly by focusing on a Boys Town or even on a Little Women and Jo's Boys—that hasn't been brought up, but it is a similar situation, although it is fictional. It was based at that time on real-life situations—that our concern is for the children.

Now, what we have not been forthright about is discussing the cost for such programs, and I think that deserves a full and essential debate, too. It is not as easy to say that those costs can be absorbed necessarily by private charities. I believe one of my colleagues alluded to that problem. But these are not irreconcilable conflicts. What we need is some honesty and sincerity of purpose in addressing it directly——

Mr. CHRISTENSEN. Thank you very much.

Mrs. ROUKEMA [continuing]. On behalf of the children.

Mr. CRANE. Are there any other members who have questions for the panel? Yes, Mr. Levin.

Mr. LEVIN. Just briefly, because Mr. Samuels is here.

Talking about Mr. Samuels, Mr. Smith, you are right. Mr. Samuels does not give your proposal a very warm embrace, and it might be useful if you might either for the record or just informally respond to it. You might send us a letter or whatever you would like. Because it is a fairly, I think, comprehensive analysis of it.

[The following was subsequently received:]

REP. NICK SMITH'S RESPONSE TO THE TREASURY DEPARTMENT'S CRITICISM OF NEUTRAL COST RECOVERY

CRITICISM: The Administration opposes neutral cost recovery because "it would encourage uneconomic investment and tax shelter activity..."

RESPONSE: Neutral cost recovery would not encourage uneconomic investment or could not be used for "tax sheltering" because it doesn't allow for deductions that are disproportionate to the amount of the investment. Instead of granting arbitrary deductions as an investment tax credit might, neutral cost recovery would allow businesses to deduct the full present value of their machinery or equipment. This depreciation schedule is called "neutral," because it would make deductions neutral in regard to inflation for both expensed and depreciated business purchases. Contrary to the Administration's claim, this legislation would actually allow business investment decisions to be based on economic considerations rather than tax penalties as under current law.

CRITICISM: The Clinton Adminstration claims that implementation of neutral cost recovery would reduce federal receipts by $120.4 billion over the eleven-year period, FY1995 - FY2005.

RESPONSE: The Department of Treasury uses a static economic model for these estimates. This method fails to take into account increased business and individual tax receipts that would result from economic growth. The economy would grow as a result of increased purchases of machinery, equipment and facilities. There is no disagreement that neutral cost recovery would lead to more of these purchases by lowering the cost. Under the dynamic model used by Gary Robbins, a former revenue estimator at the Treasury Department, neutral cost recovery would increase revenues by approximately 119 billion dollars over the next five years alone. If there is only ten percent of the economic expansion predicted by the dynamic model, revenues coming into the federal government will more than offset the losses predicted by the Treasury Department.

Mr. LEVIN. Also, there is an estimate of the revenue impact, and it very much varies from Mr. Robbins' estimate, and we are going to be getting into this. Do you have any idea how Mr. Robbins estimated the tax acts of 1981 at the time? Do you have any idea what he said about those?

Mr. SMITH OF MICHIGAN. Well, I suspect that Republicans and Democrat estimators have been somewhat consistently in error in the way we try to guess what is going to happen in the future. And that is why I briefly quoted Alan Greenspan when he said that we make our best estimate of what it might cost if you don't look at the dynamic effects and try to judge human behavior. And in the long run, if it is fair and if most of us agree that it is going to have a positive effect on jobs for our kids, then we should go ahead and do it.

Mr. LEVIN. That is what he said this morning?

Mr. SMITH OF MICHIGAN. That is what Mr. Greenspan said. I will send you a transcript of his response to me this morning when I asked him that question.

[The following was subsequently received:]

Mr. SMITH OF MICHIGAN. Mr. Chairman, thank you.

Dr. Greenspan, thank you for having—giving me the opportunity to ask you this question. What appears to me a more dramatic difference, and probably will be the decision on whether or not my bill that I introduced last session and again this session on neutral cost recovery passes, is the interpretation of the benefits and the disadvantages to revenue.

Essentially, neutral cost recovery is a tax policy that fairly taxes the real return on capital—in this case, a return that neutralizes the loss from inflation. It seems, in order to encourage businesses to invest in machinery and equipment, we need to stop penalizing businesses for making those kinds of investments; and I understand today Treasury is going to come up with their static analysis of what it is going to cost over the next 5, 10, whatever years.

And also I have a report from Gary Robins, a former Treasury estimator, that says a quite different story of what the results would be, very briefly, and then get your reaction. He is guessing that it would reduce the cost of those purchases by 16 percent, and that would increase the purchases. It would result in 2.7 million new jobs; it would increase take-home pay by around $3,300; essentially increase economic activity by the year 2000 by 3.5 trillion, compared to the tens of billions of dollars that it is going to cost, according to Treasury, and the difference that—the dramatic difference in the benefits of this policy. How does Congress make the decision whether or not it is a good policy?

Mr. GREENSPAN. Mr. Smith, this is basically the type of issue which I think is best addressed by what I indicated before, perhaps getting more individual policy initiatives such as this, calling groups of experts periodically from all sides of the issue with staff to sit down and go over the specific procedures. One of the problems we have, which I think that has been of great concern to a number of people, is that all too often we are dealing with a time frame in which estimates of various programs have got to be quick. You have got to know, when somebody brings up an amendment and you have to know within 24 hours what it costs, or 48 hours or something like that.

There are a number of initiatives, especially those which differ from the usual type of budgetary initiatives, which really cannot be scored easily or evaluated easily. And when they are important issues, it is crucial to get a number of people who have looked at them to see whether in fact firmer estimates can be made of what the impact of various policies are—not for official scoring purposes, because you probably can't do that in the time frame involved, but you do need it to make judgments about policies. And I suspect, as I indicated in my prepared remarks, that there are a number of policies which probably deserve to go forward in this Congress in the budget, which probably are unfairly scored in any objective sense.

But if they are important policies and they look as though they have great potential, my own judgment is it is probably wise to go forward with those policies and take the scoring hits on the grounds that it is unfortunate, but you may have a policy which really should move forward. And I would not allow the process of budget-making to be driven solely by official scoring, because the one thing we are sure of in that system is that it is deficient and it biases choices.

It is useful, and as I indicated to Charlie Stenholm, I think it is working in a remarkably effective way, considering how deficient it is as a structure. And I would be hesitant to change it, but I would not be hesitant to start looking at other procedures which enable us to look at more dynamic approaches, more imaginative approaches, to evaluating whether or not a particular policy option is something which should move forward in the budget process.

STATEMENT OF ALAN GREENSPAN, CHAIRMAN, FEDERAL RESERVE BOARD OF GOVERNORS

Mr. GREENSPAN. Thank you very much, Mr. Chairman. I am especially pleased to appear here today to address some of the most important issues involved in producing the budget of the U.S. Government. The views I will be expressing are my own and not necessarily those of the Federal Reserve Board.

The budget process has improved significantly in recent years. The caps on discretionary spending and the pay-as-you-go rules have restrained deficit-expanding programs far better than many had anticipated. Budget scoring is crucial to this process. Unless estimates of the outlays and revenues from budget initiatives are credible, the current system cannot work effectively. This joint hearing of the Congress' Budget Committees, unprecedented in my experience, attests the importance of budget scoring.

Accurate estimates of the effects on tax and spending policy on the budget are difficult to make, some more than others as the previous panel I am sure has expounded on at great length. In particular, concern has been raised that current methods are too "static." As these other witnesses have indicated, current scoring procedures already allow for some response in the spending, saving, and investment behavior of individuals and firms. Indeed, although it is difficult to measure, the budget scoring process has become increasingly dynamic over the years and estimating techniques have improved.

What is still generally not taken into account, however, is the effect of fiscal initiatives on macroeconomic variables like GDP, total labor compensation, and aggregate investment. Concerns that current estimating procedures do not fully track the effect of changes

in behavior on aggregate economic activity and hence on overall budget receipts and outlays are obviously justified.

The current method is admittedly incomplete, especially for policy initiatives with broad economic impacts. One central issue with respect to a more dynamic scoring is whether cyclical aggregate demand effects of fiscal changes should be taken into account or only permanent effects on aggregate supply. There are a number of ways of looking at this, but I would suggest that including aggregate demand effects would be confusing, if not misleading, in many if not most contexts. Among other things, the scope for realizing such demand effects on economic activity would be a function of the particular phase of the business cycle and could be viewed in a sense as transitory. Particularly when we are addressing the problem of the long-run structural deficit, the focus should be on how fiscal actions affect the potential of the economy to produce greater output and taxable income on a sustained, ongoing basis. Thus, if a more dynamic scoring were to be adopted, I would recommend limiting the analysis to appropriate supply-side effects.

Apart from that consideration, full dynamic estimates of individual budget initiatives should be our goal. Unfortunately, the analytical tools required to achieve it are deficient. In fact, the goal ultimately may be unreachable. The estimation of full dynamic effects requires a model that both captures micro- and macroeconomic processes and produces reliable, long-term forecasts of economic outcomes.

Unfortunately, no such model exists. Indeed, no model currently in use can predict macroeconomic developments without substantial ad hoc adjustments that effectively override the internal structure of the model. We should not assume that models can capture the long-run dynamic effects of specific tax and outlay changes any better than they can forecast the economy.

Even current procedures require relatively sophisticated techniques to determine the budget consequences of particular tax and outlay programs. Changes in the tax structure alter economic incentives in ways that may be extraordinarily complex. For entitlement programs, one has to assess, for example, how greater public awareness of the existence of such a program will affect participation, and how behavior will change to take advantage of the entitlement. The disappointing history of projections for Medicare and Medicaid attests to the difficulty of pinning down such consequences.

The assumptions required for realistic estimates, in many instances, constitute little more than informed guesses, largely because accurate information is scarce and our understanding of human behavior is limited. Not surprisingly, objective analysts often reach quite different conclusions about the impact of a specific outlay or tax program, even without trying to trace the feedback effects on the budget estimates from resulting changes in GDP and other macroeconomic variables.

This does not mean we have no judgments about the dynamic effect of various policy proposals. Martin Feldstein and others have already made useful contributions to our understanding of the long-run effects of the tax structure on work, saving, and Federal revenues. Thus, we may know, or suspect, the direction of a long-

term response. But our knowledge of its magnitude and timing is imprecise.

For example, although the empirical evidence is admittedly mixed, I strongly suspect that the elimination of, or a major reduction in, the rate of taxation on capital gains would entail little, if any, loss of total revenues over the long run. However, it is currently not possible to estimate with any degree of precision the impact of such a proposal on the deficit within the horizon of the current budget process.

If, as many advocate, outlays are reduced well below current service levels in the years ahead, the debate over scoring is likely to move off center stage. This will occur because the outlay cuts will free up significant revenues for tax cuts, regardless of whether the current or a more dynamic scoring is employed.

And if total revenues turn out to be greater than current procedures project, deficits will trend lower than estimated. If we inadvertently produce a budget surplus by such miscalculations, the implications will be positive for long-run economic growth. More to the point, if we fail to achieve adequate reductions in outlays, budget scoring will not substitute for hard political choices.

Clearly our political process has a bias toward deficit spending. Accordingly, we should be especially cautious about adopting technical scoring procedures that might be suspectable to overly optimistic assessments of the budgetary consequences of fiscal actions. Currently, real long-term interest rates remain relatively high, partly because of the expected growth of budget deficits later in this decade and thereafter.

Upward revisions to market expectations of deficits resulting from a perception that tax and outlay choices are being driven by optimistic scoring would only exacerbate this trend with negative consequences for financial stability and economic growth.

In current circumstances, the risks of more conservative assessments which might overstate the loss in revenues, for example, seem modest. Moreover, should the budget deficit turn out smaller than expected, the resultant favorable effect on real interest rates would tend to stimulate private investment.

We must avoid resting key legislative decisions on controversial estimates of revenues and outlays. Should financial markets lose confidence in the integrity of our budget scoring procedures, the rise in inflation premiums and interest rates could more than offset any statistical difference between so-called static and more dynamic scoring.

In summary, the current relatively straightforward scoring system has served us well in many regards. In particular, its very straightforwardness may limit the possibilities for major estimating differences. Nevertheless, current scoring does fail to reflect potentially important long-term structural supply-side benefits and, accordingly, unfavorably biases the choice of fiscal programs.

At a minimum, these supply-side effects should be estimated. Thus, even if not officially scored, they might influence policy choices. The Congress may choose to pass a tax cut with highly favorable supply-side effects on the economy and be willing to cut spending to accommodate it. In any event, in the longer run, we

should seek to find a way to embody such effects in our official scoring.

Let me reiterate that, although scoring is a major factor in the budget process, process does not mean much if real deficit control is not achieved. I do not intend to get into the deeper programmatic issues involved in deficit reduction and I probably could not add very much to the knowledge of these committees in that regard. I would, however, like to comment briefly on the sensitivity of deficits to the particular cost-of-living measure used to index entitlement programs and the income tax structure.

Many difficulties have arisen in the past and doubtless will continue to arise in the future. For example, as you may know, the Bureau of Labor Statistics made a significant change in how it calculates the Consumer Price Index in 1983, when it shifted from a method in which the price index for housing was constructed as if each household was paying the current home price and mortgage rate on its residence to one that is a more realistic measure of the cost of home occupancy.

Because of the run-up in house prices and interest rates between the late 1960's and early 1980's, the official CPI rose about 9 percent more than indicated by the newer, superior measure. By the time the index was changed, this overstatement had added substantially to the level of outlays in the large indexed Federal programs—Social Security, SSI, veterans' pensions, military retirement, and civilian pensions. Once the additional interest outlays required to finance the cumulatively higher Federal debt are added in, a rough estimate suggests that, all else equal, the deficit for fiscal 1994 would have been smaller by $50 billion had the overindexing not occurred.

Although, obviously, little can be done to remedy the errors of the past, greater efforts should be made in the future to ensure that the indexing of spending and tax programs accurately reflects trends in the cost of living. In that regard, concerns have been raised that, for a variety of reasons, the official CPI may currently be overstating the increase in the true cost of living by perhaps .5 to 1.5 percent per year.

To be sure, the overstatement may be a little less for retirees whose spending patterns differ from those of younger age groups and who are the main recipients of indexed Federal benefits. But even for this group, it doubtless remains significant.

Thus, when the Congress reviews the methods of indexing spending programs and taxes, attention should be given to the biases in the price indexes that are used. Removing the bias in the CPI would have a very large impact on the deficit. For example, if the annual inflation adjustments to indexed programs and taxes were reduced by one percentage point—and making the admittedly strong assumption that there are no other changes in the economy—the level of the deficit will be lower by about $55 billion in the fifth year, including the effects of lower debt levels. The cumulative 5-year savings, I might add, would approximate $150 billion.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Greenspan follows:]

PREPARED STATEMENT OF ALAN GREENSPAN, CHAIRMAN, FEDERAL RESERVE BOARD OF GOVERNORS

I am pleased to appear here today to address some of the most important issues involved in producing the Budget of the United States Government. The views I will be expressing are my own and not necessarily those of the Federal Reserve Board.

The budget process has improved significantly in recent years. The caps on discretionary spending and the pay-as-you-go rules have restrained deficit-expanding programs far better than many had anticipated. Budget scoring is crucial to this process. Unless estimates of the outlays and revenues from budget initiatives are credible, the current system cannot work effectively. This joint hearing of the Congress's budget committees, unprecedented in my experience, attests to the importance of budget scoring.

Accurate estimates of the effects of tax and spending policies on the budget are difficult to make, some more than others. In particular, concern has been raised that current methods are too "static." As other witnesses have indicated, current scoring procedures already allow for some response in the spending, saving, and investment behavior of individuals and firms. Indeed, although it is difficult to measure, the budget scoring process has become increasingly dynamic over the years, and estimating techniques have improved. What is still generally not taken into account, however, is the effect of fiscal initiatives on macroeconomic variables like GDP, total labor compensation, and aggregate investment. Concerns that current estimating procedures do not fully track the effects of changes in behavior on aggregate economic activity, and hence on overall budget receipts and outlays, are justified. The current method is admittedly incomplete, especially for policy initiatives with broad economic impacts.

One central issue with respect to a more dynamic scoring is whether cyclical, aggregate demand effects of fiscal changes should be taken into account--or only permanent effects on aggregate supply. There are a number of ways of looking at this, but I would suggest that including aggregate demand effects would be confusing, if not misleading, in many contexts. Among other things, the scope for realizing such demand effects on economic activity would be a function of the particular phase of the business cycle and could be viewed in a sense as transitory. Particularly when we are addressing the problem of the long-run structural deficit, the focus should be on how fiscal actions affect the potential of the economy to produce greater output and taxable income on a sustained, ongoing basis. Thus, if a more dynamic scoring were to be adopted, I would recommend limiting the analysis to appropriate supply-side effects.

Apart from that consideration, full dynamic estimates of individual budget initiatives should be our goal. Unfortunately, the analytical tools required to achieve it are deficient. In fact, the goal ultimately may be unreachable. The estimation of full dynamic effects requires a model that both captures micro- and macroeconomic processes and produces reliable long-run forecasts of economic outcomes. Unfortunately, no such model exists. Indeed, no model currently in use can predict macroeconomic developments without substantial ad hoc adjustments that effectively override the internal structure of the model. We should not assume that models can capture the long-run dynamic effects of specific tax and outlay changes any better than they can forecast the economy.

Even current procedures require relatively sophisticated techniques to determine the budget consequences of particular tax and outlay programs. Changes in the tax structure alter economic

incentives in ways that may be extraordinarily complex. For entitlement programs, one has to assess, for example, how greater public awareness of the existence of such a program will affect participation, and how behavior will change to take advantage of the entitlement. The disappointing history of projections for Medicare and Medicaid attests to the difficulty of pinning down such responses. The assumptions required for realistic estimates, in many instances, constitute little more than informed guesses, largely because accurate information is scarce and our understanding of human behavior is limited. Not surprisingly, objective analysts often reach quite different conclusions about the impact of a specific outlay or tax program, even without trying to trace the feedback effects on the budget estimates from resulting changes in GDP and other macroeconomic variables.

This does not mean we have no judgments about the dynamic effect of various policy proposals. Martin Feldstein and others have already made useful contributions to our understanding of the long-run effects of the tax structure on work, saving, and federal revenues. Thus, we may know, or suspect, the direction of a long-run response. But our knowledge of its magnitude and timing is imprecise. For example, although the empirical evidence is admittedly mixed, I strongly suspect that the elimination of, or a major reduction in, the rate of taxation on capital gains would entail little, if any, loss of total tax revenue over the long run. However, it is currently not possible to estimate with any degree of precision the impact of such a proposal on the deficit within the horizon of the current budget process.

If, as many advocate, outlays are reduced well below current service levels in the years ahead, the debate over scoring is likely

to move off center stage. This will occur because the outlay cuts will free up significant revenues for tax cuts, regardless of whether the current or a more dynamic scoring is employed. And, if total revenues turn out to be greater than current procedures project, deficits will trend lower than estimated. If we inadvertently produce a budget surplus by such miscalculations, the implications will be positive for long-run economic growth. More to the point, if we fail to achieve adequate reductions in outlays, budget scoring will not substitute for hard political choices.

Clearly, our political process has a bias toward deficit spending. Accordingly, we should be especially cautious about adopting technical scoring procedures that might be susceptible to overly optimistic assessments of the budgetary consequences of fiscal actions. Currently, real long-term interest rates remain relatively high, partly because of the expected growth of budget deficits later in this decade and thereafter. Upward revisions to market expectations of deficits resulting from a perception that tax and outlay choices were being driven by optimistic scoring would only exacerbate this trend, with negative consequences for financial stability and economic growth. In current circumstances, the risks of more conservative assessments, which might overstate the loss in revenues, for example, seem modest. Moreover, should the budget deficit turn out smaller than expected, the resultant favorable effect on real interest rates would tend to stimulate private investment.

We must avoid resting key legislative decisions on controversial estimates of revenues and outlays. Should financial markets lose confidence in the integrity of our budget scoring procedures, the rise in inflation premiums and interest rates could

more than offset any statistical difference between so-called static and more dynamic scoring.

In summary, the current, relatively straightforward scoring system has served us well in many regards. In particular, its very straightforwardness may limit the possibilities for major estimating differences. Nevertheless, current scoring does fail to reflect potentially important long-term structural supply-side benefits, and accordingly unfavorably biases the choice of fiscal programs. At a minimum, these supply-side effects should be estimated. Thus, even if not officially scored, they might influence policy choices. The Congress may choose to pass a tax cut with highly favorable supply-side effects on the economy and be willing to cut spending to accommodate it. In any event, in the longer run, we should seek to find a way to embody such effects in our official scoring.

Let me reiterate that, although scoring is a major factor in the budget process, process does not mean much if real deficit control is not achieved. I do not intend to get into the deeper programmatic issues involved in deficit reduction--and I probably could not add very much to the knowledge of these committees in that regard. I would, however, like to comment briefly on the sensitivity of deficits to the particular cost-of-living measure used to index entitlement programs and the income tax structure. Many difficulties have arisen in the past and doubtless will continue to arise in the future. For example, as you may know, the BLS made a significant change in how it calculates the CPI in 1983, when it shifted from a method in which the price index for housing was constructed as if each household was paying the current home price and mortgage rate on its residence to one that is a more realistic measure of the cost of home occupancy. Because of the run-up in house prices and interest rates between the

late 1960s and early 1980s, the official CPI rose about 9 percent more than indicated by the newer, superior measure. By the time the index was changed, this overstatement had added substantially to the level of outlays in the large indexed federal programs--social security, SSI, veterans' pensions, military retirement, and civilian pensions. Once the additional interest outlays required to finance the cumulatively higher Federal debt are added in, a rough estimate suggests that, all else equal, the deficit for FY1994 would have been smaller by $50 billion had the overindexing not occurred.

Although little can be done to remedy the errors of the past, greater efforts should be made in the future to ensure that the indexing of spending and tax programs accurately reflects trends in the cost of living. In that regard, concerns have been raised that, for a variety of reasons, the official CPI may currently be overstating the increase in the true cost-of-living by perhaps 1/2 percent to 1-1/2 percent per year. To be sure, the overstatement may be a little less for retirees, whose spending patterns differ from those of younger age groups and who are the main recipients of indexed federal benefits. But even for this group, it doubtless remains significant. Thus, when the Congress reviews the methods of indexing spending programs and taxes, attention should be given to the biases in the price indexes that are used. Removing the bias in the CPI would have a very large impact on the deficit. For example, if the annual inflation adjustments to indexed programs and taxes were reduced by 1 percentage point--and making the admittedly strong assumption that there are no other changes in the economy--the annual level of the deficit will be lower by about $55 billion after five years, including the effects of lower debt levels.

Mr. LEVIN. So we simply go ahead, everybody guessing the best they can?

Mr. SMITH OF MICHIGAN. The Budget Committee was having a hearing on whether we should consider moving closer to dynamic scoring as opposed to static scoring in light of what happened to revenue when Congress put a tax on the wealthy and the boat industry, et cetera, and his reaction was that maybe we wouldn't change the scoring but at least we should acknowledge and take into account the fact that that scoring can't accurately determine what is going to happen in the future. And if we use that static scoring, we, as a Congress, have to help analyze what is good and what is fair and what we think is going to be good for the future of our economy.

Mr. LEVIN. All right, thank you. Thank you very much.

By the way, Mrs. Roukema, it will be interesting to see the later analyses of the New Jersey study.

I will finish by asking you, if the New Jersey study a year or two from now showed there wasn't any discernible impact, what would your position be about the experiment in New Jersey?

Mrs. ROUKEMA. In the first place, I do think one has to look at this over time, and I think I tried to state that in the full text of my statement. Two years' experience is not adequate. Nor do I think 1 more additional year could be adequate. But it would have to be evaluated over time.

I do want to stress, however, that that proposal was taken from the U.S. Commission's lengthy study of the issue, and the Commission was not a political commission. It was not only bipartisan, but it was made up primarily of experts in the field, child development experts, poverty experts and a whole range of people that are familiar with the problems of child support enforcement nationally.

There were only three elected officials on the Commission—Senator Bradley, our colleague Congresswoman Kennelly and myself—and it was the unanimous recommendation of that committee that this be part of the reform effort.

Mr. LEVIN. Thank you.

Mr. CRANE. Are there any other questions?

If not, I want to express appreciation to all the panelists, too, for your presentations and your insights. And we will adjourn this panel and then ask Mr. Samuels, who as I understand is here, to come forth and testify.

Chairman ARCHER [presiding]. We would be pleased to have you take the witness chair. I am delighted to welcome Les Samuels, Assistant Secretary of the Treasury for Tax Policy, as our next witness.

This committee, of course, is always very, very interested in hearing what the Treasury has to say relative to the deliberations before us, and at such time as you are ready you may proceed with your testimony. I understand you have a rather lengthy written statement that you would like to insert in the record but that you have a shorter oral statement that you would like to make. Is that correct?

Mr. SAMUELS. Mr. Chairman, if I may, I do have a longer statement for the record, and I would like to summarize it, if I may.

Chairman ARCHER. Without objection, your complete statement will be inserted in the record, and we are prepared to hear from you on whatever you would like to tell us.

Mr. SAMUELS. Thank you.

STATEMENT OF HON. LESLIE B. SAMUELS, ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. SAMUELS. Mr. Chairman and members of the committee, I am pleased to appear before this committee today to present the administration's views on the tax proposals in the series of bills referred to as the Contract With America. The Contract raises broad issues of public policy concerning the proper size and scope of Federal governmental activity, the allocation of Federal budgetary resources, and the division of responsibilities between the Federal and State governments. In addition, the Contract contains several broad proposals, such as the proposed balanced budget amendment that could indirectly have a major impact on the Federal tax system. These broad issues are beyond the scope of my testimony today, which will focus on the tax and tax-related provisions in the Contract and their tax policy implications.

We look forward to working with this committee to develop and refine tax proposals that encourage economic growth and improve the lives of working Americans. We are particularly interested in crafting proposals that are affordable, simple, efficient, and focused on middle-income families. We must build on the progress we have made over the past 2 years. We have achieved a remarkable combination of high employment, high economic growth, and low inflation. In the last Congress, we worked on a bipartisan basis with this committee to pass NAFTA and GATT.

There are a number of proposals in the Contract where there is common ground, but we are particularly concerned about the capital gains and what is described as "neutral cost recovery proposals." These proposals, if enacted, would result in significant tax shelter transactions and encourage investment in uneconomic activities. Nevertheless, we are confident that together we can develop targeted proposals that are acceptable to the Congress, the President, and the American people.

There are 15 tax and tax-related proposals in the Contract. They range from tax credits for children and a savings incentive to capital gains preferences and a cost recovery system. Before I discuss a few of these, I want to offer an overview of the tax policy implications of the Contract.

We are very concerned about the potential effect of the Contract on the deficit. This administration, with the assistance of the previous Congress, has made significant progress in controlling spending and reducing the deficit. In the last fiscal year, the deficit was at its lowest level relative to the gross domestic product in the past 5 years and the second lowest in the past 13 years. Moreover, our unemployment rate has dropped to 5.4 percent, and inflation last year was below 3 percent.

We have prepared preliminary revenue estimates, shown in table 1, that reflect changes made to the Contract in bills introduced last week. There is a chart on the board there. Our preliminary analy-

sis shows that the proposed tax cuts in the Contract With America would lose $205.4 billion over the period fiscal year 1995 through fiscal year 2000. As you can see, the revenue cost grows rapidly after fiscal year 2000, to almost $120 billion per year, raising the fiscal year 1995 to fiscal year 2005 revenue cost to $725.5 billion. Thus, the tax provisions in the Contract would increase the deficit unless they are fully and permanently offset by specific financing proposals.

We learned an important lesson in the eighties: The responsible thing to do is to make certain that tax cuts and spending increases are paid for at the outset.

Our evaluation of the tax proposals in the Contract is based on three basic principles of tax policy: Fairness, simplicity, and efficiency. We are concerned that several provisions in the Contract do not fully satisfy these criteria. In particular, they would provide disproportionate benefits to high-income taxpayers; would make the law more complicated; and would encourage unproductive tax shelter activity.

The first of these basic principles of tax policy is fairness. An important dimension of tax fairness is the distribution of the tax burden among families at different income levels. Fifty percent of the tax benefits from the Contract would go to families with incomes over $100,000. The most well off in America, the richest Americans, get half of the benefits of the tax cuts contained in the Contract. That does not meet the fairness test. In fact, it reduces the progressivity of the Federal tax system.

Simplicity is also a tax policy goal by which the Contract should be evaluated. To the extent consistent with other tax policy goals, the income tax should be designed to minimize the cost of compliance by taxpayers and the administrative costs of the Internal Revenue Service. Several of the proposals may appear simple at first glance, but as I will point out in a moment, a great deal of complexity must be introduced in order to implement the proposals and administer them. If this is not done, arbitrary and unfair distinctions are created which also provide opportunities for abuse.

Finally, the tax system should be efficient. It should interfere as little as possible in the economic decisions of investors, workers, and consumers. The tax system should not encourage investment in uneconomic activities. In the early eighties we experienced a proliferation of tax shelter activity, with very adverse results, both for investors and the tax system. We must not repeat that experience.

I would now like to go over some of the provisions in the Contract.

The administration supports a $500-per-child tax credit for middle-income families. And I would point out that Congress passed a child tax credit in 1992, but it was vetoed. We believe that the Contract proposal would be improved if modified along the lines of the President's proposal. The Contract proposal provides benefits for families with an adjusted gross income up to $250,000, more than 99 percent of all families. The President's proposal is targeted to middle-income families.

American dream savings accounts, or ADSAs, are designed to provide an incentive to individuals to increase their savings. We

support this goal for middle-income families. We believe the Contract proposals, again, would be improved if targeted to these families.

A quick word here on savings. Our national savings rate is abysmally low. If we do not get the rate up, it will be hard to sustain private investment into the next century. That could endanger the continued healthy growth of the economy. We believe that expanding and improving the traditional deductible IRA is the most effective way to promote new savings.

In this regard, the President's proposal is similar to the IRA bill cosponsored by Mr. Thomas and passed by Congress in 1992. Backloaded proposals, like ADSA, can supplement expansion of deductible IRAs, but we do not believe the ADSAs are effective as a stand-alone. I would also note the Contract proposes penalty-free withdrawals from ADSAs for first home purchases, education, and other purchases. We feel those same benefits should be available for IRAs.

Finally, the Contract proposal fails to target its benefit to those most likely to increase savings. As a result, it is less cost effective than the President's proposal.

The administration supports an increase in the expensing limit for small business, which the House passed in 1993 with the administration's support. Last year, the administration proposed legislation on the tax treatment of long-term care, insurance, and services, as well as accelerated death benefits under life insurance. We generally support these proposals in the Contract, but believe they should be modified to protect policyholders and to prevent tax abuse that could occur under the Contract's proposals.

The administration opposes the proposed cost recovery system. Its generous benefits could divert dollars from investment that improve productivity to investments that yield significant tax benefits. The CRS could lead to a proliferation of tax shelters, like the see-through buildings we experienced in the last decade. In addition, indexing the basis of assets for inflation plus a 3.5-percent return without also indexing debt effectively allows businesses to earn tax-free income and fully deduct the cost of funds used to produce that income. In essence, CRS could revive the tax shelter abuses of the eighties.

Let me give you a simple example, and it is up there on the board. A business buys a machine for $1,000. Instead of depreciating the $1,000 cost, as permitted under current law, the taxpayer under the CRS proposal would be entitled to total depreciation deductions of $1,380, assuming 3 percent inflation. In addition, the taxpayer will be allowed to deduct all of the interest on money borrowed to buy the equipment. It is a better deal than buying a tax-exempt bond. The taxpayer, as you can see, has a negative income tax.

We are very concerned about the revenue loss from this proposal. While it is structured to raise $18.4 billion through fiscal year 2000, it loses $138.8 billion over the second 5-year period. As a result of the CRS, some large corporations may not pay either corporate income tax or alternative minimum tax. This would be a major retreat from tax reform enacted in 1986. I think Americans

would be concerned if we gave such a large benefit to business when it is middle-income taxpayers who need our help.

With respect to capital gains tax, the administration opposes the 50-percent exclusion and the indexing proposal. The combination of a 50-percent exclusion plus indexing is too generous, too complex, and not well targeted. The administration's 1993 capital gains exclusion that would be repealed by the Contract is limited to new investments and, thus, does not provide a windfall benefit to existing assets. It is also limited to small businesses, thus reducing the cost of equity capital to those businesses that are most likely to find it difficult or costly to obtain financing.

We believe that additional capital gains preferences for new investment, if they are determined to be necessary, should likewise be targeted and should meet the tests of fairness, simplicity, and efficiency.

I want to say just a quick word about indexing of capital gains, that is, taxing only the amount of profit that exceeds the cumulative inflation rate. Most Americans want to do less paperwork, not more, and that holds doubly so when you are talking about taxes. But that is not what will happen if you start requiring people to keep new detailed records on every home improvement and the same holds true for people who own stock or mutual funds. The recordkeeping burden really begins to pile up. This, in fact, could be a tax lawyer's and accountant's dream, but a homeowner's and small investor's nightmare.

On top of that, with quarterly inflation adjustments, investors will wait until the end of each quarter to sell, looking for that little inflation bump to reduce the tax they owe. You know, to keep that from happening, you probably have to put out a figure much more frequently. Think about the recordkeeping problems and the market inefficiencies this creates.

The indexing proposal permits investors to claim a tax loss when their investments do not keep up with inflation, even though they are able to sell the investments for more than the original purchase price. So if you buy an investment, the inflation value goes up, you sell it for more than your original purchase price, but less than the inflation adjustment, you get a tax loss.

In addition, since borrowings, and this is a very important point, since borrowings are not indexed, taxpayers would have a tax incentive to finance investments with debt. Overall, you can see how this indexing proposal would encourage tax shelter activity.

Next, the administration opposes the phaseout of the 85-percent maximum inclusion rate for Social Security because it would reduce revenues for the HI Trust Fund. Moreover, under current law, Social Security benefits generally receive more favorable treatment than do pension and other retirement income. The OBRA 1993 increase affects only 13 percent of taxpayers reporting Social Security benefits, those at the high end of the income distribution of beneficiaries. The OBRA 1993 changes did not affect the other 87 percent of taxpayers receiving benefits.

The proposed tax credit to reduce marriage penalties lacks detail on the allocation of benefits and would be difficult to administer. The administration would prefer to work with the Congress to investigate other means of addressing this issue.

With respect to an income tax checkoff for deficit reduction, the administration has a strong commitment to deficit reduction and supports the goal of this proposal. The idea is to impose discipline on spending by the Federal Government and, in doing so, reduce the amount of outstanding Federal debt. But the administration opposes this particular proposal because of the impact it could have on the legislative process, the budget process, and the economy.

The proposal would allow certain individuals effectively to override congressional choices by extending to those designating a transfer to the trust fund the right permanently to reduce the level of Federal spending. Those with high income tax liabilities would have a greater say in how Federal funds are spent. Those with low-income tax bills or with only payroll or excise tax liabilities would, in effect, be disenfranchised.

This proposal undermines the fundamental tenet of our political system, one person, one vote.

The administration supports the goal of reducing regulatory burdens to the extent compatible with responsible administration of the laws. Nevertheless, the administration and the prior two administrations have recognized that a one-size-fits-all approach to regulations is not in the best interest of the government or the public. The Contract provisions would apply to tax regulations. It is important to consider the consequences, and we would very much like to work with the committee on this critical issue.

The Contract would have a very negative impact on the tax guidance and administrative process. Without regulatory clarification of statutory issues, individuals and businesses would be subject to uneven enforcement of the tax laws. They would be denied the certainty that they need to plan for long-term investments and would be hesitant to engage in productive economic activities. We strive in tax policy for uniform administration of the tax laws and regulatory standards are essential.

The prior administration also recognized the critical role of tax regulations during the 1992 regulatory moratorium and allowed the IRS to continue to issue tax regulations on a regular basis.

In conclusion, the administration has serious reservations about some of the provisions in the Contract but we share the goals that would be advanced by other provisions. The administration is interested in crafting a set of tax cut proposals that are affordable, simple, efficient, and focused on middle-income families, as the President has done in the Middle-Class Bill of Rights.

We look forward to working with the committee to develop proposals that meet these criteria and which are acceptable to the Congress, the President, and the American people.

That concludes my statement and I will be pleased to answer any questions that you may have.

[The prepared statement and attachments follow:]

STATEMENT OF LESLIE B. SAMUELS
ASSISTANT SECRETARY (TAX POLICY)
BEFORE THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and distinguished Members of the Committee:

I am pleased to appear before this Committee today to present the Administration's views on the tax proposals in the series of bills collectively referred to as the "Contract with America."[1] The Contract raises broad issues of public policy concerning the proper size and scope of Federal government activity, the allocation of Federal budgetary resources, and the division of responsibilities between the Federal and State governments. In addition, the Contract contains several broad proposals, such as the proposed balanced budget amendment, which could indirectly have a major impact on the Federal tax system. These broad issues are beyond the scope of my testimony today, which will focus on the tax and tax-related provisions in the Contract and their tax policy implications.

There are fifteen tax and tax-related proposals in the Contract. The tax proposals are: (1) a $500 per child refundable tax credit; (2) the "American Dream Savings Account;" (3) favorable tax treatment for long-term care insurance and services; (4) tax-free accelerated

---

[1] These bills include H.R. 2, the "Fiscal Responsibility Act," H.R. 3, the "Taking Back Our Streets Act," H.R. 4, the "Personal Responsibility Act," H.R. 5, the "Unfunded Mandate Reform Act," H.R. 6, the "American Dream Restoration Act," H.R. 7, the "National Security Restoration Act," H.R. 8, the "Senior Citizens' Equity Act," H.R. 9, the "Job Creation and Wage Enhancement Act," H.R. 10, the "Common Sense Legal Reforms Act," and H.R. 11, the "Family Reinforcement Act."

death benefits under life insurance policies; (5) an increased expensing limit for small businesses; (6) a $5,000 refundable tax credit for adoption expenses; (7) a $500 refundable tax credit for elderly care; (8) the "neutral" cost recovery system; (9) capital gains tax preferences; (10) phase out of the 85 percent maximum inclusion rate for Social Security benefits; (11) a tax credit to reduce marriage penalties; (12) expansion of the home office deduction; and (13) an increase of the estate tax exemption to $750,000.[2] The two tax-related proposals in the Contract are: (14) an income tax return check-off for deficit reduction; and (15) regulatory reform.[3] Before addressing each of these proposals in detail, I will provide an overview of the tax policy implications of the Contract.

We look forward to working with this Committee to develop and refine tax proposals to encourage further economic growth and improve the lives of working Americans. We are particularly interested in crafting proposals that are affordable, simple, efficient, and focused on middle-income families. We must build on the progress we have made in the last two years. We have achieved a remarkable combination of high employment, high economic growth, and low inflation. Over the course of the last two years we have worked on a bipartisan basis with this Committee to pass NAFTA and GATT. There are a number of proposals in the Contract where there is common ground. But we are particularly concerned about the capital gains and cost recovery proposals. These proposals, if enacted, could stimulate the renewal of tax shelters and encourage investment in uneconomic activities. Nevertheless, we are confident that together we can develop proposals that are targeted to middle-income Americans and are acceptable to the Congress, the President, and the American people.

One of our primary concerns relates to the potential effect of the Contract on the deficit. This Administration, with the assistance of the previous Congress, has made significant progress in controlling Federal spending and in reducing the Federal deficit, which in the last fiscal year was at its lowest level relative to GDP in the past five years, and the second lowest in the past thirteen years. Furthermore, the Administration is proposing additional expenditure cuts that will fully pay for the tax cuts proposed in the President's "Middle Class Bill of Rights."

We have prepared preliminary revenue estimates of the tax provisions in the Contract based on the bills introduced on January 4, 1995. These estimates are preliminary because we have had only a short time to analyze the bills in their current form, and there have been

---

[2] Proposals 1, 2, and 11 appear in H.R. 6, the "American Dream Restoration Act," proposals 3, 4, and 10 appear in H.R. 8, the "Senior Citizens' Equity Act," proposals 5, 8, 9, 12, and 13 appear in H.R. 9, the "Job Creation and Wage Enhancement Act," and proposals 6 and 7 appear in H.R. 11, the "Family Reinforcement Act."

[3] These two tax-related proposals appear in H.R. 9, the "Job Creation and Wage Enhancement Act."

significant changes in some of the provisions of the Contract since the original legislation was released on September 27, 1994. According to these preliminary revenue estimates, shown in Table 1, the tax cuts proposed in the Contract with America would lose $205.4 billion over the period FY1995 - FY2000. The revenue cost grows rapidly after FY2000, to nearly $120 billion per year in FY2005, raising the FY1995 - FY2005 revenue cost to $725.5 billion. Although the Contract proposes a balanced budget amendment, it does not contain specific proposals for expenditure reductions or tax changes necessary to achieve that balance or to offset the proposed tax cuts or pay for other provisions, such as increased defense expenditures, that would further increase the deficit. Thus, the tax provisions in the Contract would increase the deficit unless they are fully and permanently offset by specific financing proposals.

We believe that the tax proposals in the Contract should be evaluated according to three basic principles of tax policy: fairness, simplicity, and efficiency. Several provisions in the Contract, in their present form, do not fully meet these criteria.

A basic principle of tax policy is fairness. One dimension of tax fairness is the distribution of the tax burden among families at different income levels. Table 2 shows the Treasury Department's estimates of the distributional effects of the tax provisions in the Contract. The fourth column shows that of the $97.2 billion of annual tax cuts from the Contract provisions when fully phased in, $48.5 billion, or 50 percent, would benefit families with incomes over $100,000. These families would receive a disproportionately large share of the tax cuts, thereby reducing the progressivity of the Federal tax system. This reduction in progressivity can also be seen in the ratio of tax cuts to income (column six in the table), which increases with income throughout the income distribution.

Another dimension of fairness may be characterized as the "equal treatment of equals," or the imposition of similar tax burdens on taxpayers in similar circumstances. As discussed more fully below, several provisions in the Contract would create disparities in the tax burdens of similarly-situated taxpayers.

Simplicity is also a goal of tax policy by which the Contract should be evaluated. To the extent consistent with other tax policy goals, the income tax should be designed to minimize the cost of compliance by taxpayers and the administrative costs of the Internal Revenue Service (IRS). Several of the proposals may appear simple at first glance, but, as will be noted, a great deal of complexity must be introduced in order to implement these proposals and to reconcile them with the rest of the Tax Code. If this is not done, arbitrary and unfair distinctions are created, which also provide unintended opportunities for abuse.

Finally, the tax system should be efficient. We strongly believe the tax system should not encourage investment in uneconomic activities and a renewal of tax shelter activities. In the early 1980s, we experienced a proliferation of tax shelter activity, with very adverse results for investors, the tax system, and the economy. We should not repeat that experience

by creating new opportunities for tax motivated transactions that distort economic and investment decisions.

1. $500 Per Child Refundable Tax Credit

Current Law

A tax exemption, in the form of a deduction, is allowed for each taxpayer and for each dependent of a taxpayer. A dependent includes a child of the taxpayer who is supported by the taxpayer and who has not attained the age of 19 at the close of the calendar year or who is a student under age 24. The deduction amount is $2,500 for tax year 1995. This amount is indexed annually for inflation.

In addition to an exemption for each child, three other tax benefits may accrue to taxpayers because of dependent children: the earned income tax credit (EITC), the credit for child and dependent care expenses, and the exclusion for employer-provided child and dependent care benefits. The EITC is a refundable tax credit based on the earnings of the taxpayer. The EITC is restricted to lower income taxpayers and phases out when earnings exceed specified levels. Although the EITC is available for taxpayers without dependents, the credit rate and income range of the credit are far greater when the taxpayer has one or more dependent children. In addition, the rate and income range are higher for taxpayers with two or more eligible dependent children than for taxpayers with only one eligible dependent child.

Proposal

The Contract with America would provide a $500 refundable tax credit for each child under age 18 for families with adjusted gross income (AGI) less than $200,000. The credit would be phased out for families with AGI between $200,000 and $250,000. The amount of the credit would be capped by the sum of the individual's income tax liability and any Social Security taxes paid with respect to the individual's earnings (including an employer's share of Social Security taxes). The $500 maximum amount would be indexed annually for inflation. The credit would be effective for tax years beginning in 1996.

The proposal would reduce tax receipts by $124.1 billion over the five-year FY1996 - FY2000 period, and by $288.5 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration supports the concept of a $500 per child tax credit, but believes the Contract proposal would be improved if targeted to middle-income taxpayers along the lines of the President's proposal.

The Contract proposal provides benefits for families with AGI up to $250,000. This income limitation denies the credit to only one percent of all otherwise eligible taxpayers.

2. American Dream Savings Accounts

Current Law

Taxpayers can contribute up to $2,000 to an individual retirement account (IRA). These contributions are deductible (so-called "front-loaded" IRAs), but the level of such deductible contributions is phased out for single filers with AGI between $25,000 and $35,000, and for joint filers with AGI between $40,000 and $50,000. If neither the taxpayer nor the taxpayer's spouse is an active participant in an employer-sponsored pension plan, then deductible contributions can be made, regardless of the taxpayer's income. No tax is imposed on the earnings on IRA balances. Taxpayers, however, are required to pay income tax on withdrawals. Penalty-free withdrawals from these front-loaded accounts are allowed only after the taxpayer reaches the age of 59 1/2, or upon disability or death of the taxpayer.

Proposal

The proposal would allow individuals, regardless of income and pension coverage, and, in some cases, regardless of employment status, to contribute up to $2,000 a year into an "American Dream Saving Account" (ADSA). ADSAs would be back-loaded, which means that contributions would not be tax deductible, earnings would not be taxed, and no tax would be imposed on withdrawals if certain conditions are satisfied. As with current-law IRAs, penalties would apply to premature distributions. Penalty-free withdrawals would be allowed after five years for the purchase of a first home, higher education expenses, or medical expenses including purchases of long-term care insurance. In addition, as with current-law IRAs, penalty-free withdrawals after five years would be allowed upon death or disability, or when the individual reaches the age of 59 1/2. Individuals could continue to contribute after age 70 1/2. The proposal would also allow individuals a one-time opportunity to convert their current IRA accounts into ADSAs. Income tax would be due on the total amount transferred, but the proposal would allow individuals to spread this tax liability, interest free, over four years. The proposal would be effective for tax years beginning in 1996.

Because of the addition of the one-time conversion feature, the proposal would increase tax receipts by $5.0 billion over the five-year FY1996 - FY2000 period, but would reduce receipts by $17.7 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration supports the expansion of IRAs, but believes the President's IRA proposal is more cost-effective than the ADSA proposal and provides taxpayers more with more choice in selecting a tax-favored savings incentive.

The nation's saving rate has declined dramatically since the 1970s. During that decade, net national saving averaged 7.2 percent of gross domestic product (GDP). Over the past ten years, the saving rate has averaged only 2.8 percent of GDP. The Administration is particularly concerned about the current level of national savings. We believe that the savings rate is too low to sustain a sufficient level of private investment into the next century. Without adequate investment, the continued healthy growth of the economy is at risk. A continuation of our successful policies of the past two years to reduce the Federal deficit is an essential element of any effort to improve the nation's savings rate. Increasing the personal savings rate is an essential supplement to that effort.

ADSAs are designed to provide an incentive to individuals to increase their savings. We support this goal. However, we do not believe that the Contract proposal as currently drafted is the best mechanism for reaching this goal.

ADSA contributions are not deductible, so they do not reduce current income tax liabilities. For many middle-income taxpayers, a major attraction of traditional IRAs is that contributions are deductible and, therefore, provide immediate tax relief. By requiring that contributions be made out of after-tax dollars, it is likely that ADSAs will be less attractive to many middle-income taxpayers than the deductible, front-loaded, IRAs. Conversely, ADS. will appeal primarily to more sophisticated savers, who have sufficient income and sufficient liquidity to make ADSA contributions out of after-tax dollars. Thus, the people whose contributions to tax-preferred saving accounts are most likely to represent new saving -- those with income of less than $100,000 -- are the ones more likely to contribute to front-loaded IRA accounts than to ADSAs. That is why the President's proposal (and other bipartisan IRA bills that have been introduced over the last few years) allow eligible taxpayers the option of choosing a traditional front-loaded IRA or a new back-loaded special IRA.

We also believe that broadening the tax incentives for saving for reasons other than retirement is an important element in any proposal to increase the nation's saving rate. By expanding incentives to include savings for first-time home purchases, higher education expenditures, and catastrophic medical expenses, ADSAs should prove to be more attractive to taxpayers than accounts limited to retirement savings. This should be particularly true for individuals with moderate incomes and those below the age of 35, who are now doing little saving. But these penalty-free withdrawal options should not be limited to ADSAs. They should be made available for IRAs, as proposed by the President and should also include penalty-free withdrawals for long-term unemployment and caring for an incapacitated parent.

In addition, the Contract proposal fails to target its benefits as well as the President's proposal to expand IRA benefits and does not provide a range of choices to taxpayers. It is thus less cost effective than the President's proposal in increasing net national saving. IRA contributions by wealthy taxpayers are much more likely to be financed by diverting assets from existing non-tax preferred accounts, while contributions by taxpayers with more moderate incomes are more likely to represent increases in savings. Thus, providing high-

income taxpayers with the option of saving in tax-preferred accounts is unlikely to generate much in the way of new saving.

3. Favorable Tax Treatment of Long-Term Care Insurance and Services

Current Law

A taxpayer is allowed an itemized deduction for unreimbursed expenses that are paid by the taxpayer during any taxable year for medical care of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer to the extent that such expenses exceed 7.5 percent of the AGI of the taxpayer for such year. The cost of personal services, including custodial care, is a medical expense if there is a direct connection between the service and a recognized, specific medical condition, and the services are performed directly for the individual. Old age is not a sufficiently specific medical condition. Regulations provide that the entire amount of an expense may be treated as a medical expense if the expense is incurred primarily to provide medical care.

To the extent that long-term care is not classified as medical care, employer-provided care is taxable to the employee. Generally, benefits paid under a long-term care plan or policy are not treated as amounts received through accident and health insurance on an excluded basis unless the amounts received for long-term care represent reimbursement for medical care expenses.

Proposal

Long-term care services. The proposal would allow expenses for qualified long-term care services for the chronically ill to be deducted as an itemized medical expense (subject to the 7.5 percent of AGI limitation). Qualified long-term care services would include services required by a chronically ill individual in a qualified facility, including home care in certain circumstances, under care prescribed by a licensed health care practitioner. A chronically ill individual must require substantial assistance with at least two activities of daily living (ADLs) for a period of at least 90 days or have a similar level of disability due to cognitive impairment.

Long-term care insurance. The proposal provides that benefits could be received tax-free from a long-term care insurance policy. Benefits could be paid on a "per diem" basis without regard to the actual expenses incurred during the period to which the payments relate. However, whether paid on a reimbursement basis or a per diem basis, any benefits in excess of $200 per day (indexed for medical inflation care) for any single policy would be taxable. Individuals would be allowed to deduct premiums paid to purchase long-term care insurance as a medical expense (subject to the floor of 7.5 percent of AGI) to the extent the premiums do not exceed specified annual limits.

The value of employer-provided coverage under a long-term care insurance contract would not be included in an employee's income because the contract would be treated as accident or health insurance. An exchange of a life insurance, endowment, or annuity contract for a long-term care insurance contract would be treated as a tax-free exchange. In addition, the proposal would allow a tax-free distribution to an individual from an IRA or a 401(k) plan for the payment of premiums on a long-term care insurance contract for the benefit of the individual or the individual's spouse.

All provisions would be effective for taxable years beginning in 1996.

The proposal would reduce tax receipts by $5.9 billion over the five-year FY1996 - FY2000 period, and by $15.3 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration has developed similar proposals for the favorable tax treatment of long-term care insurance and services, and therefore supports the goals of the provisions included in the Contract. However, we believe a number of modifications are required to ensure that the proposals reflect sound tax policy.

In particular, we believe that the Contract's provisions that (i) allow tax-free withdrawals from IRAs and 401(k) plans to purchase long-term care insurance, (ii) allow tax-free exchanges of life insurance and annuity contracts for long-term care insurance contracts, and (iii) permit unlimited tax-free long-term benefits by allowing the purchase of multiple policies that provide a $200 per day benefit are too generous, and treat amounts paid for long-term care insurance much more favorably than out-of-pocket expenses. These provisions would allow individuals to purchase future long-term care insurance without being subjected to the funding and/or benefit restrictions imposed on a long-term care insurance policy.

4. Tax-Free Accelerated Death Benefits Under Life Insurance Contracts

Current Law

Payments made under a life insurance contract other than by reason of an insured's death are generally taxable. However, the tax treatment of payments made with respect to terminally ill insureds in anticipation of death is not entirely clear. Proposed regulations issued in 1992 would permit the tax-free receipt of accelerated death benefits in certain circumstances, and would allow accelerated death benefit riders to be added to current life insurance contracts without endangering such contracts from being disqualified as life insurance.

Distributions (other than policy loans) from a life insurance policy are taxable to the extent they represent income on the contract.

Proposal

The Contract would exclude from gross income certain distributions received by an individual under a life insurance contract if the insured under the contract is terminally ill. An individual would be considered terminally ill if a licensed physician certified that the individual's death was reasonably expected within 12 months of the certification.

The Contract would also permit tax-free payment of benefits from a life insurance policy on the life of an insured who is chronically ill and confined to a qualified long-term care facility (including home care).

The proposal would reduce tax receipts by $0.1 billion over the five-year FY1996 - FY2000 period, and by $0.4 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration generally supports this provision, although we believe it should be modified. For example, policyholder safeguards should be added to ensure that the payment of accelerated death benefits under a life insurance contract would not unduly lower the remaining value of the policy's death benefits or its cash value.

5. Increased Expensing Limit for Small Business

Current Law

The cost of business or income-producing property that provides service for more than one tax year generally must be deducted over the recovery period of the property. A taxpayer may elect, however, to deduct currently up to $17,500 of the cost of the property (i.e., "expense" the property). However, this $17,500 maximum is reduced for each dollar of the total cost of qualified property acquired during the year in excess of $200,000. Thus, if the cost of qualified property placed in service during the year exceeds $217,500, no expensing is allowed.

Proposal

The Contract with America would increase the maximum investment that may be expensed from $17,500 to $25,000 for tax years beginning in 1996.

The proposal would reduce tax receipts by $4.2 billion over the five-year FY1996 - FY2000 period, and by $5.0 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration supports an increase in the maximum investment that may be expensed for small businesses. The Omnibus Budget Reconciliation Act of 1993 (OBRA 93) increased the maximum from $10,000 to $17,500. We supported this Committee's version of OBRA 93 which, like the Contract, would have raised the maximum to $25,000. Increasing the maximum to $25,000 would provide an incentive for small businesses to increase their investment in capital assets. In addition, the proposal also would simplify tax reporting for eligible small businesses.

6. $5,000 Refundable Tax Credit for Adoption Expenses

Current Law

The Tax Reform Act of 1986 repealed a deduction of up to $1,500 for expenses related to special needs adoptions and replaced it with an outlay program with several components. States are required to reimburse families for costs associated with the process of adopting special needs children. The Federal government shares 50 percent of the first $2,000 of such costs. Some special needs adoptees are eligible for continuing Federal-State Social Security assistance, including Medicare, under Title IV-E of the Social Security Act. Other adoptees may be eligible for continuing assistance under state-only programs.

Proposal

The proposal provides a refundable tax credit of up to $5,000 for adoption expenses in tax years beginning in 1996 and subsequent years. The credit would be allowed for all adoptions, not solely for the adoption of a child with special needs. The credit would be phased out for taxpayers with AGI between $60,000 and $100,000.

The proposal would reduce tax receipts by $1.4 billion over the five-year FY1996 - FY2000 period, and by $3.3 billion over the ten-year FY1996 - FY2005 period.

Discussion

We believe that it is generally more cost-effective to target federal support for adoption to adoption of special needs children. By applying to all adoptions, this proposal provides benefits for adoptions that would occur even without the credit. In addition, administrative issues need to be addressed in the context of a refundable credit.

7. $500 Refundable Tax Credit For Elderly Care

Current Law

Current law allows taxpayers who support their parents or grandparents to claim a dependent exemption. In general, a taxpayer is entitled to an exemption of $2,500 in 1995 for each dependent. An elderly person may be claimed as a dependent of another taxpayer if the taxpayer provides more than one-half of the support of the elderly person and the elderly person has gross income below $2,500. In addition, single taxpayers can file as heads of households if they provide over one-half the costs of maintaining a home in which their dependent parents reside.

Current law also provides a nonrefundable tax credit for taxpayers 65 years of age or older who receive moderate amounts of social security, railroad retirement, and other pension annuity or disability benefits and who have modest amounts of income from other sources. The tax credit is an amount equal to 15 percent of an initial amount ($7,500 if a joint return is filed and both spouses qualify, or $5,000 if single or only one spouse qualifies), but reduced for certain nontaxable income and for AGI exceeding certain levels. Taxpayers may also be eligible for the child and dependent care tax credit or the exclusion for employer-provided child and dependent care benefits (see the "Current Law" description for item 1).

Proposal

Taxpayers would be eligible for a refundable tax credit if they maintain a household that includes an elderly and disabled parent or grandparent. The tax credit would be equal to $500 for each qualified person. A qualified person would include any parent or grandparent of the taxpayer whose principal place of abode is the taxpayer's home for more than one-half of the year and who is not able to perform at least two activities of daily living (e.g., bathing or dressing) or who suffers a similar level of disability due to cognitive impairment. The credit is available regardless of the taxpayer's income. The credit amount is not indexed. The provision would be effective for tax years beginning 1996.

The proposal would reduce tax receipts by $1.2 billion over the five-year FY1996 - FY2000 period, and by $2.6 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration is very concerned about the care of elderly and disabled individuals. We believe that the Administration's long-term care proposals made in 1993, as well as the President's IRA proposal, better address this issue and would provide many taxpayers with greater assistance than would the tax credit contained in the Contract. The President's proposals would also be easier to administer.

Under our long-term care proposals, taxpayers could deduct long-term care expenses if such expenses exceeded 7.5 percent of AGI. In addition, taxpayers could exclude employer contributions for long-term care insurance from their taxable income. Under the President's "Middle Class Bill of Rights" proposal, taxpayers would be allowed to withdraw funds, without penalty, from their IRAs in order to pay for nursing home and other long-term care expenses of their parents and grandparents.

8. Neutral Cost Recovery System

Current Law

For regular tax purposes, depreciation deductions for most tangible personal property are calculated using the 200-percent-declining-balance method over recovery periods of 3, 5, 7 and 10 years. Certain longer-lived types of property are depreciated using the 150-percent-declining-balance method over recovery periods of 15 and 20 years. The straight-line method is used over periods of 27.5 and 39 years for residential and nonresidential real property, respectively. Certain other specified property (including property used by a tax-exempt entity, property used predominantly outside the United States, and property financed with tax-exempt bonds) is depreciated using the straight-line method over a prescribed recovery period. Depreciation deductions are not indexed for inflation.

For purposes of the alternative minimum tax (AMT), property other than residential or nonresidential real property is depreciated using the 150-percent-declining-balance method over assigned class lives. These class lives are generally longer than regular tax recovery periods. Real property is depreciated for AMT purposes using the straight-line method over a 40-year recovery period.

Proposal

The proposed "neutral" cost recovery system (CRS) would replace the current depreciation system for property placed in service after December 31, 1994. Taxpayers would compute cost recovery allowances using the 150-percent-declining-balance method for tangible personal property, and the straight-line method for real property, over the recovery periods prescribed under current law. These recovery allowances would be adjusted upward by multiplying them by "CRS ratios". For assets with recovery periods of 10 years or less (most tangible personal property), the CRS ratios would adjust for actual inflation (based on the GDP deflator) plus 3.5 percent per year for each year the property has been in service; for all other depreciable assets (including real property), the CRS ratios adjust only for inflation. Additional depreciation adjustments attributable to the CRS ratio would not reduce the basis of assets or any interest in a pass-through entity holding these assets, and would not affect recapture. The CRS ratios could not be less than one, and the sum of the adjusted cost recovery allowances would exceed the original basis of the property if the property were held for its full recovery period.

Depreciation deductions under the AMT system for CRS property would be calculated in the same fashion. Allowances would be computed as under the AMT system prescribed by current law, but would be adjusted upward for actual inflation, plus 3.5 percent for property with recovery periods of 10 years or less.

Because of the slower depreciation method for some property, the proposal would increase tax receipts by $18.4 billion over the six-year FY1995 - FY2000 period. However, tax receipts would be reduced by $120.4 billion over the eleven-year FY1995 - FY2005 period.

Discussion

The Administration opposes this cost recovery system because it would encourage uneconomic investment and tax shelter activity and would be very costly beyond the five-year budget window. The CRS proposal would also add significant complexity to the tax system.

Table 3 provides an example of how CRS back-loads revenue losses. It compares depreciation deductions for a property acquisition under current law and under CRS, assuming a seven-year recovery period and 3.0 percent annual inflation. While deductions are smaller for the first three years, total deductions increase by over 23 percent. The early revenue gains accrue entirely from property with recovery periods of ten years or less. For longer-lived property, CRS loses money after the first year.

For equipment, CRS is intended to provide taxpayers with deductions spread over a period of years that have the same present value as expensing, thus reducing the effective tax rate on the income for new investment to zero (as under a consumption-based tax). In a consumption-based system, however, the return on all investments, and not solely investments in equipment, would be subject to an effective tax rate of zero. The proposal does not achieve tax neutrality with respect to investment decisions.

Contrary to its title, this cost recovery system is clearly not "neutral." The difference in treatment between short-lived tangible property and real and other property (including certain intangibles), the difference in treatment of assets subject to CRS and assets subject to the capital gains indexation provisions, and the ability of a taxpayer to elect out of CRS on a property-by-property basis, all compel taxpayers to consider carefully the tax impact on the investment decision. Furthermore, the CRS proposal creates a bias against investment in longer-lived depreciable property, in non-depreciable property, and in certain intangible property.

The CRS subsidy is so large, especially when coupled with the Contract's capital gain proposal, that it could lead to significant investment in uneconomic activities. Taxpayers will have significant incentives to engage in transactions designed to use CRS deductions to shelter other income from tax. Some businesses will even be able to "zero-out" their tax liabilities (including their AMT liabilities). The net effect may well be to hurt, rather than

help, the economy, just as very accelerated depreciation allowances in the early 1980s contributed to the proliferation of "see-through" buildings.

The policy justifications for these differences are far from clear. In fact, the exclusion of real property from application of the full CRS adjustment may serve to aggravate the existing controversy regarding classification of components of real property. In addition, property subject to CRS is precluded from application of the capital gains indexation provisions.

The CRS introduces substantial additional complexity to an already complex depreciation system. Depreciable property placed in service after December 31, 1994 will be subject either to CRS with the full CRS ratio, to CRS with an inflation adjustment only, or to the current cost recovery system (i.e., for property not eligible for CRS or property that the taxpayer elects to have excluded, which may be the case if the taxpayer intends to index for purposes of capital gains). Moreover, property subject to CRS will have to be tracked by quarter and year of acquisition. In addition, existing property will continue to be subject to current depreciation provisions, including the AMT system.

In addition to these areas of complexity, there are a number of areas where the interaction of the CRS provisions with related provisions of the Code is not addressed in the statutory language. Issues such as the effect of additional CRS deductions on the normalization rules, the operation of the CRS provisions with certain pass-through entity provisions (e.g., election to adjust basis of partnership property), and the interaction of CRS provisions with general asset accounts must be addressed. In addition, specific, detailed anti-churning rules would be required to assure that only new property is being covered in the CRS.

9. Capital Gains Tax Preferences

Current Law

Under current law, nominal capital gains are fully included in taxable income upon realization, and for taxpayers in the 15 percent and 28 percent brackets are taxed at ordinary rates. In general, individual taxpayers in the 31, 36, and 39.6 percent tax brackets pay a maximum capital gains rate of 28 percent. The 28 percent maximum rate effectively provides exclusions of 10, 22, and 29 percent to taxpayers in the 31, 36, and 39.6 percent tax brackets, respectively. Capital losses can be deducted against capital gains, and up to $3,000 of net capital losses per year can be deducted against other income.

Capital gains on the sale of a principal residence can be deferred if the taxpayer purchases a replacement residence of equal or greater value. Taxpayers age 55 and over are eligible for a one-time exclusion of up to $125,000. Capital losses on principal residences are not deductible.

OBRA 93 provided a 50 percent exclusion for gains on the sale of certain small business stock that is purchased directly from the business (or through an underwriter) at the time of issue and held for at least five years. Eligible corporations must have assets (including the funds from the stock issue) of under $50 million and must meet certain other conditions throughout the taxpayer's holding period. The amount of gain eligible for the 50 percent exclusion is limited to the greater of ten times the taxpayer's basis in the stock and $10 million gain from the stock in that corporation. One half of the excluded gains are treated as a preference for purposes of the Alternative Minimum Tax.

Proposal

The proposal would allow individuals and corporations to deduct 50 percent of net long-term capital gains from gross income effective January 1, 1995. Only 50 percent of net long-term losses would be deductible. These capital losses could offset ordinary income up to the annual $3,000 limitation. The 28 percent maximum tax rate on taxable gains of individuals and the targeted small business capital gains provision in OBRA 93 would be repealed. In addition, individuals and corporations could prospectively index the basis of corporate stock and certain tangible assets (including collectibles such as antiques) for inflation after January 1, 1995 in computing gains and losses. The proposal also would allow individuals to deduct any capital loss from the sale or exchange of a principal residence, subject to the annual $3,000 limitation on the deduction of net capital losses.

The proposal would reduce tax receipts by $60.9 billion over the six-year FY1995 - FY2000 period, and by $183.1 billion over the FY1995 - FY2005 period.

Discussion

The Administration opposes the 50 percent exclusion and indexing proposals. The combination of these proposals is too generous, too complex, and not well targeted, both with respect to the investors benefitted and the assets included. The OBRA 93 capital gains exclusion (which would be repealed by the Contract) is limited to new investments, and thus does not provide a windfall benefit to existing investments. It is also limited to small businesses, thus reducing the cost of equity capital to those businesses that are most likely to find it difficult or costly to obtain financing. We believe that additional incentives for new investment, if they are determined to be necessary, should likewise be targeted and consistent with the tax policy principles of fairness, efficiency, and simplicity.

50 Percent Exclusion. Proponents of a 50 percent capital gains exclusion argue that this exclusion could reduce barriers to the sale of existing assets by taxpayers with unrealized gains. But it would also increase the incentive to convert ordinary income to capital gains and confer the largest benefits to the highest-income taxpayers. Consequently, the Administration believes that the exclusion is too large and is not sufficiently cost effective.

Studies of the effects of capital gains tax cuts by the Treasury (1985), the Congressional Budget Office (1990), and the Congressional Research Service (1990) have all concluded that any effects on saving, investment and economic growth are likely to be quite small. This is because much of the income from savings is already tax favored, the responsiveness of saving to changes in the after-tax return is uncertain, and only a fraction of the additional savings will be used to fund new investment in domestic plant and equipment.

Increasing the preferential treatment of capital gains would create economic efficiency losses and make the tax system more complex by encouraging taxpayers to convert ordinary income into capital gains. One example of such tax arbitrage is contributing ordinary income property to a corporation and then selling the stock of the corporation. Corporations used in this way are referred to as "collapsible" corporations. The Code contains provisions aimed at preventing abuse through the use of collapsible corporations, but these and other provisions designed to prevent similar abuses are extremely complex. Such complexity increases transaction costs to taxpayers and the costs of ensuring compliance for the IRS. While incentives to engage in tax arbitrage, and thus some of the accompanying complexity, already exist as a result of current law's limited preferences for capital gains, this proposal would greatly increase taxpayers' incentives to engage in arbitrage transactions.

Indexing. Proponents of indexing of capital assets contend that it limits capital gains taxes to "real" gains that increase a taxpayer's purchasing power as opposed to "nominal" gains that result simply from inflation and do not increase the taxpayer's purchasing power. The best approach to deal with inflation, however, is to keep the rate of inflation low. The combination of the deficit reduction under this Administration and Federal Reserve policies has achieved this goal -- inflation over the past year has been held to under 3 percent.

Even if some form of capital gains relief is considered desirable, providing <u>both</u> an exclusion and indexation of basis clearly provides too large an adjustment for inflation. Rather than taxing "real" gains, the combination of indexing and the 50 percent exclusion would largely eliminate the capital gains tax. For example, for a taxpayer in the 28 percent bracket who sells after one year a $1,000 capital asset that increased in value by 8 percent while prices generally increased by 3 percent during the year, the capital gains tax would decrease by 69 percent (from $22.40 to $7.00), resulting in an effective tax rate on the nominal gain of 8.75 percent.

Indexing the basis of capital assets for inflation would significantly increase complexity and distortions in the tax system. This is one of the reasons this proposal has been rejected, after careful consideration, in the past. Basis indexation has the potential to affect every area of the Code. Addressing all of these aspects would add considerable complexity to the Code, while ignoring them would leave the door open to tax avoidance opportunities. Indexing basis would also place a great deal of strain on the Internal Revenue Service's ability to administer the tax system.

The distinction between real and nominal gains is not limited to the assets that would be indexed under the proposal. For example, interest payments on debt have inflationary components, as do capital gains. Yet the Contract would not differentiate between real and nominal interest income or deductions. Indexing the basis of capital assets without indexing debt used to finance these assets would greatly expand the potential for tax arbitrage and tax shelter opportunities. Without complicated anti-arbitrage provisions, indexing capital gains alone would make it possible for taxpayers to reduce their effective tax rates to zero.

For example, assume that a taxpayer purchases undeveloped land for $100,000, giving a $20,000 cash down payment and borrowing $80,000. If the land were sold several years later for $130,000, with the $30,000 gain representing an inflationary increase in the value of the property the taxpayer could repay the $80,000 mortgage and retain $50,000 in cash without being subject to taxation. However, only $6,000 (20,000/100,000 x $30,000) of the taxpayer's total $30,000 gain from the transaction represents the inflationary gain on the taxpayer's $20,000 investment; the remaining $24,000 of gain has been shielded from taxation because the proposal would index the basis in the property but not the debt or the interest adjustments used to finance it.[4]

Unlike some previous indexing proposals considered by Congress, this proposal would allow nominal capital gains to be turned into deductible capital losses. Under current law, taxpayers already benefit from the fact that their capital gains are taxed only when realized. They are thereby encouraged to claim losses when the losses are incurred, while deferring the tax on gains. This proposal would even allow taxpayers with gains that have not kept pace with inflation to claim losses on those nominal gains. Also, the use of quarterly indicators to measure inflation could lead to a disruption of the normal operation of markets as investors attempt to recognize their gains early in any given calendar quarter.

Rules would have to be developed to address the treatment of common investments made by many individuals, such as dividend reinvestment plans in mutual funds and investments in partnerships and other pass-through entities. Computation of the taxpayer's income in each of these cases would require more than merely determining basis, holding period, and the amount realized. Rather, these circumstances would require the development of special indexing rules that coordinate entity level and investor level adjustments and provide appropriate allocation of indexation benefits among investors. Rules would also have to be developed for complex transactions involving indexed assets where the date of sale or acquisition may be unclear, such as sales pursuant to forward contracts, options, and sales with contingent purchase prices. Similar issues arise with respect to a disposition pursuant to a corporate or partnership distribution, or an installment sale. Adjusting the basis of investments in foreign tangible property and certain foreign stocks for domestic inflation

---

[4] Stated differently, because of indexation of gains, the taxable gain on the asset is reduced from $30,000 to zero, but because of the failure to index liabilities, taxpayers escape tax on the $24,000 real gain on the debt.

would generate additional complexities, especially under the tax rules that apply to foreign currency. Complexity would also result from adjustments made to basis over time as the result, for example, of improvements to real property or contributions to the capital of a corporation.

Any system of indexation would have to provide rules for all these cases. Every such rule, however, would impose additional computational burdens of a magnitude far greater than the single basis calculation now required. While certain simplifying assumptions could be adopted, these simplifications would arbitrarily deny indexation benefits to some taxpayers while providing planning opportunities to others.

Deduction of Losses on Principal Residences. We have some concerns about the proposal to allow the deduction of losses on sales of principal residences. Generally, the tax law does not allow capital losses arising from personal use assets. Under the proposal, taxpayers in neighborhoods or sections of the country that experience general declines in real estate prices would benefit, but the proposal would also benefit those whose homes have lost value from anticipated real depreciation or other deterioration in the property.

10. Phase Out of the 85 Percent Maximum Inclusion Rate for Social Security Benefits

Current Law

The amount of Social Security benefits included in income is determined by the amount of income and benefits in excess of certain thresholds. The thresholds also determine the maximum percentage of benefits included in AGI.

Under OBRA 93, people with income and Social Security benefits above the top threshold must include up to 85 percent of Social Security Benefits in AGI, beginning in 1994. The top threshold is $34,000 for unmarried individuals and $44,000 for married individuals. The amount of benefits subject to tax is: (1) 85 percent of income and benefits over the threshold, plus (2) an adjustment for amounts below the threshold subject to inclusion at the 50 percent rate. However, the total taxable amount does not exceed 85 percent of benefits. The OBRA 93 change does not apply to people with income and benefits below the top threshold. The revenue from the OBRA 93 changes is earmarked for the Hospital Insurance (HI) trust fund.

Proposal

The Contract with America would phase out the OBRA 93 changes in the taxation of Social Security (and Railroad Retirement Tier I) benefits. As a result, not more than 50 percent of Social Security benefits would be subject to income tax, regardless of the level of the beneficiary's total income. The phase out would occur between 1995 and 2000. This change would affect only taxpayers with income above the second threshold ($34,000 for single taxpayers and $44,000 for married taxpayers filing jointly).

The proposal would reduce tax receipts deposited in the Hospital Insurance (HI) Trust Fund by $15.0 billion over the five-year FY1996 - FY2000 period, and by $48.5 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration opposes this proposal, because the OBRA 93 changes were necessary to achieve consistent tax treatment of retirement income, and because it would reduce revenues needed for the HI Trust Fund.

Even with the changes in OBRA 93, Social Security benefits generally receive more favorable tax treatment than do pension and other retirement income. Generally, the portion of pension payments representing previously untaxed income is included in gross income when received, while the portion of pension payments representing previously taxed contributions is excluded. Social Security benefits are treated more favorably. For those with higher incomes, the portion of Social Security benefits subject to tax is phased in, based on the recipient's total income level. However, even for the highest income retirees, no more than 85 percent of benefits are taxed, even though over 90 percent of the benefits may represent previously untaxed income.

The OBRA 93 increase affected only 13 percent of taxpayers reporting Social Security benefits in 1994 -- those at the high end of the income distribution of beneficiaries. The OBRA 93 changes did not affect the other 87 percent of taxpayers receiving benefits.

11. Tax Credit to Reduce Marriage Penalties

Current Law

Couples in which both spouses have similar levels of income generally have a higher tax liability than the combined tax liability of two single persons with the same levels of income. This extra amount of tax is called a "marriage penalty." Conversely, where one spouse has most or all of the couple's income, the tax liability of the couple is usually lower than the combined liability of two single persons with the same levels of income. This lesser tax liability is called a "marriage bonus." The extent of the marriage penalty or bonus depends on the division of income, deductions, and credits between the spouses as well as on the relative sizes of standard deductions, on the level of income tax rates, and on the relative widths of income tax brackets for married and unmarried taxpayers.

If couples filed tax returns as two separate individuals, there would be neither marriage penalties nor bonuses (except for those living in community property states). But married couples with the same total income would then pay different amounts of tax, depending on the division of income between them.

Proposal

The proposal provides a tax credit in the amount of, but not more than, a married couple's "marriage penalty." The dollar amount of the credit would be determined each year by the Secretary of the Treasury so that the aggregate amount of credits for all taxpayers would not exceed $2 billion for the year. The proposal would be effective for tax years beginning after the date of enactment.

The proposal would reduce tax receipts by $9.0 billion over the five-year FY1996 - FY2000 period, and by $19.0 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration does not support this particular proposal because it lacks detail on the allocation of benefits and would be difficult to administer. We would, however, be willing to work with the Committee to consider other ways to address this issue.

Since the total amount of marriage penalties greatly exceeds the $2 billion a year limit on the cost, this proposal would only partially reduce, but not fully eliminate, marriage penalties. As a result, one major problem with the proposal is the lack of detail on how the $2 billion of benefits would be allocated among families with marriage penalties. Another problem is that marriage penalties intrinsically depend upon how people would live if they were not married -- what housing arrangements they would make, how they would divide their assets, etc. While a hypothetical calculation can be made, such a calculation may overstate the actual penalty for some and understate it for others.

The proposal could also result in a married two-earner couple having a lower tax liability than a one-earner couple with the same total income and deductions. Moreover, the proposal does not address the treatment of heads of household. Any proposal that significantly reduced marriage penalties while leaving marriage bonuses unchanged would shift the overall tax burden away from families filing joint returns and would increase the relative tax burden of heads of household and single persons.[5]

12. Expansion of the Home Office Deduction

Current Law

Under current law, home office expenses are deductible only if the home office is used (1) as the principal place of business, (2) as a place of business used by patients, clients

---

[5] As the result of complaints about tax penalties for single persons, in 1969 a separate tax rate schedule was enacted for single taxpayers. Prior to that time, single taxpayers used the same tax rate schedules as married taxpayers filing separate returns.

or customers in meeting or dealing with the taxpayer in the normal course of business, or (3) in the case of a separate structure which is not attached to the dwelling unit, in connection with the taxpayer's trade or business.

The principal place of business definition was interpreted by a recent Supreme Court case. In *Commissioner v. Soliman*, 113 S. Ct 701 (1993) the Supreme Court held that the principal place of business should be defined to include only the place of business where the activities most crucial to the operation of the business occur. As a result of the decision, the Internal Revenue Service set forth in Revenue Ruling 94-24 the factors to be applied in determining whether a taxpayer's home office qualifies as a principal place of business. For example, activities crucial to certain service businesses require personal contact with customers outside the service provider's home office. In such cases, the home office would not be regarded as the principal place of business, even if no other principal place of business existed.

Proposal

The Contract with America proposal would loosen the standards under which home office deductions would be allowed. The proposal would allow deductions for an office where a taxpayer's essential administrative or management activities are conducted on a regular basis provided the taxpayer has no other place to perform those activities. The proposal would also allow a taxpayer to deduct costs attributable to the storage of product samples in a residence if the taxpayer is engaged in the business of selling those products at retail or wholesale and the residence is the sole fixed location of the taxpayer's business.

The proposal would reduce tax receipts by $0.4 billion over the five-year FY1996 - FY2000 period, and by $1.0 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration believes this proposal needs further review in order to minimize potentials for abuse and associated audit difficulties.

13. Increase of the Estate Tax Exemption to $750,000

Current Law

Under current law, an exemption from estate tax is generally allowed for the first $600,000 of a taxable estate. This is effected through a credit of $192,800 against estate tax, which translates into an exemption for $600,000. The credit reduces the estate tax liability of most decedents, but is phased out for estates that exceed $10 million. The credit is referred to as the "unified credit" because it is also utilized (and reduced to the extent so used) to offset gift tax.

Proposal

The proposal contained in the Contract with America would increase the amount of the unified credit against estate tax. The increase would be to $700,000 for decedents dying (and gifts made) in 1996, $725,000 in 1997, $750,000 for 1998, and would be indexed for later years.

The proposal would reduce tax receipts by $6.7 billion over the five-year FY1996 - FY2000 period, and by $20.7 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration recognizes that this threshold has not been increased since 1987. We are willing to work with the Committee to address this issue. However, we are concerned about the cost of this proposal and the limited number of taxpayers it would affect. Only one percent of all estates are taxable with the current exemption, and only half of one percent would be taxable under the proposed increase in the exemption.

14. Income Tax Return Check-off for Deficit Reduction

Current Law

The Presidential Election Campaign Fund check-off is the only analogous federal program. Section 9006 of the Internal Revenue Code establishes the Presidential Election Campaign Fund (the Campaign Fund). Each taxpayer may designate, by checking the appropriate box on his or her income tax return, that $3 be paid into the Campaign Fund. The amount designated for the Campaign Fund does not affect the taxpayer's tax liability. Monies in the Campaign Fund are used for three purposes: (1) payments to the national committee of each major and minor political party for its nominating convention; (2) payments to the eligible candidates of a political party for President and Vice-President; and (3) payments to eligible candidates seeking the nomination of a political party to be President.

Proposal

The Contract would allow individual taxpayers to designate on their federal income tax returns up to ten percent of their tax liability to be earmarked for reducing the public debt. The IRS would tabulate the amounts designated and the Treasury Department would transfer those amounts into a "Public Debt Reduction Trust Fund" (the Trust Fund). The amounts in the Trust Fund would be used to retire or purchase outstanding Treasury securities, and therefore could not be used to fund federal programs.

The proposal also mandates a corresponding decrease in federal spending through an essentially across-the-board sequestration. Social security payments, net interest payments on

federal debt, and funding for certain insurance funds established to resolve the savings and loan problem are exempted from sequestration under the bill.

Sequestration reports under the Balanced Budget and Emergency Deficit Control Act of 1985 would be expanded to include an estimate of the amount earmarked to the Trust Fund. Budget authority for the new fiscal year would be cut by the "sequestration percentage" (i.e., the total amount earmarked by taxpayers for debt reduction divided by all government spending programs that are not explicitly exempted).

The provisions of this proposal would remain in effect until the entire outstanding public debt is retired.

Discussion

This Administration has a strong commitment to deficit reduction and supports the goal of this proposal, which is to impose discipline on spending by the federal government and, in doing so, reduce the amount of outstanding Federal debt. The Administration opposes the proposal, however, because of the potentially adverse effects it could have on the legislative process, the budget process, and the economy. In addition, the proposal would complicate tax returns and tax administration.

By requiring across-the-board spending cuts, the proposal could disrupt the orderly development of a Federal budget and discourage the Administration and Congress from making difficult budgetary choices. The proposal would allow certain individuals effectively to override Congressional choices by extending to those designating a transfer to the Trust Fund the right permanently to reduce the level of federal spending. Further, by incorporating a "one dollar, one vote" concept into the budgetary process, the fundamental "one person, one vote" tenet of our political system would be undermined. The proposal would allow citizens with significant tax liabilities to have a potentially greater voice in the way Federal funds are spent than those who incur little or no tax liability. The millions of voters who have no income tax liability would, in a sense, be disenfranchised, even though these individuals pay payroll and excise taxes. The role of government in society, and the way in which Federal monies are raised and spent, clearly are questions that deserve to be addressed by all citizens. These fundamental issues should be decided through the voting process, not through the tax system.

Amounts designated to the Trust Fund reduce Congressional budget authority for the following fiscal year, and in all future years. Thus, designations in successive years would result in significant cumulative reductions. These spending cuts, which are required to be spread equally across nearly all federal programs, would quickly have major, and in many instances unanticipated, impacts on these programs.

15. Regulatory Reform

The Administration supports the goal of reducing regulatory burdens to the extent compatible with responsible administration of the laws. Nevertheless, this Administration and the prior two Administrations have recognized that a "one-size-fits-all" approach to regulations is not in the best interests of the public or the government.

The IRS already must satisfy elaborate procedures before issuing regulations and taxpayers have extensive safeguards in enforcement proceedings. If existing procedures and safeguards need amendment, we would welcome the opportunity to work with this Committee to achieve a satisfactory result.

We assume that many of the Contract's regulatory and enforcement reform provisions were not intended to apply in the tax area. Nevertheless, the Contract would apply as written, and it is important to consider the consequences.

Proposal

The Contract would establish many additional requirements for issuing tax regulations. For example, a 23-point regulatory impact analysis would have to be prepared for each regulation. This analysis would include an evaluation of the costs and benefits to be derived from the regulation, a demonstration that the regulation adopted the least costly approach, and a description of the alternative approaches that were considered but rejected. In addition, no regulation could be issued unless the Office of Management and Budget (OMB) certified, among other things, that the regulation was easily readable, employed proper grammar, used short and well-organized sentences, and did not contain double negatives, confusing cross-references, or words with multiple meanings.

Other provisions would grant those subjected to Federal investigative, enforcement or official proceedings more rights.

Discussion

The Internal Revenue Code is extraordinarily complex and there inevitably are questions as to the meaning of its provisions and the ways in which they interact with each other. Without regulatory guidance interpreting the Code, taxpayers would be subject to uneven enforcement of the tax laws, denied the certainty they need to plan for the long term, and hesitant to engage in productive economic activities.

For these reasons, the Treasury is often requested to issue more tax guidance, more promptly. The prior Administration also has recognized the critical role of tax regulations and, therefore, did not apply the 1992 regulatory moratorium to those regulations.

By putting tax regulations "on hold" until the completion of a complex regulatory impact analysis and other requirements, the Contract would bog down the guidance process and increase compliance burdens on taxpayers. The Contract also would undermine the ability of taxpayers to rely on published guidance by permitting any tax protestor to challenge the validity of a regulation on procedural grounds. Congress has long recognized in the Anti-Injunction Act and Declaratory Judgment Act that the tax collection system could not function if taxpayers could so easily disrupt IRS operations.

These issues should be in the jurisdiction of the tax writing committees. We would like to work with the Committee to insure that the tax regulatory process continues to function in an orderly and efficient manner.

Conclusion

The Administration has serious reservations about some of the provisions in the Contract, but it also shares goals that would be advanced by other provisions in the Contract. The Administration is interested in crafting a set of tax cut proposals that are affordable, simple, efficient, and focused on middle-income families. We look forward to working with this Committee to develop proposals that meet these criteria and are acceptable to the Congress, the President, and the American people.

Table 1

Preliminary Estimates */

CONTRACT WITH AMERICA

Proposal 01/10/95 09:41 AM	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	1995-00	1995-2005
							Fiscal years ($ billions)						
1 $500 per child tax credit	--	-13.4	-27.0	-27.2	-27.4	-28.9	-30.4	-31.9	-33.4	-33.6	-35.1	-124.1	-288.5
2 American Dream Savings Accounts	--	0.3	1.3	1.9	1.3	0.2	-1.7	-3.6	-4.7	-5.9	-6.8	5.0	-17.7
3 Favorable tax treatment of long-term care insurance and services	--	-0.9	-1.1	-1.2	-1.3	-1.4	-1.6	-1.7	-1.9	-2.0	-2.2	-5.9	-15.3
4 Tax-free accelerated death benefits under life insurance contracts	--	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
5 Increased expensing limit for small business	--	-0.8	-1.3	-0.9	-0.7	-0.4	-0.3	-0.2	-0.1	-0.1	-0.0	-4.2	-5.0
6 $5,000 refundable tax credit for adoption expenses	--	-0.0	-0.3	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-1.4	-3.3
7 $500 refundable tax credit for elderly care	--	-0.1	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-1.2	-2.6
8 Neutral cost recovery	3.3	10.0	13.4	8.5	-2.6	-14.1	-21.5	-26.0	-28.7	-30.4	-32.2	18.4	-120.4
9 Capital gains tax preferences	0.2	-1.1	-8.4	-15.0	-17.4	-19.2	-20.9	-22.6	-24.4	-26.2	-28.2	-60.9	-183.1
10 Phase-out of the 85 percent maximum inclusion rate for social security benefits	--	-0.5	-1.9	-3.2	-4.2	-5.2	-5.9	-6.3	-6.7	-7.0	-7.4	-15.0	-46.5
11 Tax credit to reduce marriage penalties	--	-1.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-9.0	-19.0
12 Expansion of the home office deduction	--	-0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-1.0
13 Increase of the estate tax exemption to $750,000	--	0.0	-1.4	-1.6	-1.8	-2.0	-2.2	-2.5	-2.8	-3.1	-3.5	-8.7	-20.7
	3.5	-7.6	-29.0	-41.5	-57.0	-73.9	-87.5	-97.7	-105.5	-111.2	-118.3	-205.4	-725.5

Department of the Treasury
Office of Tax Analysis

*/ Estimates are preliminary. The Office of Tax Analysis has had only a short time to analyze the legislation in its current form. There have been significant changes in some of the provisions since the original legislation was released on September 27, 1994.

PRELIMINARY

Table 2
Tax Proposals in "Contract with America" (1)
(1994 Income Levels)

Family Economic Income Class (4) (000)	Federal Taxes Under Current Law (2)			Change in Federal Taxes (3)			Total Federal Taxes After Change		
	Amount ($B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)	Amount ($B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)	Amount ($B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)
0 – 10	6.4	7.5	8.1	−0.4	−0.5	−0.5	6.1	7.1	7.6
10 – 20	25.8	9.4	10.3	−1.8	−0.7	−0.7	24.0	8.7	9.6
20 – 30	54.7	13.8	16.0	−4.3	−1.1	−1.2	50.5	12.7	14.7
30 – 50	152.3	17.3	20.9	−12.4	−1.4	−1.7	139.9	15.9	19.2
50 – 75	204.1	19.1	23.6	−15.3	−1.4	−1.8	188.8	17.7	21.8
75 – 100	175.2	20.5	25.8	−14.2	−1.7	−2.1	161.0	18.8	23.7
100 – 200	244.5	21.3	27.1	−21.0	−1.8	−2.3	223.5	19.5	24.8
200 & over	275.0	23.3	30.3	−27.5	−2.3	−3.0	247.6	20.9	27.3
Total (5)	1,139.8	19.5	24.2	−97.2	−1.7	−2.1	1,042.5	17.8	22.1

Department of the Treasury
Office of Tax Analysis

January 10, 1995

(1) This table distributes the estimated change in tax burdens due to the tax provisions in the "Contract with America," as introduced January 4, 1995 in H.R. 6, H.R. 8, H.R. 9, and H.R. 11. The effect of the proposed change in the estate tax exemption is excluded.

(2) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total comsumption expenditures. Taxes due to provisions that expire prior to the end of the Budget period are excluded.

(3) The change in Federal taxes is estimated at 1994 income levels but assuming fully phased in law and long-run behavior. The effect of the back-loaded ADSA proposal is measured as the present value of tax savings on one year's contributions. The effect of the neutral cost recovery proposal is measured as the present value of the tax savings from one year's investment. The effect of the prospective capital gains indexing proposal is the fully phased in tax savings, multiplied by the ratio of the sum of the present values of prospective indexing over 20 years to the sum of the present values of fully phased in indexing over 20 years, holding realizations constant. The effect on tax burdens of the proposed capital gains exclusion and prospective indexing are based on the level of capital gains realizations under current law. The incidence assumptions for tax changes is the same as for current law taxes (see footnote 2).

(4) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(5) Families with negative incomes are included in the total line but not shown separately.

TABLE 3

Comparison of Deductions Under Current Law and the "Neutral" Cost Recovery System (CRS)

(Example of a $1,000 asset with a 7 year recovery period and 3% inflation)

Year	Current Law	CRS	Difference
0	143	107	-36
1	245	204	-41
2	175	171	- 4
3	125	148	23
4	89	158	69
5	89	169	80
6	89	180	91
7	45	96	51
Sum	1,000	1,233	233

Chairman ARCHER. Thank you, Mr. Samuels.

There are several questions that come to mind, and that probably will not surprise you.

I have noted over the years that, even during the Reagan administration, that the Treasury has opposed the indexing and the cost basis for capital gains. So, your presentation today is no different than it has been for many, many years. Yet this committee has passed on several occasions, with overwhelmingly bipartisan basis, the indexing, recognizing that it is totally unfair to tax inflation.

I must say that although your testimony is no surprise to me, I believe this committee will once again override the position of Treasury and do what is right for the people of this country.

As far as the complexity for the taxpayer is concerned, the details that you mentioned, I understand the law and I am very sensitive to it. As you know, I do my own income taxes, so I suffer through all of the complexities, like all the detailed records required of taxpayers as to every cost that they put into an asset, even if they hold it for 50 years under the current capital gains tax requirements. I do not see it will be a whole lot more complicated to simply take a table from the Treasury and add on *x* amount based on the inflation that has occurred over the years that the asset has been held.

If I make an improvement to my house, I have to keep a permanent record of that in great detail under the current law. I do not see that that would really be changed. So maybe I misunderstood your testimony relative to the details that would be imposed as a result of indexing on the taxpayer.

Mr. SAMUELS. Mr. Chairman, it is correct that taxpayers are required to keep records on improvements and the times of purchase and the price. It is our view that when you take a look at the details, and it is important to get into the details of this, that adding the burden on to taxpayers of keeping track of cost-of-living adjustments, inflation adjustments, over a long period of time, will add a significant burden to them.

Take, for example, mutual funds. You own a mutual fund and you reinvest your dividends, which many people do. It is very common for a mutual fund shareholder to reinvest dividends. Well, if you reinvest your dividends—let us assume they redistribute dividends quarterly, or sometimes even monthly. You have to keep track of all of that and then apply these factors to each month. And, in our view, that will add considerable burden on to taxpayers.

I think the other issue, on indexing, is that the indexing proposal is limited. It does not apply to all assets, and it does not apply to liabilities, and that is the reason that we believe that it will give rise to significant tax shelter opportunities.

Chairman ARCHER. Well, when the indexing proposal was designed by the Joint Committee, and when Mr. Wexler did most of the work on it, as a member of the staff of the Joint Committee, all of that was considered, and the Joint Committee designed this and approved it as the appropriate approach. So I guess, here again, the Treasury is in disagreement with the Joint Committee.

I do not want to pursue that laboriously. It is interesting for me to note that as I look at your presentation that the so-called "bur-

den tables" on which you base your judgment make it appear that the Contract proposals are unfair from a distribution standpoint. Once again you are using what I believe is a publicly and totally discredited formula—family economic income. It includes the so-called "imputed rental value" of your home to determine what income class you are in. It also includes the imputed value of inside buildup of pension plans, life insurance, Kehoe plans, IRAs and 401(k)s to determine what your income is in a particular year, and it includes what is labeled as a lump-sum income that you did not report.

Now, how does the Treasury know how much income a family does not report? Can you look under their mattresses and enter their bathrooms and all the other things that relate to their lives and be able to come up with some magic figure that we know they did not report and that therefore you are going to include to determine how "rich" you are?

Mr. SAMUELS. Mr. Chairman, the distribution tables that the Treasury prepares uses a concept of family economic income. The distribution tables that the Joint Committee on Taxation and the Congressional Budget Office prepares has somewhat different income clarifiers but they are reasonably close. They all recognize that in doing a distributional analysis that you need to look at more than what is reported on tax returns as adjusted gross income because various families have other sources of income that do not show up on the tax return. For example, tax-exempt interest. For example, transfer payments, like Social Security, the part that is not taxable.

And in developing a reasonable measure, the Treasury's family economic income includes a number of items. The one that you mentioned on the rental value of homeownership is a very small part of the family economic income measure. And I do not think that anyone would dispute, from an economic point of view, that that would be a reasonable thing to take care of.

Of course, it does not reflect any view that any of the items, other than what show up on a tax return, should be subject to tax. I think it is a well-accepted approach among the economic community and shows as fairly as possible how to distribute tax proposals among income classes. As I say, I do not think our distribution tables historically have varied in any significant way from those done by the Joint Committee on Taxation or the Congressional Budget Office.

Chairman ARCHER. Well, it may seem logical to you, but to every American family that I spoke to after this concept appeared in the President's fiscal year 1993 budget, they do not understand it. They do not understand that they are richer by an amount equal to some hypothetical rental income on the house that they own and they live in. They do not understand that.

Mr. SAMUELS. As I say, Mr. Chairman, it is a very small part of it.

Chairman ARCHER. It is a significant part of it. They do not understand how you can magically create some number and say, well, you did not report this and we know you have that income, but you do not identify it. They don't see how you pull out of thin air an income number and then tell these people they are rich. No family

that I have spoken to since 1993 understands that and I do not understand it, but you do.

Well, let us move on to one or two other things quickly. First, you say that all we do should be targeted, and yet the minority leader this morning said the worst thing about the income tax is the targeting that we do now changes the level playingfield. He says we should get away from that. On the one hand you testify that we should have a level playingfield and on the other hand, you say we should target everything that we do. Those two, it seems to me, conflict with one another. So I just want to point that out for the benefit of the committee.

Finally, and quickly, let's go back to the burden tables, or the distribution tables. You include a hypothetical projected amount of revenue loss resulting from the reduction in the tax rate on capital gains but you do not include one single dollar that is part of the burden or the distribution in taxes that are paid by people who unlock an asset that they would never have sold during their life. I think you will agree, in fact, I believe you will agree, that there will be many transactions that will occur at a reduced capital gains rate that would not occur at all and these will generate taxes that would otherwise not be received by the Treasury.

We can argue about the dimension of that, but certainly the unlocking effect is accepted by all economists. Why do you not include in your burden table the extra taxes that are going to be paid by those people with assets they sell that they would not otherwise sell at all?

Mr. SAMUELS. Mr. Chairman, if I can answer this question by first making one point very clearly. The revenue estimates that are prepared by Treasury, and as well are prepared by the Joint Committee on Taxation—the revenue estimates—those revenue estimates take into account behavioral effects like the unlocking that you refer to. These are the revenue tables, take in clearly, and they have for quite awhile, the revenue effects of increased sales of assets as a result of reducing the capital gains tax. So that is in the revenue tables.

The burden tables is what you are referring to?

Chairman ARCHER. Yes.

Mr. SAMUELS. The burden tables, or the distributional tables, the question of who gets the—in this case the benefit, because the Contract proposals are to cut taxes. So we are looking at who gets the benefit. These are the benefit tables. Who gets the benefit. They are not burden tables. Who gets the benefit of various proposals in the Contract. That is what the distributional table provides information on.

That table measures benefits at current realization rates. This shows how much better taxpayers are under a proposal. If taxpayers choose to realize more gains voluntarily in the face of lower rates, the extra tax that the person decides to pay voluntarily because they decide to sell their assets, is not an extra burden. That is why they are not reflected in these distributional tables.

Chairman ARCHER. But is not every transaction voluntary with a capital asset? Is not the transaction——

Mr. SAMUELS. What the distribution table is based on is realizations at current expectations, at current rates. It does not deal with

realizations that might be induced, because that is up to the taxpayer. It assumes that taxpayers will realize what they have been historically, and then if they want to realize more because——

Chairman ARCHER. We will have to pursue this in more detail at a later time.

Mr. SAMUELS. We will be glad to do that.

Chairman ARCHER. But you do bring me to one subject that I want to ask you which is very, very important. Has the Treasury, since January 1993, in any way changed the model for estimating capital gains revenues or losses compared to what it was at the turn of the decade, prior to this new administration? Has any part of the model for estimating capital gains been changed?

Mr. SAMUELS. Mr. Chairman, the model has not changed. What we have done and what Treasury has always done is to update the model to reflect new information and studies that have taken place over the years. And we are always trying to update our models for purposes of revenue estimating so that we have the most up-to-date revenue estimating capacity. And I know that has been a concern of certain members and that the revenue estimating process is not up to date. The Treasury tries to stay as up to date as possible and, as a result, it would have gone through the normal adjustments that it does for all parts of its model, not just the capital gains, but for the entire model we use for estimating revenues from various tax proposals.

Chairman ARCHER. But is updating not changing?

Mr. SAMUELS. We think——

Chairman ARCHER. The model is not the same. It has been changed. You can call it updating but it has been changed as I understand it.

Mr. SAMUELS. This model is maintained by career economists at the Treasury. There has been absolutely no political input into any changes to the model. As I say, the changes reflect current information to make the model better so that these revenue estimates can be the best that we can possibly make them. And I am sure that that is what the committee would like us to be doing.

Chairman ARCHER. But it has been changed. The model is not the same as it was when this administration took office.

Mr. SAMUELS. It wasn't the same as—every—it wasn't the same——

Chairman ARCHER. I understand, but just simply has it or has it not been changed? It has been changed, has it not?

Mr. SAMUELS. The model has not. The methodology for the model has been to update the model to reflect new information and studies.

Chairman ARCHER. I understand, but it has been changed.

Mr. SAMUELS. If you want to characterize it that way, that is up to you.

Chairman ARCHER. When the Joint Committee refines and updates their model, that is not cooking the books, is it?

Mr. SAMUELS. I think the Joint Committee as well as the Treasury consistently——

Chairman ARCHER. I just want to be sure about that because——

Mr. SAMUELS [continuing]. Consistently keeps their models up to date.

Chairman ARCHER. When you update and change your model, it is "not cooking the books." And I just want to establish that if the Joint Committee updates their model and refines it to take into account information to make it more accurate, that you will agree that that is also not cooking the books.

Mr. SAMUELS. I think, Mr. Chairman, two points: First, the Joint Committee on Taxation is well known for its nonpartisan analysis of tax proposals and of revenue estimating. Second, to the extent that they make changes in their models, I think that if they are changes that are viewed as new types of analyses, we would all want to withhold judgment on what those changes are until we see them.

Chairman ARCHER. If there is a discrepancy between the Joint Committee's estimates and the Treasury's estimates on capital gains, due to their updated and refined model, I hope you would agree that is not cooking the books any more than your updating and refining your model is not cooking the books.

I am sorry, I have taken too much time, with the indulgence of the committee. I recognize Mr. Gibbons for inquiry.

Mr. GIBBONS. Well, Mr. Samuels, we welcome you back here. Pursuing the revenue modeling discussion that we had here, are there any substantial differences that you know of between the Joint Committee's model and the Treasury's model? Do you know of any?

Mr. SAMUELS. Mr. Gibbons, if you compare revenue estimates on various proposals, you will see that there are differences from time to time, and those are based on good faith differences of judgment about different issues. So to that extent, there are, from time to time, differences between the Joint Committee on Taxation's approach to a particular proposal and the Treasury's approach. And I guess that depends on the issue.

I think from my perspective we strive to have the Joint Committee's estimates and the Treasury's estimates, we think that they should—for your purposes, one hopes that they are as close together as possible. It is not always the case. And when it is not the case, we carefully discuss with the Joint Committee why there would be a difference of view because we think that the committee and other Members of Congress would be very interested in trying to understand that.

Mr. GIBBONS. I would assume that the Joint Committee gets all their raw information from you; is that correct?

Mr. SAMUELS. Correct.

Mr. GIBBONS. In other words, from the tax returns that we have and——

Mr. SAMUELS. That is correct.

Mr. GIBBONS. The basic fundamental building blocks for all of this. It is just a matter of assumptions as to what human behavior might be or economic behavior might be that we vary on; is that where——

Mr. SAMUELS. Yes, sir.

Mr. GIBBONS. From your experience in looking at these things, I know there are some differences. Are these differences substantial?

Mr. SAMUELS. Generally not. I think that where we have probably the biggest difference historically is scoring compliance initiatives; that that tends to be where you have the biggest disparity between the Joint Committee on Taxation and the Treasury. And as I say, we try to—and continue to have a dialog to try to make those discrepancies as small as possible, or those differences as small as possible.

Mr. GIBBONS. Well, I asked the majority leader the other day, Mr. Gingrich, how he expected to pay for this over a 10-year period, this—at that time it was $710 billion. And he spent most of the time killing the messenger. He blamed it on those Socialist estimators down there that you all harbor somewhere.

Can you tell me who these socialist estimators are?

Mr. SAMUELS. Mr. Gibbons, I would like to say that the career staff of the Treasury, which are the staff that prepares the revenue estimates, are a dedicated, hard-working and professional group. They have been there throughout various administrations. The people who are preparing revenue estimates now are the same folks, many of them are the same folks who were preparing revenue estimates in the Reagan administration, the Bush administration, and now the Clinton administration.

I have enormous confidence that they are going about their task in the most professional way that they possibly can.

Mr. GIBBONS. You mean to tell me you all didn't fire all the estimators down there and replace them with all people from Arkansas when you came in?

Mr. SAMUELS. No, sir. No, sir, these are career economists. They all have Ph.D.s. Many of them have spent their entire career at the Treasury. It has been a spot of, I think, real honor for many in the economics profession to work in this field at the Treasury. And as I say, I have enormous respect for their talents and their intellectual abilities and their honesty, and I do not get involved in any of the discussions about how revenue estimating is done. They come and explain what they have done. If I have a question, they will explain it to me. But we do not—I do not get involved in any way in influencing their estimates.

Mr. GIBBONS. Well, I wish you would explain to Mr. Gingrich, if you have an opportunity, that you are not harboring a bunch of Socialists down in the Treasury that are cooking the figures.

I kept a rough track of these proposals as you went through them. There are 13 tax proposals here. As I see, you sort of supported three of them. You outright oppose three of them. And then the others, I must have missed your comment on them.

Let me see, I suppose you are opposed to increasing the estate tax exemption; is that right?

Mr. SAMUELS. Yes, sir.

Mr. GIBBONS. And the home office deduction?

Mr. SAMUELS. The home office deduction is one where I think we would really like to work to deal with potentials for abuse and administrative difficulties in trying to craft a proposal on that one. So I would not—we do not oppose that proposal.

Mr. GIBBONS. How about the tax credit to reduce the marriage penalties? Do you all feel strongly about that? It is not a big figure, but it is——

Mr. SAMUELS. Mr. Gibbons, in my remarks, I indicated that this proposal lacks details on the allocation of the benefits, and I think it would be, therefore, very difficult for us to devise a proposal and then administer it. So we would like to work with the committee to investigate other means of addressing this issue.

Mr. GIBBONS. The $500 refundable tax credit for elderly care. What about that?

Mr. SAMUELS. Mr. Gibbons, on that one, the administration has made proposals on dealing with what we understand and agree is a serious problem of caring for elderly Americans, and I think our view on that is that our proposals would be more efficient and better targeted. But we would certainly like to work with the committee to try to address this difficult problem.

Mr. GIBBONS. The adoption expense.

Mr. SAMUELS. Excuse me?

Mr. GIBBONS. The adoption expense. It is not a big item, $3 billion over 10 years.

Mr. SAMUELS. I know that is not a big item, but it is certainly a very important item. And our view on that is that, as you know, there was a deduction for adoption expense. It was repealed in 1986 and replaced with a direct spending program for children with special needs. And we think that that is how we should target our resources, is to really look at the programs for children with special needs and make sure that that is working properly, rather than necessarily running the program through the tax system.

We think we will get more value for our money with the existing program. But that is certainly an area where we are willing to look at it and discuss it with the committee and try to be as constructive as possible.

Mr. GIBBONS. I don't think you took a position on long-term care insurance and services.

Mr. SAMUELS. Mr. Gibbons, the administration proposed last year favorable tax treatment of long-term care and services. So we support the goal that is in the Contract.

However, we think that there are some issues associated with the Contract's proposals. It has been revised in ways that make it, we believe, to be too generous. For example, under the Contract's proposal as revised in the bill that was introduced last week, you can buy multiple policies. So that with the way the proposal works, you can buy a policy that will give you $200 tax free if you become entitled to claim against the policy. Two hundred dollars per day tax free. And the proposal, as revised, allows you to buy five contracts so you can get $1,000 a day tax free. You can buy multiple contracts.

And we think those are the kinds of issues we need to work together on the committee to refine these proposals. And I say we think that the proposals that the administration brought forth last year are good starting points. And on this one we have significant common ground with the Contract, and basically I think we really need to work on some of the technical but very important issues as to exactly how the proposal will work and make sure it accomplishes its intended purpose.

Mr. GIBBONS. Thank you very much.

Mr. CRANE [presiding]. Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman.

Mr. Samuels, good to see you again. I have a question, because we are throwing these numbers around and they get so big it is hard to put them in perspective. But let me hone in on one—which is the neutral cost recovery.

I think you are worried about this because for the first 4 years it is a plus for the Federal Government and after that it loses money. And for the years 1995 to 2005, it loses $120 billion.

Mr. SAMUELS. Yes, Mr. Houghton.

Mr. HOUGHTON. Now, I don't know whether those numbers are right; however, we have had testimony from a Member of Congress and he used figures put together by a former revenue estimator from the Treasury Department which indicated this, and the two things just do not jibe. Maybe you can help me here.

If you put the neutral cost recovery program into effect, it would create almost 3 million new jobs, increase wages by $4,800 per employee, and provide an additional $3.5 trillion in economic activity by the year 2000. Now, if all those things happen, how can you lose $18 billion between 1995 and the year 2000 and then $120 billion for the next 5 years? I just do not understand that.

Mr. SAMUELS. Mr. Houghton, I think that those numbers you read illustrate the differences between the type of revenue estimating that has been done by the Treasury and the Joint Committee on Taxation, which is to take into account behavioral effects but not what we refer to as macroeconomic feedback effects. And the revenue estimates and predictions that you are referring to take into account, I believe, macroeconomic feedback effects.

One of the reasons and a very important reason that we do not take into account macroeconomic feedback effects is because there is not a consensus among the economists about what the effects will be with respect to any proposal, including the reaction of the Federal Reserve bank to various proposals that would potentially have an effect on the economy.

That is the reason, I believe, for example, that Chairman Greenspan testified this morning that he had serious reservations about using macroeconomic feedback for purposes of revenue estimating and the use of those revenue estimates for congressional scorekeeping.

So that is the problem. Everybody can have their views as to what is. There is a wide range of views as to what impact various proposals will have on the economy, not only tax proposals but infrastructure proposals, like building bridges and building roads. They obviously make the economy more efficient. And if we had to take into account those macroeconomic feedbacks, then you would not have to pay under our budget rules, if they produce positive results, you would not have to pay for spending programs. So those differences show, I think very much, the danger of getting into the area of using macroeconomic feedbacks, and we should stick to what we are doing, which is we use behavioral effects.

We have done that and we think it is not perfect. We recognize that it is not perfect, that there are pluses and minuses of it, but we think that it is a good conservative approach for Congress to take in evaluating tax proposals for purposes of the budget rules.

Mr. HOUGHTON. Mr. Chairman, my time is up but can I just sort of continue this for a second longer?

I don't understand what the components are of macroeconomic effects. Maybe you can teach me someday. But, however, having been in the business community all my life, I know if something went in this way I would buy more equipment and I would hire more people. And I cannot help but believe that this would not have a big plus for the economy. So you may not—you cut these numbers in half. I don't know what it is. There is something plus but it always comes out minus in some of these Treasury proposals and I still do not understand it.

Mr. SAMUELS. I think on this particular proposal, when you look at how in fact and in practice it will effect investment decisions and the opportunities for creating tax shelters, we have this example of how you can get a negative tax rate by combining borrowing and the cost recovery system; and, as a result of that, you will have uneconomic investments made, like the see-through buildings that we saw built in the eighties as part of the tax shelter frenzy.

And I think that you have to take that into account and you could wind up with a lot of uneconomic activity and this proposal could not have the effect that its proponents state.

Mr. HOUGHTON. Thank you very much.

Mr. CRANE. Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman.

Welcome again, Mr. Secretary. From your responses to the Chairman, it appears as though you do not expect any dramatic differences from the estimate of the Joint Committee on Taxation and that from Treasury as relates to the Contract.

Mr. SAMUELS. Mr. Rangel, I have not yet seen any estimates from the Joint Committee. As I say, from time to time, there are differences and sometimes one is surprised. One hopes they are reasonably close. But, as I say, we have not seen any yet so I cannot really——

Mr. RANGEL. Have you had a chance to look at the CBO report which shows over a $1 trillion deficit reduction would have to be required between 1995 and 2002 if all these things are locked into place? Do you challenge——

Mr. SAMUELS. No, Mr. Rangel. I have heard—no, the CBO numbers that you are referring to, I believe, based on what I heard this morning, was that in order to balance the budget by the year 2002, there would have to be a reduction in spending of $1.2 trillion. Now, that does not take account of the Contract. And if you look at our revenue table you will see that the Contract loses approximately $400 billion from 1995 through the year 2002.

So when you add those two together, you need $1.6 trillion between now and the year 2002 in order to balance the budget and pay for the Contract.

Mr. RANGEL. But is there any difference in the estimate of the cost of the tax consequences of the Contract between Treasury and CBO?

Mr. SAMUELS. What CBO has done is just estimate what it would cost, as I understand it, to balance the budget; they have not estimated the Contract.

Mr. RANGEL. Well, historically, you say there has not been that much difference between Treasury and the Joint Committee.

Mr. SAMUELS. Well, that is——

Mr. RANGEL. What I am getting at, and I think the Chairman was referring to this, this idea of dynamic scoring. It is perceived that the majority has a method of determining the cost of the tax cuts that is inconsistent with the standards that have been set by Treasury and the Joint Committee.

Now, how do you perceive the term "dynamic scoring" as relates to how you came with this presentation on the cost of the tax provisions in the Contract?

Mr. SAMUELS. We prepared revenue estimates on the Contract using a process of which includes taking into account behavioral effects. So if you, for example, impose a gasoline tax, the estimate just does not multiply the number of gallons you expect on the baseline times the tax. It takes into account that maybe less gasoline will be used. We take that into account. And that has always been the traditional revenue estimating process, Mr. Rangel.

Mr. RANGEL. Is it possible under traditional revenue estimating processes that you use that it could be described by any other economists as being dynamic?

Mr. SAMUELS. Yes, I think that that is a fair characterization. What we don't do is take into account macroeconomic feedbacks. We take into account these behavioral effects, and in that sense it is clearly dynamic.

Mr. RANGEL. But aren't your figures dramatically different from those that support the majority's Contract as relates to the tax provisions? Aren't there dramatic differences in the costs between your dynamic scoring and what they call dynamic scoring?

Mr. SAMUELS. Mr. Rangel, I haven't seen any Joint Committee estimates, and those—let me say that the numbers that I heard before that Mr. Houghton kind of referred to, those are prepared by a private firm.

Mr. RANGEL. I wasn't talking about Mr. Houghton at all.

Now, first of all, you are basing all of this on a contract which this is supposed to be—a new contract—after the election and before the election. Have you been working on two Contracts With America or one? I understand there are some tax changes that have been made since the original legislative language was issued.

Mr. SAMUELS. Mr. Rangel, we are working with the legislation that was introduced last week. And so there have been changes, and so we are working with the revised Contract.

Mr. RANGEL. Are you saying that the majority has not associated any figures at all as to the economic impact of these tax provisions in the Contract? I mean, you haven't read anywhere from the Speaker or his representatives as to whether or not these tax provisions lose revenue or whether they gain revenue? I mean, you have just dealt with your estimators, but you have nothing to compare the majority's tax provisions with at all?

Mr. SAMUELS. Correct.

Mr. RANGEL. And in the newspapers you have seen articles that would indicate that what they are suggesting are revenue raisers. Have you read that?

Mr. SAMUELS. I have read that.

Mr. RANGEL. And you heard them say that?

Mr. SAMUELS. I have read reports of that, yes, sir. I just haven't seen any details so we could evaluate.

Mr. RANGEL. Somewhere, either in your written statement or the one that you have said, it was indicating that the capital gains tax provisions could be used for baseball cards and collectibles and antiques and things that could not possibly generate any economic growth. Could you share that with the—did you state that or did you write that?

Mr. SAMUELS. Mr. Rangel, you were correct. The Contract's proposal applies to all capital assets, including collectibles such as antiques, fine art. You said I guess baseball cards are still valued even though there has been a strike. Those types of assets would be entitled to the capital gains preferences that are in the Contract.

Mr. RANGEL. Well, you will give them time to omit all these baseball cards. I am certain that is not what they are talking about with capital gains, but I am here to work with them so, Mr. Chairman, you can make certain you get the right corrections in this capital gains thing because we don't want people to laugh at this Contract. Thank you very much.

Mr. CRANE. Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman, and welcome, Les. It is very good to see you again.

I would like to get to the proposal that the President mentioned. It is not mentioned in your testimony. At least—and I am sorry that I wasn't here while you were testifying. Maybe you mentioned it.

But this $10,000 tax credit for education that the President mentioned in his speech shortly after the election, I have a little bit of a problem with that from the standpoint that I would like to see whatever tax structure that we come up with in the Contract is primarily designed to create a climate where people would have a tendency to save money ahead of time. The $10,000 credit for education would apply I think only to people—is it only for people with $100,000 or less income or something like that? Isn't that what he mentioned?

Mr. SAMUELS. Mr. Hancock, the proposal is to permit a deduction of up to $10,000 for taxpayers with incomes up to $120,000. It phases out between $100,000 of adjusted gross income and $120,000 of adjusted gross income.

Mr. HANCOCK. OK. Well, I thought it was a tax credit. Actually it is a tax deduction if you have a child in school.

Why not give the parent a tax deduction for that child when the baby is first born to save the money to send his own kid to college instead of waiting for the government to make a grant or an aid or what have you? Why not—it has been kicked around for a long time, what I call an individual deductible education account, similar to an IRA. Why not do it and let the individual do it themselves rather than waiting until a child is 18 and then saying, well, if you are making enough money, we will let you take a $10,000 tax credit? I mean, that isn't going to benefit the average-income individual.

Mr. SAMUELS. Mr. Hancock, in fact, the administration's proposal includes the type of savings incentive that you mentioned. Our expanded IRA proposal, which I have said is like the IRA proposal that was cosponsored by Mr. Thomas and passed by Congress in 1992, permits penalty-free withdrawals for education, and we think that that is a very important part of our proposal, and it is in the Contract as well.

I think the difference between the President's proposal on this savings incentive and the Contract's proposal is that the Contract's proposal only allows penalty-free withdrawals for the ADSA, this new American dream savings account, and does not permit penalty-free withdrawals for people who already have IRAs or who want to continue IRAs. So we think it ought to be expanded. And that would be one place where we would very much like to work with the committee to try to make these savings incentives that we believe are very important to the future of the country available for families who want to save for their children's education.

Mr. HANCOCK. Let me ask you another question, then, Mr. Samuels.

I understand that we agree that there needs to be some way—and personally I think that a better way to allow people to have money to educate our children at higher education is to start accumulating that money when the baby is first born instead of when they get 18 years old.

You know, we get away, basically, with the uniform gift to minors, that by coming up with, after you make a certain amount of money, the child—you give the money to the child for an education then, but it is taxed at the parents' rate up until, what, age 14, 13 or something like that. So we have—actually, we have penalized the parents in the past couple of changes in our laws if they even try to save money to educate their children. Shouldn't we go back and address that?

Mr. SAMUELS. Mr. Hancock, I agree that encouraging families to save is very important. That is why we have had these IRAs, these expanded IRA proposals.

And I understand as well as Mr. Thomas you were a cosponsor of that proposal in 1992. And we feel that IRA proposal, which people understand—there has been a lot of advertising over the years. They understand how they work. We don't have to explain new kinds of things to taxpayers and families. And so it is a very good proposal that we would like to work on with you together.

In addition, the President's proposal to provide a deduction for education and training, we believe, is very important. That if you look at the future of this country and the need to educate our young people and to provide training if someone unfortunately loses a job or decides to move from one job to another type of job, that that is very important. And we should be investing in human capital as well and that that is a very important objective that I think we can probably all agree on. And we think that this is a good way, a very good way, to accomplish that objective.

Mr. HANCOCK. Mr. Chairman, one final question, real briefly. You know, we keep talking about capital gains taxes are only good for the rich. We keep implying—I mean, especially the minority party that used to be the majority party always said that capital

gains is only good for the rich. Why don't we make it good for everybody and give a zero capital gains say up to $2,500 a year for everybody? Think about it.

Mr. SAMUELS. We would be happy to think about it.

Mr. HANCOCK. Thank you.

Mr. CRANE. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Mr. Secretary, does the administration accept the premise that the cost of raising a child—the costs associated with raising a child—generally increase with the age of the child?

Mr. SAMUELS. I think that when we have designed our child credit proposal—as you may know, there is a difference between the administration's child credit proposal and the Contract's child credit proposal. The administration's child credit proposal is for children under 13. And, as I recall, the Contract's proposal are for children——

Mr. RAMSTAD. It applies to children under age 18.

Mr. SAMUELS [continuing]. Eighteen and under.

Mr. RAMSTAD. Right.

Mr. SAMUELS. And in designing the administration's proposal, we looked to try to target to those where we thought there was the greatest need and the greatest risk. And—and I think this is very important—and we took into account the budgetary effects of the proposal and the fact the administration has said and we have proposed spending cuts that will fully pay for our tax proposals.

Now, if you look at our revenue table, you will see that the Contract's cost over 10 years is $288.5 billion. As I mentioned before, the Congressional Budget Office has said that over—between now and the year 2002 it is going to take $1.2 trillion to balance the budget. You add on to that the cost of the Contract between now and 2002 as an extra $400 billion, you have $1.6 trillion that has to be financed in order to pay for the Contract and balance the budget.

Now we believe that we should pay for all of our tax cuts, and we have proposed that—actually we have proposed more spending cuts so that we have some modest deficit reduction. And in making these judgments you have to make tradeoffs. And, in our judgment, given the fiscal constraints, and we went through and did 500 billion dollars' worth of deficit reduction in 1993, we know how hard it is to come up with deficit reduction, we decided that this was an appropriate age cutoff.

Now, would we like to go higher if we have the money? We would be prepared to think about going higher, but we have to put this all in context, and there are difficult tradeoffs, and we have, as you know, very, very difficult times in cutting spending to pay for these types of proposals, and we think it is important to be completely responsible and identify your spending cuts in advance so we can be fully satisfied that we are going to pay for any of these types of proposals.

Mr. RAMSTAD. Which is precisely what we will do.

So, in other words, you are admitting that you realize that only one-third of married couples have children under the age of 13. So you recognize that this credit only applies to one-third of the families of America?

Mr. SAMUELS. I don't have that particular——

Mr. RAMSTAD. Those are the demographics.

Let me ask another question. This I think relates somewhat to the testimony of our colleague, the gentlewoman from New Jersey, Mrs. Roukema, who suggested that we cut out the war on words with respect to orphanages, to raise the level of discourse and to help in a positive way with the policymaking. And I would respectfully suggest that in terms of tax credits that we cut out the talk about class warfare.

And I don't mean to suggest that you have been initiating such talk, but, again, when you analyze the figures, only 5 percent of households, 5 percent, have incomes above $75,000 in our country, so we are talking about a very small percentage of families who have incomes between $75,000, where the administration's tax credit phases out, and the $200,000 where the Contract's tax credit begins to phase out. So to make such a fuss about the credit's lower income threshold it seems to me it doesn't serve the public policy debate well. And I would hope that we could make that recognition that we are only talking about a very, very small percentage of families, and I think we should be promoting rather than hindering social mobility.

That would be my comment. Thank you, Mr. Chairman.

Mr. CRANE. Mr. Jacobs.

Mr. JACOBS. Mr. Secretary, this idea of imputed income in the form of rent from a house you own and live in and don't rent, with all due disrespect, it kind of bothers me, too. With all due respect, that bothers me, too. Did your administration come up with that?

Mr. SAMUELS. No, sir. This has been——

Mr. JACOBS. Who came up with that idea? Which administration?

Mr. SAMUELS. This has been used since President Ford's administration.

Mr. JACOBS. Since what?

Mr. SAMUELS. President Ford's administration.

Mr. JACOBS. Did they come up with that?

Mr. SAMUELS. That is when it was developed and was used. Like I say, these are measures of distributional effects.

Mr. JACOBS. No, no I understand what it is, all too well.

Mr. SAMUELS. It has been around for a long time.

Mr. JACOBS. I understand. Well, that is right. If the Ford administration came up with it, it has been around for a long time.

Mr. SAMUELS. It has been used in the national income accounts since 1940, I have been informed.

Mr. JACOBS. Imputed rent?

Mr. SAMUELS. Yes.

Mr. JACOBS. Then what did Mr. Ford have to do with it?

Mr. SAMUELS. It was used in the national income accounts since 1940, and it was used—which is a different set of statistics—and it was used for purposes of determining distribution of tax proposals by the Treasury since the Ford administration. So it is a long time——

Mr. JACOBS. Could it go back to "Alice in Wonderland"? Would it go back that far? The average Social Security retiree today has paid in what percent of the benefits he or she will receive? Do you have that?

Mr. SAMUELS. As I understand it, it is about 10 to 15 percent.

Mr. JACOBS. That includes the interest that the contributions have generated, I believe? Five percent is my number. The average retiree today, Social Security retiree, has paid in 5 percent of the benefits he, she or they will receive, average, and that 5 percent has earned an amount equal to another 10 percent of the benefits, thus leaving the 85 percent.

Now, to the naked eye that 85 percent is in the nature of a freebie from those of us who are still paying Social Security taxes. You might even say like a lottery. Now, if you have lottery proceeds, you would have to pay taxes on them?

Mr. SAMUELS. Yes, sir.

Mr. JACOBS. Even if you lost all but 15 percent, right?

OK. So when President Reagan agreed to tax 50 percent of the Social Security benefits he agreed to include in the gross income or the adjusted gross income. He agreed that 35 percent of the benefits would be exempt no matter what your income was, correct?

Mr. SAMUELS. Yes, sir.

Mr. JACOBS. And then the 1993 act said if your income were even higher than the threshold to require you to pay taxes on just the 50 percent of your freebies—I don't mean 50 percent of the freebies but the 50th percentile of the freebie part. If your income were even higher—and the way I calculate it your income would have to be, including the Social Security benefit, on average about $66,000 a year before you would be required to include the entire amount that you didn't pay for, the free subsidy from the taxpayers in your adjusted gross income. Now, where does that money go when it is taxed? Does that go in the General Treasury?

Mr. SAMUELS. No, sir. It goes into the HI Trust Fund.

Mr. JACOBS. The Medicare Trust Fund?

Mr. SAMUELS. Right.

Mr. JACOBS. Thank you.

Mr. CRANE. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. Samuels, in your statement you were talking about the IRA, and you felt like that it should be targeted toward middle-income families. What is the gross income, annual income, for that family? What is the cap?

Mr. SAMUELS. The cap in the President's proposal is $100,000 for joint is the maximum.

Mr. COLLINS. $100,000 annual income.

Mr. SAMUELS. Adjusted gross income, yes.

Mr. COLLINS. OK. There has been mention of the $500-per-child tax credit for middle-income families. What is your ceiling there for annual gross income?

Mr. SAMUELS. $75,000.

Mr. COLLINS. Why the discrepancies in the two?

Mr. SAMUELS. As I mentioned before, in devising these proposals one had to take into account a number of factors and tradeoffs. And when we looked at the various proposals we felt that for the child credit that a $60,000 to $75,000 phaseout range was appropriate, given the scarce resources that we have to spend on tax cuts.

We think that we need to pay for all of our tax cut proposals, announce those in advance, and that they be credible spending cut

proposals. And we looked at the current IRA law and felt that the appropriate way to encourage savings was basically to double the limits, which got you to the limits that we have in our proposal.

Mr. COLLINS. The discrepancy doesn't matter. Earlier this morning Mr. Gephardt referred to the $75,000, too, as an income, but he also made the comment that he would favor a lower rate across the board for all taxpayers, which includes all income levels. What is your position on such measures?

Mr. SAMUELS. I haven't seen Mr. Gephardt's proposal. What I guess I would——

Mr. COLLINS. It just simply said—reclaiming my time, let me rephrase. Let me restate it to you. He said he would favor a lower tax rate for all taxpayers. I mean, that is not hard to understand. What would be your position on that?

Mr. SAMUELS. Mr. Collins, we are in a situation where we have a serious budget deficit that faces this country, that threatens our children and grandchildren, and that is why the Contract has a balanced budget amendment that has a trillion two plus the 400——

Mr. COLLINS. I am going to run out of time. Reclaiming my time.

Mr. SAMUELS. I think what I would say is we are very concerned about fiscal responsibility, and we think that all of these proposals should be paid for. And when you—we would also like to cut tax rates. We would very much like to cut tax rates, but we have to do it in the context of fiscal responsibility.

Mr. COLLINS. OK, let's move on, then, to the cost recovery depreciation schedules. You used 10 years for a $1,000 calculator. That is kind of a little farfetched. Would you really depreciate a calculator for 10 years?

Mr. SAMUELS. That was for 10-year equipment.

You will also see attached——

Mr. COLLINS. My question is, what about 5-year?

Mr. SAMUELS. I would be happy to get you that number.

We have a 7-year example attached to my written testimony which shows how it works for 7 years. There was a 10-year example on the board. We would be happy to provide you with the number for 5 years.

Mr. COLLINS. Good. I would like to see that.

[The following was subsequently received:]

]Response to Question by Rep. Collins[

The following tables provide a comparison of the annual depreciation deductions allowed under current law with those allowed under the Neutral Cost Recovery System (CRS) for five and ten year recovery property; a similar table for 7 year recovery property was included in my testimony.

Comparison of Deductions Under Current Law and the "Neutral" Cost Recovery System

($1,000 Asset with 3.0 Percent Inflation)

- 5-Year Property -

Year	Current Law	CRS	Difference
0	200	150	-50
1	320	272	-48
2	192	203	11
3	115	201	86
4	115	216	101
5	58	114	56
Sum	1,000	1,156	156

- 10-Year Property -

Year	Current Law	CRS	Difference
0	100	75	-25
1	180	148	-32
2	144	134	-10
3	115	121	6
4	92	112	20
5	74	120	46
6	66	129	63
7	65	136	71
8	66	147	81
9	65	155	90
10	33	83	50
Sum	1,000	1,360	360

Mr. COLLINS. On the capital gains—a couple years ago I walked into a small TV rental store in a small town in middle Georgia, and a lady immediately stopped me to discuss taxes and the fact that she has a small piece of property at the edge of town. And this is not metro Atlanta. This is rural Georgia. She could have sold that piece of property, but she had chosen not to because she would have had to pay a significant capital gains tax. So what happened when she didn't sell that piece of property?

Mr. SAMUELS. Excuse me?

Mr. COLLINS. What happened when she did not sell that piece of property?

Mr. SAMUELS. Well, she obviously owns an asset, and she maintained ownership of the asset. Presumably, if she sold it to someone, that buyer would then own the asset. So the asset would either be owned by her or a buyer if, in fact, she decided to sell the property. Or she could have exchanged it for some other property. As you know, we have like-kind exchanges, and you could defer the tax.

Mr. COLLINS. That is fine, but the truth is that nothing happened. She did not sell it. She did not receive any income. Neither did the Federal, State or local governments receive any revenues from the sale because it didn't happen.

Thank you, Mr. Samuels.

Mr. CRANE. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman.

It is unfortunate, I think, this hearing came at the end of the day so many of us could not be here, and I take it some of the media has gone because I really think that this isn't the heart of the matter, but it is part of the heart of the matter, and I think your exchange with the chairman of the committee should be read by everyone, Republicans and Democrats alike.

For some reason, people who are sometimes called Conservatives kind of become Radicals. I don't think those of us here are by any means Radicals. We become Conservatives when it comes to this whole effort to estimate the impact of proposals on the deficit, and I really think before we leap we really better look. We have been through this before.

And I was thinking as we were discussing it here—take the President's proposal for an education deduction. If you use what you call macroeconomic feedback effects, I would think you could come out with an answer that that deduction would make money, no? I mean, the biggest deficit we may have today or one of the biggest deficits is in education, in training, and we have this mismatch between positions and people, right?

Mr. SAMUELS. That is correct.

Mr. LEVIN. So if you look at the macroeconomic effects of a deduction for education, presumably education will increase, will it not? I mean, more children will go to college?

Mr. SAMUELS. That is correct, Mr. Levin.

Mr. LEVIN. And the impact of that has to be positive. In fact, some people argue that more children are economically positive automatically, so I would think you could take the $500-per-child tax credit in the Contract With America and come out with a plus or at least much less of a minus than you have.

And I think all of us have to ask ourselves what is driving this discussion. I don't think it is a nefarious group within the Treasury Department. I am not sure always what it is.

I think some of us were somewhat surprised to read about the capital gains proposal so that even if you sold at a gain it could be a loss, and you could take that loss against another gain, right?

Mr. SAMUELS. Correct.

Mr. LEVIN. And I just wonder, really, if the majority side is serious about that and the revenue impact that that would have.

So I think it has been interesting, Mr. Samuels, to sit through your testimony, and I just hope that, you know, as you have done today that you will proceed in a sober way. You are a political appointee, but you bring some expertise here and that maybe we will look and listen to people who have some expertise before we jump to conclusions.

Somehow, I think the end is shaping here very much the means, and I think maybe distorting it. So, Mr. Chairman, I hope that Mr. Samuels' testimony will be transcribed rather soon—I don't know what the provision is—and that everybody on this committee will read it before we proceed to mark up bills.

Thank you, Mr. Chairman.

Mr. CRANE. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman.

Thank you, Mr. Samuels, for being here. I am sorry I was not able to join you earlier to hear your testimony. I have had an opportunity to read your oral statement. I share Mr. Levin's concern that we are at the end of the day here, and we have a lot of competing interests.

In reading it quickly and in listening to your answers to the questions that have been posed by the last couple of my colleagues, I guess I have two questions. One is with regard to the issue of progressivity. You talk about three concerns with the tax provisions in the Contract. One is fairness. One is simplicity. One is the efficiency. In terms of the progressive nature of our tax system, I guess what I would ask you, is our current system adequately progressive? Would you say that our current Tax Code and tax system is an adequately progressive system?

Mr. SAMUELS. Mr. Portman, I think that, overall, when you look at the income tax rate structure, that that is within a reasonable range, and I believe that it is an appropriate range. And also if you look at it going back to World War II you will see that it is actually today relative to periods in the fifties and sixties and seventies. It is—in terms of the nominal rates, they are lower. So I think that we have got a reasonable balance here.

Mr. PORTMAN. I just think it is an interesting discussion to get into to talk about what is the appropriate progressivity in the tax system, and it is difficult for me to judge fairness or unfairness until someone comes up with that. And I think it is difficult. It is ephemeral.

It is certainly true Mr. Collins talked about the middle-income constituent with regard to capital gains, that one could argue that capital gains will unlock as an example—which I think is one of your top examples of lack of progressivity—that the capital gains

will unlock capital and help people at all levels and certainly create more jobs.

I just think to throw around the fairness, unfairness issue is difficult until we come up with a sound description of how progressive our system should be.

The other one I wanted to mention is efficiency. You talk a little bit in your testimony about how the tax system ought to be efficient and not distort economic decisionmaking. I like that. I think our whole tax system—as the chairman of this committee is apt to say, and I think he did earlier today—needs to be looked at in that light.

But I guess what I would ask you, I assume you were with the administration in 1993 when OBRA was passed by this Congress. Would you have considered that to be an increase in tax efficiency, the tax provisions in the 1993 reconciliation bill?

Mr. SAMUELS. Well, as you recall, the purpose of OBRA 1993 was to get the budget deficit under control, and I think that from our perspective we have made an important step forward. We have high growth, high employment and low inflation.

In addition, in OBRA 1993, through the earned income credit expansion, we gave a tax cut to what will be in 1995 this year about 20½ million taxpayers. So we looked in OBRA 1993 at a whole series of issues. And, as I say, deficit reduction, I think we all agree, is crucial to the future of this country. And in accomplishing deficit reduction we cut spending and we increased revenues as a package, and I feel that was an appropriate package.

Mr. PORTMAN. I would just say, in closing, that I would hope that these same standards would be applied to the administration's proposals and that we perhaps learn from 1993.

I don't have all the statistics here, but I think if you look at economic decisionmaking, how it has affected people since that time, you will find that indeed those people who are involved in subchapter S corporations, sole proprietorships, limited partners have changed—their decisionmaking has been such that they have changed their behavior, and they have done it because of the marginal rates being increased on those individuals who are again out there creating the opportunities for other Americans to work. And I would just hope that when we are applying these standards prospectively we also look back in a fair way and see what the impact has been.

Thank you for your testimony today.

Mr. CRANE. Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Samuels, for your testimony here today.

I wanted to ask you about the child tax credit for taxpayers with more than $60,000 of adjusted gross income and if it wouldn't aggravate the marriage penalty for many taxpayers.

Take—for example, I am from Omaha, Nebr. Let's take an Omaha public school teacher that is making $35,000 a year. Let's say that he or she marries a middle manager at Mutual of Omaha that is making $40,000 a year. Wouldn't the administration's policy in effect, if they were to get married, cause this couple to be penalized and lose that thousand dollars? And wouldn't we almost be sending the wrong message?

What we are trying to move away from is a policy that has been discouraging marriage. We would like to move toward a policy that is promoting marriage. Wouldn't the administration's policy have the opposite effect of what we are trying to move away from?

Mr. SAMUELS. Mr. Christensen, I think that you have to look at this issue in the context of the structure of the tax system.

We are concerned about the marriage penalty. As I say, we would be happy to work with the committee to try to figure out whether there is some way that we can address the marriage penalty issue. The marriage penalty issue arises because we tax family units rather than only workers as single persons, and we have a progressive tax system. That causes the marriage penalty.

We also have marriage bonuses so that if somebody who is working gets married to a spouse who is not working that their taxes go down. That is a part of our system. We have marriage penalties, and we have marriage bonuses.

Mr. CHRISTENSEN. But isn't it true, Mr. Samuels——

Mr. SAMUELS. And I would say that, with respect to the administration's proposal, when you look at the proposal overall, in addition to the child credit, we have an expanded savings proposal to use the IRAs, that the taxpayers know and understand where the income limits are higher as well as the education and training where the income limits are higher.

And I would also say that in looking at the proposals one should carefully consider the cost to the Federal Treasury. Now——

Mr. CHRISTENSEN. If I could reclaim my time here real quick.

Mr. SAMUELS. Well, I would just say the Contract's proposal over 10 years will cost the Federal Treasury $288.5 billion. And the administration's proposal is, over 10 years, about $90 billion. So it is about three times as large.

Mr. CHRISTENSEN. I guess returning money back to the hard-working families in this country—I don't see where that should be seen as a cost to the Federal Government. I see that as returning money back properly where it should belong. So if we use that example——

Mr. SAMUELS. We agree that deficit reduction——

Mr. CHRISTENSEN. So if we use that example of a teacher and a middle manager, that each has a child under age 13, in effect they would be losing $1,000 under your proposal. And I guess I would like to see more fairness for our working families under your proposal.

And I just think that we need to continue to look out for really who is paying the taxes here, who are paying the bills, and it is the working man and woman in America. And, you know, you are here at their discretion. We are here at their discretion. And we need to remember who is in charge here, and it is not the government bureaucrats. And we are all tightening our belts. For example, I see 14 assistants behind you.

Mr. SAMUELS. That is why I said we have to come up with $1.6 trillion, $1.6 trillion to balance the budget and pay for the Contract's tax cuts by the year 2002.

Mr. CHRISTENSEN. Thank you, Secretary Samuels. I appreciate your testimony.

Mr. CRANE. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman.

Mr. Samuels, thank you very much for being here and your testimony. I think it has been very helpful to understand the Contract With America better and its costs.

Let me, if I might, just review a couple things we have talked about today. First, as I understand it from your testimony, the cost of these tax provisions or the Contract With America would be $725 billion over 10 years.

Mr. SAMUELS. That is correct, Mr. Payne.

Mr. PAYNE. I think many of us like many of these provisions and feel that there would be things that certainly would be advantageous and popular to the people that we represent. We are really looking for bipartisan ways that we might get to the very best solutions we can, recognizing that we have to pay for the provisions. I think this committee has certainly said that they will be paid for, and others who have testified before this committee, including the Speaker, acknowledged that they will be paid for as well.

Now, you also then went on to say if you took a part of this through the year 2002, we would have a $400 billion impact that we would be adding to the $1.2 trillion that we already need to produce in order to get to a balanced budget, which I think that I and many others feel is a goal that we need to try to attain.

The question then becomes in terms of the $725 billion or the $400 billion, depending on the period of time, that one way that we could deal with that is to cut costs to that extent—and knowing what we have been through in 1993 to get the $500 billion deficit reduction, I know what a large task that is. But there is another way to deal with this, and that is to say let's change the way we estimate or let's change the scoring in some way to make these numbers less. And that is what I would like to explore for just 1 minute with you.

Mr. SAMUELS. Surely.

Mr. PAYNE. You had mentioned that the technique that is used generally takes into account behavioral aspects but does not take into account macroeconomic feedback effects. This is the same technique that was used 2 years ago in 1993 as we reduced the budget deficit by $500 billion over 5 years, as I understand it.

Is there anything instructive about what we looked at 2 years ago in terms of the $500 billion which we then estimated would be the impact of those policy decisions and what we know now a year and a half later? Were we on target? Was this a tremendously conservative technique that was used? What do we know now that might be helpful to us in this regard?

Mr. SAMUELS. Mr. Payne, we don't yet have details of exact proposals because we don't—the information isn't all available as to exactly how various tax proposals have come in in 1994 because we don't—people haven't filed their 1994 tax returns.

But I believe that there have been estimates that the deficit reduction effort in 1993—as you know, the target was $500 billion, and at least I had heard some numbers that they thought that it might actually rise to $700 billion, so that they were conservative. And I think that philosophically, at least, I believe that when we are going through these exercises we should be conservative. And if we underestimate that is great because then we will have a

lower budget deficit than we thought we would and that that is the way that we should look at this. If we are wrong, we should wake up surprised and have a lower deficit than we thought, so that would be how I would look at it.

Mr. PAYNE. So you might view, then, the $725 billion as a conservative figure. So, in fact, the numbers might be realistically somewhat different from that?

Mr. SAMUELS. The numbers, yes, might be different, but I mean we used, as I say, the traditional revenue estimating techniques, and those are people's best estimate. And sometimes they come in under and sometimes they come in over.

Mr. PAYNE. So that it has not consistently been that these estimates are off by the difference between $500 and $700 billion?

Mr. SAMUELS. And, by the way, the $500 and $700 billion wasn't revenue. That was the whole package. It included all of the parts of the package, not just the tax parts.

Mr. PAYNE. I see my time has almost expired. But the bottom line here then is that, given the unknowns and given the risk associated with getting the wrong answer, that you feel that we should continue to use these conservative techniques because of the impact that it could have in the future if, in fact, our estimates were off?

Mr. SAMUELS. Correct.

Mr. PAYNE. Fine. Thank you very much.

Mr. CRANE. Mr. McCrery.

Mr. MCCRERY. Mr. Samuels, thank you for joining us and staying so long. I will try to be brief and let Mr. Cardin ask his questions or make his comments.

Before I talk to you just 1 second about IRAs, though, I just want to make a point about the administration's characterization of the EITC as being a tax cut.

In fact, much of the revenue spent on the EITC is not really a tax cut. It is welfare, workfare, if you will. And I approve of that. I like the EITC. But it is not really a tax cut for many of those folks who enjoy it because they get all their taxes back under the regular tax rules.

What they get on top of that through the EITC is not really a tax cut, it is the government giving them more money to give them a living wage. And I agree with that, but I just wanted to make that point that I don't think it is fair to count all that as a tax cut.

With respect to IRAs—and I like the administration's IRA proposal. I also like the one in the Contract. But I commend you and the administration for coming forward with what I think is a sound IRA proposal.

Besides that, though, does the administration plan to propose any other savings and investment incentives?

Mr. SAMUELS. Mr. McCrery, the President announced a package of three proposals in December, and it is my understanding that is the program of tax proposals that the administration will propose in the budget.

Mr. MCCRERY. Besides the IRA, what are they?

Mr. SAMUELS. They are a $500-per-child tax credit. They are a deduction for up to $10,000 of education and training expenses. So it is a child credit, education and training expense deduction, IRA proposal. And we are focusing this—we think it is very important

to have our proposals focused to middle-income taxpayers. We think that is who needs relief the most. And we are also extremely interested and dedicated to encouraging the development of education and training.

Mr. MCCRERY. So you think it is more likely that a middle-income taxpayer will save that $500 than an upper-middle-income taxpayer? I mean, if we are trying to promote savings and investment, that is my question. You used the child credit as an example of that. I am just wondering, if you are after savings and you are going to target the middle class, it is more likely then you think that the middle class will save that $500?

Mr. SAMUELS. I think we look at our expanded IRA proposal as our savings incentive.

Mr. MCCRERY. I like that. I like that. My question is, is there anything else that you are going to offer to promote savings and investment?

Mr. SAMUELS. We think that our education and training—in terms of investment, we are investing in human capital. And we think that that is a very important area which we think needs extra effort for the future.

Mr. MCCRERY. Anything else?

Mr. SAMUELS. Those are the three proposals.

Mr. MCCRERY. OK. On your IRA proposal, I wish you would have added something that we have added to ours, which is to allow a homemaker to put aside just as much as her working spouse or his working spouse in an IRA. I think that is an unfairness in our tax system that should be corrected. I am disappointed that you all——

Mr. SAMUELS. Mr. McCrery, we would very much like to work with you on that issue.

Mr. MCCRERY. Good.

Mr. SAMUELS. As I said, when we prepared our package, we had fiscal constraints as to what we could do, and we had to make difficult judgments, as this committee is going to have to do in its job of reducing the deficit, getting a balanced budget and paying for the Contract.

Mr. MCCRERY. But if we could come up with something——

Mr. SAMUELS. We would be very pleased to work with you on that. We understand the benefit of it, and if we could afford it that is something we would like to—that would meet our objective as well.

Mr. MCCRERY. Thank you.

Mr. CRANE. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman.

Mr. Samuels, thank you for your testimony. One of the advantages of being one of the last to inquire is that I have the opportunity to listen to my colleagues and responses. I really want to compliment you on your testimony.

You have made a very strong case that if we were to act on the Contract without some significant changes that we will see the return of tax shelters, and the return of some large, profitable corporations paying no taxes at all. We also run the real risk of adding significantly to the deficit of this country. That is what I get out of your testimony.

Let me, if I might, talk about tax shelters for one moment. I remember the day when we had people making their livings off of selling investments to professionals who had no idea what the investment was, but they knew that they were guaranteed to get all their money back plus a hefty return with no risks at all.

It seems to me that the chart that you put on the table concerning the neutral cost recovery system does exactly that. A company can guarantee that the person is going to get back more than they invested plus a return with no risk at all because of the depreciable asset—you actually end up deducting more than that asset cost you, taking advantage of inflation.

You don't have to mark up your interest on borrowing costs for inflation, so you take advantage of inflation when it helps you, and you discard it when it doesn't help you. That doesn't seem very fair, and it seems like you are guaranteeing that tax shelters are going to come back.

Mr. SAMUELS. Mr. Cardin, as I testified, we are very concerned that the cost recovery proposal and the capital gains proposals would lead to an introduction of tax shelter activity which would lead, of course, to uneconomic investments, and we think that that is a serious problem and should be carefully considered in evaluating these proposals.

Mr. CARDIN. It would seem to me that one of the goals is to take tax considerations out of economic judgments, and these proposals do just the opposite. Taxes are going to drive the economic decisions if you are guaranteed a certain return rather than letting the economics of a transaction make its own judgments. I take it that is your major concern on that also.

Mr. SAMUELS. Yes, sir.

Mr. CARDIN. We run the significant risks of profitable companies being able to figure out how to use this new cost recovery when it benefits them, use capital gains treatment when that benefits them, and use depreciation schedules—so that they figure out a way of paying no taxes.

Mr. SAMUELS. As I testified, we think that there will be corporations in using these techniques who will not pay any corporate income tax or the alternative minimum tax because of the way these proposals are structured, and we will basically have a significant change in the tax reform proposals that were adopted in 1986.

Mr. CARDIN. Let me just get your judgment on the issue of simplification. I read the summary that the Ways and Means Committee prepared on the bill, and I must tell you that these summaries are very difficult to understand.

Taxpayers would have to make a judgment as to what is real property, what is personal property—and that makes a major difference—to choose whether to use capital gains treatment or the new cost recovery system, and decide which depreciation schedule to use. You add that all together, it seems like it is going to be impossible for the average person to understand how the Tax Code is going to operate. Rather than moving in the direction of trying to make it simpler, are we moving in the process to make it more complicated?

Mr. SAMUELS. Mr. Cardin, as I testified, we have serious concerns about the complexity that these provisions would add to the

Internal Revenue Code and would require taxpayers to make the kinds of judgments and decisions that you outlined.

Mr. CARDIN. Let me just get one more comment from you if I might. Treasury has estimated the cost to be about $200 billion for the first 5 years, and $700 billion for the first 10 years approximately.

It seems to me that these proposals are aimed in a way to mislead the real cost of the programs by having the first few years' revenue losses much less than the real revenue losses once these proposals are fully implemented. Why does that take place? How come we find relatively low revenue losses in the first couple years with high revenue losses after the 5-year budget window?

Mr. SAMUELS. I think it is a function of how the proposals were designed and the fact that it is also a factor of the way the indexing works.

And if you look at the revenue table you can see that the revenue loss grows for the Contract as a whole in the year 2005 to almost $120 billion, of which $32.2 billion is the neutral cost recovery. And, as you can see, neutral cost recovery grows every year in the terms of the revenue loss. And, in addition, the capital gains proposal grows every year. So it is continuing to grow out there in the later years.

And I think, in evaluating the proposals, the committee should look out into the future. That is a time when we should be, according to the Contract, balancing the budget, and you are going to have to deal with these problems in those outyears.

Mr. CARDIN. The most important thing we can do for middle-income people is get the Federal deficit down. That is costing them more than anything else.

Thank you, Mr. Samuels. Thank you, Mr. Chairman.

Mr. CRANE. Mr. Samuels, I want to thank you for your presentation. I have just one question to put to you before you get away, and that is your reference to provisions in the Contract failing to meet your standard of fairness because they reduced progressivity of the tax system. And I was wondering if you could tell me exactly how progressive the tax system ought to be in order to meet your test of fairness?

Mr. SAMUELS. Mr. Crane, my comment was in the context of looking at how the tax cuts in the Contract were distributed. And on our distribution table you will note that approximately 50 percent is distributed to those taxpayers with incomes over $100,000. And it just seems to us that when you look at who gets the benefit of the cuts, 50 percent of the cuts going to that group is disproportionate, and that is why we have trouble.

With respect to your question about how progressive the system should be, I think that is a matter of debate, as I said before. I think the system now is a reasonably progressive system.

We have had a progressive tax system virtually since the beginning of the income tax, since World War I. And it has been a feature—and I think people accept a feature of our tax system that those with ability to pay more should pay more than people with lower incomes. And, obviously, there are limits and judgments that have to be made along the way, and that is something that one can make a judgment on as you kind of look at the economy, look at

the deficits, look at the future of the country as to what is appropriate at any point in time.

Mr. CRANE. So what you are conceding is the term fairness is totally subjective?

Mr. SAMUELS. I think that, obviously, it has an element of that. I think it is a question of what the perception of the public is. It is a question of how we are going to finance our government expenditures and how that should be distributed among taxpayers and families with different incomes, and that is something that this committee spends a lot of time on thinking about.

Mr. CRANE. Well, in that context, I have the figures from the tax foundation for 1992. And the top 1 percent of income earners paid 27.5 percent of the total taxes that year. The top 10 percent of income earners paid 57.5 percent. And the top 50 percent paid almost 95 percent. That means the bottom 50 percent of taxpayers paid roughly 5 percent of the total. Does that sound like a fair distribution?

Mr. SAMUELS. Let me just say I haven't looked at those numbers. And one question, of course, in looking at the distribution is to focus on also who is paying payroll taxes.

As you know, the FICA taxes phase out. We collect about a third of our total revenues from payroll taxes which cut off now in the $60,000 range or so. And our corporate—our income tax we collect about 45 percent of——

Mr. CRANE. This was exclusively income tax payments.

Mr. SAMUELS. That is why I am saying you have got to look at the whole burden. You can't just pick one thing. And, obviously, the payroll taxes, which is a third of our collections, roughly speaking, 35 percent or so, are paid by taxpayers with incomes under 60—I have forgotten exactly where the cutoff is—about $60,000.

So it seems to me when you want to look at the system you should look at the total tax burden on the whole system, and that is something that, you know, we would be happy to discuss with you and the committee.

Mr. CRANE. Well, I would love to discuss that at some later time because I have had a bill in to eliminate all taxes on business altogether on the grounds they don't pay taxes, they gather them. And, ultimately, business taxes are passed on to you and me as consumers. With that in mind, I would point out that there is no distinction based on some necessities that we all need—the basics in life such as food and clothing.

But that is for a later time, and so I thank you again for your performance today. Appreciate it.

Mr. SAMUELS. Thank you, Mr. Chairman.

[Whereupon, at 5:00 p.m., the hearing was adjourned.]

CONTRACT WITH AMERICA—OVERVIEW

WEDNESDAY, JANUARY 11, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 10:02 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

Chairman ARCHER. We have a lot of work to do so we need to get started promptly this morning.

Today, we mark the third of four overview hearings on the Contract With America. Yesterday we heard some very constructive and bipartisan ideas from the Clinton administration and from our own Members of Congress. Today we turn our attention to three panels.

The first, I am pleased to say, consists of citizens who have taken the time from their own busy lives to be with us. We are deeply appreciative of that. We have four individuals from Maryland, Kentucky, and Utah who will talk to us about their everyday experiences dealing with welfare, senior citizens, and tax issues. I want to thank all of you for traveling to Washington. I am glad you are here and I know I am joined by the other members of the committee.

One of the things we plan to routinely do on the full committee and on all the subcommittees is to listen to the testimony of American people. Some would say real American people. There are those who think we live in an unreal world up in Washington, D.C., although we know that every one of us as human beings is real. I have said that I plan to chair this committee with the taxpayer first in mind, and I think it is important that we listen to the voices of the American people.

Our second panel will consist of four distinguished experts from several leading think tanks, and our third panel consists of several guests from interested policy organizations. In advance, I thank all of them for coming.

But before turning to our witnesses, does the distinguished ranking minority member wish to make a statement?

Mr. GIBBONS. Well, Mr. Chairman, I will yield my time to Mr. Stark.

Mr. STARK. I thank the ranking member and the Chair.

As we continue to analyze the Contract With America, several points come into focus. There is really just a lick and a promise here to fiscal responsibility. The Treasury yesterday said that the

revenue loss would be $725 billion over 10 years, $204 billion in the first 5 years, and there are no cost cuts yet.

It is a rather cavalier attitude toward the deficit which will make many financial markets pretty nervous, probably vastly increase the deficit, will raise interest rates, which I am sure that businesspeople with us today will be glad to comment on. And the majority may claim that they will pay for these tax cuts with spending cuts, but it seems to me if we don't cut Social Security and we don't—as I think we should—cut defense, and we obviously will not renege on the interest on public debt, the Contract has got to be paid for with spending cuts which will likely be borne by middle- and low-income Americans.

The tax proposals in the Contract disproportionately benefit upper-income families. Half the tax benefits will go to those above $100,000. That is about 5 percent of the people. So giving half of these benefits to the wealthiest 5 percent, middle- and low-income Americans will disproportionately suffer. Wealthy Americans, like Members of Congress, will gain. This probably ought to be called the Gingrich congressional pay increase because those of us who get $135,000 a year are going to disproportionately benefit from these proposals. Of course the complexities that will be added to the Tax Code and the chance for gaming and scheming for tax avoidance schemes will increase.

I am glad Newt Gingrich pointed out that I was an enemy, me and my fellow Democrats, of normal American people. The Chair has referred to real American people and I am glad to see some real American people here. I checked on the real people in my 13th Congressional District in California, which I might add is very much above the State average. They have a median family income of $52,627. About 60 percent of them own their own homes. Only 22 percent of them have a college degree. And 23 percent of them have no health insurance.

Now, these are people whose wages have been declining in a State that has been badly hurt by Federal budget cuts. And they are people whom we should concentrate on helping. And I want to ask each of the witnesses today if they will compare their situation with the real people in my district: Your income, your home ownership, and what you think your recommendations will do to help them.

My people could be helped by a tax cut that is limited to the middle class, but to increase the deficits and the debt on my children and my grandchildren to help people who make our level of salaries seems to me to be a waste of the national resources.

So I am happy to see that we are going to deal with the real issues and perhaps realistically assess how we are going to pay for this very generous gift to the rich, and so far the only way we see to pay for it is to take from the low- and middle-income people.

I look forward to the witnesses' testimony, Mr. Chairman. Thank you.

Chairman ARCHER. Any other opening statements that members might like to make may be inserted in writing in the record without objection.

[The following was subsequently received:]

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON THE CONTRACT WITH AMERICA
January 11, 1994

Mr. Chairman, thank you for gathering this extensive panel of witnesses for today's hearing on the "Contract with America."

This committee has the responsibility to consider some of the most important legislation in the Contract With America -- reforms that will make a real difference to many Americans.

I believe we should make the issues we will discuss here today a top priority. Polls show that voters in last November's election were adamant that we need to ease the tax burden on American families and seniors and reform our dependency-breeding welfare system.

I am especially gratified that we will hear from American citizens who can offer a "real world" and "outside-of-the-Beltway" perspective on the proposed reforms in the Contract With America. These people must live under the laws Congress passes and can give us some much-needed, common sense advice on how the Contract's legislation would affect them.

I'm also delighted that we will be hearing from a number of distinguished panelists today who have real expertise in reducing and reforming government. Too often, past Congressional hearings have ignored these experts or refused to provide opportunities for their voices to be heard.

Many of us have worked with these scholars and policy experts in the past and know that they and their organizations have many innovative proposals that would effectively down-size government.

I thank you all for being here and look forward to your testimony.

The Honorable Phil English
Before the House Ways and Means Committee
Full Committee hearings on the Contract with America

Mr. Chairman and Members of the Committee, it is indeed an honor to be present this day as we begin a series of three Full Committee hearing on provisions contained in the Contract with America. Mr. Chairman, I commend you for your expeditious consideration of these provisions and for hosting such competent and informative individual and panel witnesses. Tomorrow, in particular, we will hear from one of the top city executives in my state - the Mayor of Philadelphia, Pennsylvania, Ed Rendell. Mayor Rendell could not be a more appropriate witness to testify before this committee as he will be directly involved in administering our reforms at the state level. In addition, he has successful administered tough yet effective reforms of his own initiation, and has handled them like a true professional.

I am equally pleased to hear the testimony of Members of this body, agency and Administration professionals, and our nations' citizens. I am eagerly anticipating hearing examples, through these witnesses, of current situations across the country which will exemplify the need to enact legislation such as the Personal Responsibility Act and the Senior Citizens Equity Act.

Mr. Chairman, this year Congress has an important opportunity to embrace the cause of working Americans. This committee will play a critical role in setting a reform agenda for the House, including mainstream welfare reform, family tax relief, and pro-jobs tax reform. I look forward to working with Members of the Committee on a bipartisan basis.

Mr. Chairman, I look forward to the following testimony, and I thank the witnesses in advance.

###

Chairman ARCHER. I believe Mr. Bunning would like to introduce our first two witnesses.

Mr. BUNNING. Thank you, Mr. Chairman. It gives me a great deal of pleasure to welcome two members of our panel of witnesses, Phil and Barbara Semler, who have traveled all the way here from Richmond, Ky., to be with us today.

Although the Semlers don't live in my Fourth Congressional District, we have something else in common, that is a deep interest in seeing the Social Security earnings limit raised. We agree that it is an unfair tax on working seniors.

I am delighted to have you with us here today and look forward to hearing your testimony. Thank you for coming.

Chairman ARCHER. Mr. and Mrs. Semler, welcome to the committee. I will recognize each of you individually because each of you has an individual perspective, even though you are married to one another.

I would ask that all of the witnesses confine their opening remarks to 5 minutes. If you have a lengthier statement that you would like to have the committee look at, it can be entered into the record in full.

So if you would like to begin, Mr. Semler, please give us the benefits of your thoughts.

STATEMENT OF PHILIP M. SEMLER, RICHMOND, KY.

Mr. PHILIP SEMLER. Mr. Chairman, Congressman Bunning, and members of the committee, I am Phillip M. Semler from Richmond, Ky. Here with me is my wife of almost 45 years, Barbara. It is an honor to testify before you today. This is our first trip to the Nation's Capital. And I think I can speak for my wife as well in saying that it is a thrill to both of us.

Before I begin, I want to thank Congressman Jim Bunning for giving me the opportunity to address this committee on an issue that we feel so strongly about. As Congressman Bunning knows, I am not from his district. I contacted his office because he was chairman of the Social Security Subcommittee, because he thinks that the Social Security earnings limit is unfair, and because I felt if anyone could help us get an unfair Social Security law changed, he could.

Mr. Chairman, my wife and I are here today because last fall Congress said it wanted to hear from citizens like us and what we are—private citizens, senior citizens—who still work, and who still want to contribute something to this country that we care so much about. We believe there are so many others like us who will help who have never had the chance to address Members of the Congress.

Raising the earnings limit and removing the penalty for working would tell senior workers that Congress wants them to stay productive and keep contributing to society rather than stay at home and do nothing because they are afraid they might have to give back some of their Social Security benefits.

My story is like many men of my generation. After serving in the Navy in World War II, I got an engineering degree and went into manufacturing in the foundry business, eventually as foundry manager. Then came the recession of the early eighties. Because of

changes in the car industry, the basic metal industry was hard hit by plant closings and downsizing. Many midlevel managers were let go because of their higher salaries and their age. I was one of them.

In 1982, after 30 years in the foundry business, I lost my job. I was 58 years old, with the youngest of five children still in college. Now, I am sure you can imagine how difficult it was to get a new job at 58. Companies were not hiring men of my age, salary level, and foundry experience. For the better part of 8 years, I worked at jobs that didn't pay much more than minimum wage, many times two jobs at the same time just to help maintain a decent standard of living.

Because I did not spend all my 32 years at the same foundry business, my pension was very small. My wife had gone to work when our children started school, but even with her earnings, it was rough. What should have been my peak earning years were actually my lowest, and putting money aside for retirement was next to impossible.

By the late eighties, things began to look better. We both had adequate jobs and I was looking forward to drawing money from the Federal program I had been paying into for some 40 years called Social Security. Until I lost my job in 1982, I paid in the full amount matched by my employers, and since I am working I am still paying into Social Security and will do so as long as I work, even though it will not increase the amount I will collect back.

About 6 years ago I began working as a salesman for Red Hed Oil Co. in Richmond, Ky., an independent, family owned oil business. I enjoy the work very much and work full time, but it costs me about $1,500 above Federal, State, city and Social Security taxes I pay to work there. This is the amount of Social Security benefits I will have to give back this year because I will earn over the earnings limit. It is ironic that I get a Federal tax refund which I turn back to Social Security for benefits I have to give back.

Mr. Chairman, by increasing the amount a person can earn without penalty, the Congress would help many people of retirement age who want to or need to continue to work. Many people of retirement age like Barbara and I really like to work. We also enjoy traveling, pursuing interests, and being involved in community activities, but using our knowledge and skills in the workplace is very important to us. In fact, so important that I am willing to pay the extra tax by paying back my Social Security benefits in order to work.

Unfortunately, we know many people drawing Social Security who, no matter what, will not use their skills in the work force because they do not want to pay back a large portion of what they earn. So they never reenter the work force after they start drawing Social Security or they quit when they reach the earnings limit, which is now $11,280, which in my view is unreasonably low in this day and age.

What a waste of the knowledge and talent for our Nation which desperately needs the experience, dedication, and good example of older workers.

Remember, regardless of age we are still paying taxes on everything we earn Federal, State, city, and Social Security taxes. There

are no free rides on paying taxes just because you turn 62 or 65 and start drawing Social Security. We older workers on Social Security who earn over the earnings limit, we become the people paying the highest rate of taxes on our earnings.

In my own case, which I believe is quite typical, money earned after reaching retirement age goes in part to maintain a better standard of living. It also goes to investments to provide income for my wife and I when we are no longer able to work, investments which I was not able to make because I did not have the income after I lost my job at 58. In this way, we will not be a burden on our children or society as soon or hopefully ever. Whether the income from work is spent or invested, it will always help the economy.

Mr. Chairman, I am 68 years of age, and by the time the new earnings limit goes into effect in 1996, I will be 70 and able to earn all I can without penalty. So the change will not benefit me. However, for many Americans in the future, I am sure it will be of great benefit but it will benefit many Americans like me who want to stay active. For their sake, I urge you to pass a change in the law allowing older Americans to work and earn without penalty.

Mr. Chairman, and members of the committee, I want to thank you for your attention. I appreciate your interest in hearing from a private citizen like myself. I truly appreciate your efforts on my behalf.

I thank you very much.

Chairman ARCHER. Mr. Semler, thank you for your testimony to the committee. I am particularly touched by it because back in the early seventies, I initiated the first proposal to eliminate the earnings limitation and it was cosponsored in the Senate by Barry Goldwater who continued to push for it as long as he served in the Senate. I too have continued to push for it over the years, and your testimony gives great support and body to the arguments that I have made for so very many years and I appreciate your input.

Mrs. Semler, I understand you also would like to speak to the committee and please give us the benefit of your thoughts.

STATEMENT OF BARBARA SEMLER, RICHMOND, KY.

Mrs. BARBARA SEMLER. Thank you. Mr. Chairman, Mr. Bunning, and members of the committee, thank you for the privilege of speaking to you today.

My name is Barbara Semler. I am the mother of five adult children. I went to work after my children started school, but because I changed school districts and moved with my husband, I was not able to become vested for a pension. I still work part time as a substitute teacher for the mentally and physically challenged.

My husband has told you his story, which is in part my story as well. It was extremely rough financially after my husband lost his job. After putting our five children through school, college, my husband and I hoped to begin saving all that we could for a stable retirement. Our children are wonderful but the last thing we want to be is a burden on them or on society. One of the reasons we both work now is because we were not able to save after my husband lost his job and we need to catch up on our savings for the time when we will not be able to work.

We are children of the Great Depression and therefore not extravagant with our funds. It is quite discouraging for us, and other seniors that we know, to work hard and to be penalized for what we earn over an amount that is really below poverty level.

Excellent talents are being wasted because some older people on Social Security feel it is not worth the effort to work under these limitations. So they stop working rather than continue at a below-minimum wage after you consider the taxes and benefits that have to be paid back. I am particularly thinking of some men that I have taught with, and women, excellent teachers who are desperately needed as role models in our school system, especially with all the troubled children we have nowadays.

Many of those who do work after 65 are widows who have no choice. They are trying to live on Social Security alone because, in spite of hard work, there was never enough income to be able to save while their husbands were alive. Then when they work, they are penalized. I know this because my mother was one of these people and there are many, many more women like her.

We seniors have much to offer. Don't let our skills go to waste. Raise the limits on earnings and encourage these wonderful people to use their experience and skills in the workplace. Please change the law and let us know that society still wants what we have to offer.

Thank you.

Chairman ARCHER. Thank you, Mrs. Semler.

Our next witness is Craig Willett from Provo, Utah.

STATEMENT OF CRAIG WILLETT, CPA, OWNER, WILLETT & ASSOCIATES, PROVO, UTAH

Mr. WILLETT. Thank you, Mr. Chairman.

I am a small business owner and CPA, a director of a local community bank, and an adviser to the board of several other businesses in my community. In addition to my professional involvement, I also volunteer time to different organizations in helping them and their members understand and comply with the tax laws and in making strategic economic decisions.

I would like to discuss three aspects of the Contract With America. They are capital gains tax reduction, depreciation, and the marriage penalty. In addition, I would like to address two other areas that are not covered by the Contract which are of concern to me: The health insurance deduction and tax rate reduction.

The first, capital gains. I have many clients referred to me when they are starting new businesses. Some of these companies are now part of large public companies and become large employers. Others are still in the development stage. These embryo companies find difficulty finding capital. One of the reasons is that the risk-reward ratio was greatly narrowed with the passage or—with the removal of the capital gains exclusion in 1986. Many would-be investors were taken out of the investment arena.

A lot of my clients get capital from small groups of people who pool their money to invest in a unique product, idea, or service. Allowing a 50-percent exclusion of capital gains income, in my opinion, would give greater access to capital in a more timely basis. We live in an environment of rapidly changing technology, and it is

crucial that these businesses have an opportunity to seek capital before they fail. I feel that the capital gains exclusion would result in the creation of many jobs.

The second area I would like to discuss is depreciation. As a business owner, one of my primary concerns is cash flow. This past year I purchased a building for my business. And even though I am an accountant, I am having a hard time dealing with the fact that the Tax Code allows me to depreciate this building in no less than 40 years. My bank then tells me they will finance it for no longer than 15 years. I am going to pay the building off 25 years before I am able to depreciate the asset. This does not make for good cash flow.

Since you can't legislate economic real estate financing, I would ask that you consider a more reasonable depreciation schedule allowing—that more closely matches a business' ability to finance its assets, thereby helping with cash flow.

From my professional analysis of neutral cost recovery, I have determined that it favors large, capital-intensive businesses. It decreases the depreciation benefits in the first 3 years for most taxpayers. A solution for small business would be to increase the section 179 expense allowance.

As a delegate to the 1995 White House Conference on Small Business, I have proposed to the Utah delegation to increase the 179 amount to a conservative $30,000. While proposing this, two other business owners on the delegation suggested that we consider a $50,000 to $100,000 179 amount.

I asked my firm to analyze the purchase of equipment by the businesses that are my clients. I submitted that as part of my testimony, and I am sure after you review these amounts you will conclude, as I have, that increasing the 179 amount to up to $100,000 would help businesses better able to match the tax deductions with their cash flow.

The third area I would like to discuss is the reform of the marriage penalty. My practice is located in the heart of a State that was founded on strong family values. From a strict tax standpoint, I have to resist the urge to advise my clients to divorce in order to take advantage of higher standard deductions and greater and more liberal tax brackets afforded the unmarried individuals.

These inequities need to be restructured to allow fair treatment to married individuals who sacrifice to hold down multiple jobs and raise families.

Another area is the health insurance premium deduction. As a small business owner, I felt abandoned during the health care reform debate. During the debate little consideration was made for the self-employed. Consequently, there is no deduction currently available for the self-employed. This lack of a tax deduction makes health insurance artificially more expensive for the self-employed.

For example, my family's health insurance premium is $413 a month. On a comparable basis with taxpayers who can deduct their insurance premiums or exclude them from their income, my health insurance actually costs me $578 per month. This is one of the most unfair treatments currently in the Tax Code.

I am encouraged to hear that this committee will attempt a 25-percent deduction for health insurance retroactive to January 1,

1994, but I don't think this is enough. The committee should not stop here but should increase the deduction to 100 percent and make it permanent, allowing equal treatment for all taxpayers.

I would like to commend this committee for considering changes in the tax law to provide tax relief for families in the middle class. I would like to ask you to consider a tax rate reduction. Since 1985, the worst of two possible things has happened to my clients. The tax base has been expanded dramatically while rates have continued to consistently rise. This has put a pinch on small business. I believe all the changes I have proposed today could be paid for through spending cuts.

I want to express, Mr. Chairman, my hope for positive actions on the proposals you are considering, and I want you to know that I am willing to work with this committee to ensure that small business is treated fairly.

Thank you.

[The prepared statement follows:]

TESTIMONY OF CRAIG WILLETT
WILLETT & ASSOCIATES, PROVO, UTAH

Mr. Chairman, I would like to thank this committee for the invitation to appear today. My name is Craig Willett, and I am a small business owner and CPA from Provo, Utah. I have a Masters Degree in Taxation and specialize in tax compliance, tax planning, and tax strategy. I started my practice eight years ago and during that time have also started several other small businesses. I currently employ five staff members and expect to double the size of my firm within the next year. In addition to my knowledge of the U.S. tax code, I have developed a hands on understanding of capital formation through my involvement in raising capital for a new community bank. I am a director of Orem Community Bank and was instrumental in raising half of the $2.5 million capital required to gain FDIC approval. As a board member I have been able to assist the bank in dealing with the strategic decisions necessary to implement a successful business plan.

My involvement as advisor to the board of several other businesses has provided me background and practical knowledge of the difficulties small business face in this country.

I have enjoyed the opportunity to testify before Congress in the past on small business issues, and I am also vice-chairman of the Utah delegation to the 1995 White House Conference on Small Business.

In addition to my professional involvement as a CPA, I volunteer time to different associations and organizations in helping them and their members understand and comply with tax laws, government regulation and strategic economic decisions.

I appreciate the opportunity to participate in this hearing examining certain provisions in the Contract with America. The Contract is a step towards less taxes, less spending and less burdensome government regulation. I believe that the implementation of certain provisions in the Contract with America will not only help small businesses but the entire nation. I am pleased that the Contract with America recognizes the role small business plays in our economy.

I would like to discuss with you five specific aspects of the Contract with America as they relate to small business. These areas are capital gains tax reduction, neutral cost recovery, section 179 expense election, increasing the estate tax exemption and indexing it for inflation, and reform of the marriage penalty. I would like to address three other areas not covered by the Contract which are of concern to me; the health insurance tax deduction, tax rate reduction and a safe harbor for independent contractors.

Specific Provisions

CAPITAL GAINS

I have many clients referred to me as they are starting new businesses. Some of these businesses are now parts of public companies and have become large employers while some are still in the development stage. These embryo companies find difficulty obtaining capital. One of the reasons they have trouble obtaining capital is that since 1986, the risk/reward ratio has been narrowed by tax policy. With the removal of the capital gains exclusion in 1986, many would-be investors who were on the margin were taken out of the investment arena.

Some of my clients are able to get investment capital from small groups of people who pool their money to invest in a unique product, idea, or service. Allowing an exclusion from taxes of 50 percent of capital gains income, in my opinion, would give greater access to capital on a more timely basis. We live in an environment of dynamic and rapidly changing technology. Access to capital on a timely basis is vital to the success of many start-up companies in our country.

There are several costs to raising capital: time, control, and resources. In my opinion, the effect of a reduced capital gains tax rate as proposed in the Contract would dramatically increase the risk/reward ratio for investment capital, thereby increasing the supply of investment capital. This in turn reduces the time frame in which start up companies can access much needed capital to maintain their uniqueness, control of their markets, and thereby maintain their competitive edge. This increased access to capital will allow small businesses to compete in our world economy. It will also allow the entrepreneur to control the destiny of his or her company, and in turn many jobs will be created. Ninety-nine percent of America's employers are small businesses. In today's service oriented economy, business owners who access investment capital will create many jobs.

I have a client who started a business eight years ago. Over the first five years, this company employed a total of ten people. The company was funded on a shoe string budget. This particular company currently employs over 150 employees and from its modest beginnings has formed a new standard in high technology for data applications in 3-D software. This company's technology is so unique that one of the international software communications giants has acquired a 30 percent ownership interest. Without creative financing, the owner of this company may not have been able to hold his dream together long enough to negotiate the capital resources he now has. In this instance, a $210,000 investment over five years has produced in excess of 100 jobs.

Being in the trenches every day I see many other companies with similar technology and/or ideas who are starving for capital. Therefore, in my opinion, exclusion of 50 percent of capital gains income from taxation would entice investment capital and would result in the creation of many jobs.

NEUTRAL COST RECOVERY

I have two different points of view on neutral cost recovery, the first as a business owner and the second as an accountant. As a business owner, one of my primary concerns is cash flow. This past year I purchased a building for my business and two start-up businesses. I have had difficulty dealing with the tax effect of recovering my investment through depreciation over 40 years. Based on original cost and considering the time value of money and inflation, I will recover 34 percent of the original cost in 1994 dollars by the year 2035. On top of that, my bank tells me that they will not finance the building for longer than 15 years. Therefore, I will pay off the building 25 years before I am able to fully depreciate it. The principal reductions I am making on this loan will be more than twice as fast as I am able to depreciate the underlying asset. This does not make for good cash flow. The depreciation appears to be out of sync with the cash flow. Since you cannot legislate the economics of real estate financing by our country's financial institutions, how about legislating a depreciation schedule that is more in line with our ability to finance assets, thereby more closely matching cash flow. A more realistic depreciation schedule coupled with the concept of neutral cost recovery would make more sense and help contribute to cash flow. In the example of my building, neutral cost recovery would allow me to recover 100 percent of the original cost as adjusted regardless of the number of years over which I can depreciate the asset.

However, neutral cost recovery, will all of its merit, brings added complexity to the tax code.

The accountant in me says that all we need are new depreciation schedules. My analysis of neutral cost recovery as proposed is that it favors large, capital intensive businesses. A solution for smaller service and labor intensive businesses is to increase the Section 179 expense election. In fact, small business owners tend to be very frugal in making capital budget decisions. Their dependence on cash flow for survival is not well served under neutral cost recovery. Neutral cost recovery as proposed would reduce the depreciation in at least the first three years as compared to the current depreciation method. This would be harmful to small business in the short run.

For many small businesses, maintaining adequate cash flow is a constant challenge as payroll and bills become due. The proposed benefits of neutral cost recovery have merit; however I question their effectiveness as it relates to small service and labor intensive businesses. It is beneficial to small business to be allowed to write off deductible costs in earlier years where the need for cash is much greater rather than in later years. Higher deductions in later years primarily benefit businesses that purchase long term depreciable assets.

SECTION 179 EXPENSE ELECTION

In addition to the concept of neutral cost recovery, small businesses need an alternative that will allow them to expense more of their purchases of depreciable assets. I would like to see a provision that would favor small businesses and not just lean toward large capital intensive businesses. I recommend that this committee consider a $50,00 - $100,000 Section 179 expense election provision instead of the current provision of $17,500. As a delegate to the 1995 White House Conference on Small Business I have proposed to the Utah delegation to expand the Section 179 amount to $30,000. While proposing this, other delegates indicated their desire to consider a $50,000 to $100,000 Section 179 expense election. As a business owner, I would certainly benefit from this proposal. However, so as not to appear self-serving, I asked my staff to calculate the average purchase of equipment for each of the last three calendar years for which we have tax information on my clients. My staff calculated the average purchase based on gross receipts calculations for each of the following years: 1991, 1992 and 1993. This excludes the acquisitions of real property and/or improvements on real property. The following chart represents these findings:

	1991	1992	1993
	Gross Receipts $3M +		
Average Equipment Purchase Per Year	$19,400	103,975	20,200
	Gross Receipts $1M-$3M		
Average Equipment Purchases Per Year	$50,600	72,450	60,760
	Gross Receipts $500K-$1M		
Average Equipment Purchases Per Year	$60,988	54,188	52,020
	Gross Receipts $100K-$500K		
Average Equipment Purchases Per Year	$19,669	18,976	19,773

In each and every classification of taxpayer, the average purchase exceeds the current Section 179 expense election amount. By increasing the expense election up to $100,000, small business owners would be able to better match cash flow to income deduction.

ESTATE TAX EXEMPTION

I support the proposal to raise the estate tax exemption from $600,000 to $750,000 and to index the exemption to inflation. The estates of closely held business owners have been dealing with estate taxes more frequently than in prior years. Indexing the exemption to inflation can prevent many mom and pop shops from being subject to estate taxes. Raising the exemption will also eliminate the need for many small businesses to argue for a lower valuation for estate tax purposes. In my opinion, one of the most uncertain areas in estate planning is the ability to value a closely held business in the same manner in which the Treasury Department may view its value. Raising the exemption and indexing the exemption will eliminate the need for many businesses to second guess how the Treasury Department will value their estate.

REFORM OF THE MARRIAGE PENALTY

In my professional practice, I have entertained many interesting questions on the selection of filing status for my clients. My practice is located in the heart of a state that was founded on strong family values. I have found myself avoiding making the recommendation to my clients to divorce and co-habitate in order to take advantage of the higher standard deduction and more generous tax brackets afforded unmarried individuals. These inequities need to be restructured to allow fair treatment for married individuals who make the sacrifice to hold down multiple jobs and raise a family.

Other Provisions

HEALTH INSURANCE PREMIUM TAX DEDUCTION

The high cost of health insurance is a major concern for small business owners. As a small business owner, I felt abandoned during the health care reform debate. In 1994 there was much discussion about health care reform and the high cost of health care, yet little consideration was made for the high cost for the self-employed. In my opinion, health insurance premiums are artificially high cost of insurance for the self-employed. I do not want to imply that insurance companies do not fairly charge the self-employed (that discussion is for another day); my point is that not having a tax deduction that is comparable to other taxpayers, the self-employed are treated unfairly.

For example, my family's health insurance is $413 a month. On a comparable basis with an employee that can deduct his or her health insurance expense, my insurance actually costs me $688 a month. This is one of the most unfair treatments currently in the tax code, and something needs to be done to level the playing field. I have many clients who do not have health insurance coverage. Their primary argument is that they cannot afford the premium and if they cannot afford the premium for themselves, then how can they offer the benefit to their employees? If these clients were allowed to deduct 100 percent of the health insurance premiums, it would certainly make health care more affordable to them. In so doing, this would actually reduce the number of uninsured.

I am encouraged to hear that this committee will attempt a 25 percent deduction for health insurance retroactive to January 1, 1994. I do not think that this committee should stop here but should increase this deduction to 100 percent in 1995, and make it permanent, allowing equal treatment for all taxpayers as it relates to the deductibility of health insurance premiums.

INCOME TAX RATE REDUCTION

I commend you for considering changes in the tax law to provide tax relief for families and the middle class. Rather than target families or certain income brackets, I would like to ask this committee to consider a tax rate reduction. Over the last several years the tax base has been expanded dramatically. Since 1986 the worst of two possible things has happened: the tax base has continued to increase while tax rates have continued to rise. This has put a pinch on small business, especially those businesses who have inventory fluctuation, seasonal businesses and those that are subject to the cyclical nature of our economy.

I favor deficit reduction and do not want to propose tax provisions that would increase the deficit. However, I believe that government spending is out of control and whatever fair treatment I have asked for today, whether it be tax rate reduction, depreciation allowances or fair treatment on health insurance premiums, these can be paid for by cuts in spending. Small business owners should not be subject to unfair treatment of the tax code for the sake of our country's deficit. Since tax laws are to be revenue neutral, the money to pay for the provisions I have asked for should come from reduced spending. The cost of any of these proposals should not be used as a deterrent for the passing of fair and reasonable legislation, especially when spending is out of control. As a business owner, I have learned to budget and manage within my means. Our government is in the process of learning to do a better job of this and I would encourage this committee and this Congress to look for areas that would further reduce spending.

INDEPENDENT CONTRACTORS

Last February, I appeared before the Select Revenue Subcommittee of the Ways and Means Committee on the subject of health care reform. One of the major issues in the proposed health care reform was the treatment of independent contractors. I would like to encourage this committee to fully examine the definition of independent contractor. In health care reform, some proposals contemplated granting the IRS administrative authority to define independent contractor status. In my opinion, the 20 point common law test, albeit unclear, is a better alternative that granting the IRS carte blanche authority to define worker classification, be it employee or independent contractor.

Mr. Chairman, thank you for this opportunity to testify before the Ways and Means Committee. I would like to express my appreciation for the committee's willingness to consider less taxes, less spending and less government regulation. As an active and involved citizen, I want to express to you my hope for positive action on the proposals before this committee. I believe that the proposals being considered will have positive impact on the lives of many Americans. I want you to know that I am willing to work together with the committee to ensure that small business is treated fairly regarding the legislative issues before you and that small business owners will have greater access to capital, lower taxes and less regulation as a result of your endeavors. I hope that you will consider some of the specific provisions that I have proposed to help you in your work as representatives of the people.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Willett, thank you for your input.

Our last witness in this panel is Virginia Kellogg from Maryland. We are happy to have you before the committee, and we would be pleased to receive your thoughts this morning.

STATEMENT OF VIRGINIA KELLOGG, OWNER, KELLOGG STRESS INSTITUTE, MITCHELLVILLE, MD

Ms. KELLOGG. Thank you, good morning. I am Virginia Kellogg, owner of the Kellogg Stress Institute in Mitchellville, Md., a small business. I have been in business for myself since 1982, providing stress education and stress management training.

When I look at our country today, I see an American public that is highly stressed. This stress manifests itself in violence, crime, depression, and major physical disorders.

Why are people so stressed? Because they have lost their power. The sense of empowerment that individuals and families once possessed now rests with the Federal Government. Yet people feel that no one in government is listening to what they say they need and want. What Americans do not want is to surrender any more of their freedom or their power to the Federal Government.

What should the government's role be? Government should help equip people to solve their own problems. It should offer people opportunities to improve their lives, but it should not control people's lives. Government should not do for people what free people can do for themselves. American people need to be empowered to make the decisions that affect their own lives. People feel empowered and content when they have a say in what happens to them.

Furthermore, authority needs to be decentralized and given back to the State and local governments because these governments are closer to the people who are in need and can better help solve their problems. The Federal Government needs to get back to doing those things the authors of the Constitution intended it to do and it needs to turn away from doing those things that are not called for in the Constitution.

In the past, the Federal Government has been a savior of civil rights for African-Americans, allowing doors of opportunity to be opened in many areas. Many African-Americans migrated to northern cities from the South just to find that good government job. Federal jobs were available when prejudice and racism made getting other jobs impossible. Indeed, the Federal Government did and still does offer good job opportunities, but out of that migration of African-American government workers decades ago grew a dependency on the Federal Government that is not unlike the overdependency today on welfare, but with a different slant.

We have allowed the government to parent our children, discipline them, care for them, and feed them. In too many cases over the years, we have learned not to do for ourselves but to be totally dependent on the government. This dependency must be redirected. It has been and is harmful because a person who is dependent financially is also dependent mentally. Mental dependency breeds anger, hostility, and a desire for power that often is channeled into unsavory acts.

It will take some tough love to teach people to be independent and self-sufficient and to fend for themselves, learning to use re-

sources that are available, and learning self-discipline and self-control. Our moral values must be redefined and we must go back to basics. I say we have had enough enslaving handouts.

The Federal Government has created a subculture through our welfare system. It has encouraged having children when young girls and boys are neither mature nor responsible enough to parent. Individuals in this subculture are ill educated and lacking in marketable skills, and they play a passive role in society. Consequently, the children that are born into this subculture are limited in their growth because their parents can only give to them according to the parents' own limited experiences and exposure. These situations have created an environment of hopelessness, a trap where there is no education and no marketable skills, so you have another child and another, until having children becomes your career.

Many people on welfare do not want to be there. They feel entrapped by the system. They want out. The Federal Government's welfare regulations have run fathers out of their own homes, instead of helping them to stay with their families and take responsibility for them.

I recall what happened to unwed mothers when I was growing up in rural North Carolina some years ago. Families took care of their own, there were fewer unwed mothers, and discipline was at the forefront of child rearing.

In today's society, unwed mothers get cash benefits for having children. The Federal Government has seemingly taken away the families' responsibility. Consequently, an apathy has set in that causes people to look to the government for everything.

I was speaking with someone the other day about America's welfare system. They told me that the Federal Government has so many rules and regulations for the State government to follow that service to clients, that is moving them off the welfare roll into jobs programs, becomes stagnant while time and energy go into completing Federal forms. There needs to be a shift away from massive paperwork and a shift toward getting results.

People could get off welfare if the Federal Government would eliminate some of the redtape that has piled up over the years and that now causes welfare recipients to feel powerless, angry, and discontent.

The welfare system has done nothing to help people develop and grow. The system has, in fact, enslaved people. People progress through self-initiative, self-drive, and when needed, help from others. We need programs that help people help themselves, not programs that take away people's self-determination and self-esteem.

Life without goals, without purpose, and without love produces anger, hostility, and violence. We can and must rear fewer violent children. I say it is time to get back to basics.

I believe that the right of the individual to achieve his or her best while respecting the rights of others is the source of our Nation's strength; that government activities should be limited to those things that people cannot do at all or cannot do so well for themselves; that those who cannot provide for themselves should be assisted by both government and society, and that every effort should be made to help people become self-supportive, productive

citizens with pride in their independence; that equal rights, equal justice, and equal opportunity belong to all, regardless of race, creed, or sex; and that the preservation of our Nation and the security of our citizens depend upon the upholding of the Constitution, the adherence to and enforcement of our laws, and the justness of our courts, and that respect for the Constitution, the law, and the judicial system is the responsibility of every individual.

So, let's cut the redtape and give the power back to the people so we all can become less stressed, more content, and committed to pursuing a better quality of life.

I thank you.

Chairman ARCHER. Ms. Kellogg, thank you for your excellent testimony.

Thank you, each of you, for taking the time out of your own lives to give us the stories and input that I think represents the backbone of America.

People are willing to take on personal responsibilities with the ups and downs in life and they believe that government really does not help to provide freedom but rather takes away from freedom. So I am very grateful to you.

I yield my time for questioning to Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman. I want to congratulate all the witnesses today.

However, Ms. Kellogg, I want to tell you how impressed I am with what you have to say.

I was brought up in the same kind of family you were, with religious values and it was hard scrabble and we all worked. My dad when he went to college ate leaves at times just to have something on his stomach because he couldn't afford to pay for a meal, and brought us all up with those values that said you have an obligation to help those less fortunate than yourselves, and we were taught to tithe, to give 10 percent of what we earned to those less fortunate.

Welfare has been a part of our entire national experience going back to the colonial era. And up in the Boston area in the 1630s, if I lost my job, then a local government official came to the Chairman, who lived next door to me here, and Mr. Shaw, who lived next door to me there, and he would say, Phil Crane is out of a job, he has a family, you two have the obligation to support him until he gets back on his feet. It created a whale of a compulsion to get a job in a hurry and get out of that kind of dependency.

And you are very right when you point out what can happen in our welfare system today when you have a rebellious teenage daughter—and I have seven daughters. If she gets pregnant out of wedlock today, all of a sudden she can move out on her own, she has got her own health care system, her own living quarters, aid to families with dependent children, food stamps, and I am sure it is a positive incentive to destroy all the values that we believe in.

Your point is so well taken about trying to give this authority back to State and local communities. Historically, that is where it resided. A lot of Americans don't realize that the National Government never flirted with welfare until the Great Depression. And I am embarrassed to say that Herbert Hoover made the first tentative gesture before he went out of office. But Franklin Delano

Roosevelt in 1935 in a State of the Union Message said, "to administer this kind of assistance is to administer a subtle narcotic and destroyer of the human spirit." Think of that. That was FDR in 1935.

And he went on to say in that State of the Union Message, "The National Government must, the National Government shall quit the welfare business." Now, that was an awesome problem because of the unemployment rates coming out of the Depression.

The fact is I was interviewed the other day on the steps of the Capitol about homeless people who were putting on a demonstration. And I said, you know, one of the problems is when the National Government takes it over there is a depersonalization that occurs because suddenly that person is not my responsibility. That is what I pay my Federal Government taxes for. We have all this welfare assistance, you know. The Federal Government is supposed to be there. The fact is those people in our community are our responsibilities.

One of the consequences that you touched upon in your testimony that I couldn't agree with you more on is the destruction of all of our traditional values. Walter Williams is a black economist over here at George Mason and a dear friend. I am sure you know Walter.

Walter told me that back in the midtwenties in New York, 85 percent of black families were still together and they looked after their children. And today they are projecting that by the year 2000 in our major cities, 85 percent of black children are going to be illegitimates if these trends aren't reversed. You bring a child up in a handicapped circumstance like that with no future and the deterioration of our educational system where he is illiterate, he has nothing to look forward to, and he has the enticement of gangs and drugs and so forth. I think it has had exactly the effect that Franklin Delano Roosevelt talked about.

And so I would hope that we could follow your suggestion here and try to figure out how we decentralize, take these responsibilities back to the local level where they never should have left in the first place and we can start rebuilding.

The other point you make is absolutely on target. We have created a Federal plantation system in our major cities, and the fact is we have in the process destroyed those values of black people in our society who historically had as strong a base of religious values and as family oriented as any group that you could find in the United States.

We have been working perhaps with good intentions but it has been a tremendous failure. Our welfare system has corroded all those fundamental values. And so I just salute you. I mean you are an exception, but you are in the vanguard of the future and so thank you for coming and testifying.

Chairman ARCHER. The gentleman's time is expired.

Mr. Gibbons.

Mr. GIBBONS. Ms. Kellogg, I believe, if I understood you correctly, you were complaining about the man in the household rule; is that correct?

Ms. KELLOGG. I am sorry. I am not hearing you clearly.

Mr. GIBBONS. You were saying that the welfare system was destroying families by prohibiting a man in the household.

Ms. KELLOGG. Running the man out of the house.

Mr. GIBBONS. Well, you will be happy to know that has never been a Federal regulation, that has been a State regulation. And that finally in 1988 this committee, and the Congress concurring, outlawed that State regulation.

So since 1988, the States haven't been able to drive the man out of the household and destroy the family. You ought to go to the Governors and the State legislatures to complain about that. We acted on that. We never employed a regulation against a man in the household. That has been the 50 States taking that prerogative themselves. We outlawed it here in 1988.

Mr. and Mrs. Semler, I feel very sympathetic toward you, of course, and it is costing me about $70,000, working penalty, and so I know how you feel.

Mr. Willett, yesterday the Secretary of the Treasury was in here—Assistant Secretary of the Treasury, saying that he thought that indexing of capital gains for inflation would be an excessive bookkeeping requirement upon the asset holder.

As a CPA, do you have any views on that?

Mr. WILLETT. Are you talking about the indexing of neutral cost recovery for depreciation or are you talking about capital gains?

Mr. GIBBONS. Capital gains.

Mr. WILLETT. Capital gains. Indexing anything is actually more complex. I mean, as an accountant it would be great if I wanted to be self-serving, but actually as a taxpayer it is more complex and more burdensome to try to figure that out every year.

Mr. GIBBONS. All right. Thank you.

That is all the questions I have right now, Mr. Chairman.

Chairman ARCHER. Is Mr. Thomas here?

Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman.

Mr. and Mrs. Semler, I would like to raise a point. The day before yesterday, the Commissioner of Social Security, Shirley Chater, testified before my subcommittee that she favored raising the earnings limit a moderate amount. And I asked her specifically what she thought was a moderate amount and she said $1,000 over 5 years. That is a $200 per year increase.

I just would like to get your opinion about that and what you consider a moderate amount, because, in my opinion $200 a year for 5 years is not a moderate amount.

Mr. PHILIP SEMLER. I certainly agree with you, sir. That wouldn't even protect us from the cost of the living increase really, this $200.

What I would like to say is I think that—let's eliminate it altogether. It makes more sense to me to do away with this limitation on the income for a number of reasons. I think it would allow us to earn this money regardless of your profession and, in turn, the Federal Government would still collect a lot of taxes back by these people who drop off the ability to earn or get into the work force to earn this.

I think $200 a month—$200 a year is about what they have been raising it the last 10 years, and so that really this proposed rule isn't really changing the law as it stands right now.

Mr. BUNNING. Last year it went up $180, so she is proposing a $20 increase as the moderate increase that the administration wants.

Mr. PHILIP SEMLER. This will not entice people to keep in the work force, I am afraid, and this is what—one of the reasons we are saying that.

Mr. BUNNING. Let me ask both of you. Both of you work and you know many seniors who are also working. Mrs. Semler, you have mentioned some, including your own mother, who was a widow.

From your experience, how many of your contemporary seniors who are working are doing so because of need, financial need?

Mrs. BARBARA SEMLER. It would be hard to put a number to that but I know of many widows that are out there standing in stores or even in McDonald's, in places like that, trying to earn enough money to get by. And they are very limited in their income because of this flaw and yet they have to do this or they can't live. They have no one to depend on and they are left out there to fend for themselves at an age where they should be able to sit back and enjoy themselves a bit. They are under great stress.

Mr. BUNNING. From your experience—how many of those seniors that you know try to limit their earnings in order not to lose Social Security benefits? Half? More than half? Or what percentage of those that you know are working have to stop sometime during the year because they are approaching the earnings limit and are going to get penalized if they go over it?

Mrs. BARBARA SEMLER. Possibly half. Possibly. Some of them continue working because they are afraid they will lose that job and at their age they are afraid that no one will take them back, so if they have a job, they keep it as best they can.

Mr. BUNNING. So they throw themselves into the higher tax bracket, the penalty that comes upon them?

Mrs. BARBARA SEMLER. That is right. To go out and try to find a job at our age is very, very difficult, and once you get it, you don't let go.

Mr. BUNNING. Do you know any seniors who don't work at all because they are afraid of losing some type of Social Security benefits?

Mrs. BARBARA SEMLER. Yes, yes. I know a few teachers that are doing this, at college level also.

Mr. BUNNING. Mr. Semler.

Mr. PHILIP SEMLER. I just talked to a man in the last 2 days who has not drawn his Social Security and he is 70 years old. I said, why did you wait until 70? He says, so I won't ever have to pay any money back. I said, do you realize how much money you might have lost already? He says, well, I am still living.

So he looked—I think he was working on the principle that he just didn't want to get involved in it and get into the fact that the government might come and say you owe so much more money back to us. So I think—and this has happened to us when we do pay our money back.

Mr. BUNNING. I want to thank you for traveling back up from Richmond, eastern Kentucky, and being here.

Mr. PHILIP SEMLER. We are pleased to be here. Thank you for the opportunity.

Chairman ARCHER. Just very quickly, there is another aspect of this that is an unseen major problem. It creates the single biggest administrative headache for the Social Security offices around this country of any other part of Social Security, and my own mother-in-law who has continued to work, as you have, for a lot of the same reasons that you continue to work, had a stack of filed papers this thick trying to work out the problems on this earnings limitation. It is a morass of redtape. Now, that doesn't serve anybody.

Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman.

Mr. Semler, I appreciate your comments. I am one of the few people on the committee that is 65 years old and would be drawing my Social Security if in fact I wasn't employed here in the U.S. Congress, I guess.

Do you think that there should be some consideration given to means testing of Social Security? We keep hearing that people making $100,000 a year hadn't ought to draw their Social Security.

What is your opinion of that?

Mr. PHILIP SEMLER. I will let you know if I win the lottery. Social Security, in my opinion, was set forth to give a retirement program so people could be independent. I think each person when they get to this age, and depending on how much wealth they acquired, it might be a judgment call on their part. And I know that is sort of evasive, but at the same time a man whose investments are paying him retirement money right now, $200,000 a year, I don't think that he would really miss the Social Security, but at the same time I can see where a man says, I paid into it, I think it is mine.

Mr. HANCOCK. Well, I don't want to cut you off, but basically what I think you are saying is if that individual voluntarily wants to donate that money or contribute it to some charitable cause or give it back to the government, then he should have that option, but that the government should not say just merely because you have been successful and you have accumulated some assets you should not draw your Social Security. Is that basically it?

Mr. PHILIP SEMLER. That is right. Because I think that is the incentive our country has been based on, is to obtain this.

Mr. HANCOCK. Thank you.

Mr. Willett, you talked about the greatest concern currently is estate taxes. I am sure you analyzed the situation where people have been successful, they start wanting to distribute their assets ahead of time or prior to the time they get into the estate tax.

Have you ever analyzed what it costs a family to transfer the ownership to the family members prior to death, for instance, say you own a business, you want to transfer that business to a member of your family, so for every $100,000 that you sell it for, the government ends up with about $80,000 by the time the receiving member earns the money to pay that $100,000.

Have you ever come up with the figures on what it actually costs?

Mr. WILLETT. I have never actually calculated that but that would be an interesting study. But I think your estimate of approximately $80,000 would be correct. Plus, a lot of people have a hard time—just a general litmus test in looking at my clients—have had a hard time of meeting the cost of having then to sit down with an attorney to try to transfer the assets. And going through those expenses on top of it creates a lot of distraction from the productive use of their time.

Mr. HANCOCK. Not only productive use, but it gets to the point of where—how do you value it? A small family held operation that is dependent upon those personalities, but yet Internal Revenue is going to come in at some time in the future and is going to say, well, this is what the price was. In fact, it gets to the point where it is just almost impossible to transfer the assets, and if you do transfer it, the government ends up with more money out of the deal than anybody else.

Mr. WILLETT. In addition to that, Mr. Hancock, I think it goes even further in that it creates a difficulty on the second generation that is taking that business over to be able to finance it and pay the estate taxes that can be anywhere from 35 to 55 percent of the value of the business.

Mr. HANCOCK. They usually have to go deeply in debt to keep that business going.

Mr. WILLETT. Right. And in so doing, think of that $100,000 or $200,000 of estate taxes that they pay, how many jobs would that have paid for in that first year where the next generation took over the business and how much more could the business have expanded and created more taxpaying dollars through income taxes rather than through estate taxes.

Mr. HANCOCK. Ms. Kellogg, we have got just a second here, I don't think you will have time to answer this one, but the question is, in your view, what is the best way to move people off of welfare?

Now that one is the question I think that we have got to answer here in the U.S. Congress, and I don't think you can answer that in 5 minutes. In fact, we haven't got that much time. I think that is the key, that one question. What is the best way to move people off of welfare?

Ms. KELLOGG. Do you want me to answer that?

Mr. HANCOCK. If you can answer it that quickly, yes, ma'am.

Ms. KELLOGG. I certainly think I can give you a quick answer. I think we should do away with welfare as we know it, particularly I think that we know it does not work so we should start weaning people off welfare and——

Mr. HANCOCK. Are you talking about completely canceling our welfare system and say, look, folks, you are on your own?

Ms. KELLOGG. I think that is what we should be looking at. We cannot do that overnight. We cannot just leave people hanging, but I would certainly think in 5 years' time we can certainly have canceled the welfare system that encourages mothers to have babies out of wedlock because they know that I don't have to worry about it because I can go and I can get food and I can get cash benefits and I can get housing.

And then, of course, what we find, and I have had lots of experience in working with welfare mothers in my business and having

contracts and trying to help them get off of welfare, and I know the population very well. I identify with them very much, and I have talked with them very much and I feel that the welfare system as it is has been more harmful.

No, we cannot just shut it down tomorrow, but I certainly think in 5 years' time it should be shut down, and I think the kind of welfare system or assistance that people would get would be based more on where the Federal Government should be and let the States determine what the needs of their people are and how they will take care of it.

Mr. HANCOCK. Thank you, Ms. Kellogg.

Chairman ARCHER. Mr. Stark will inquire.

Mr. STARK. I was going to yield, Mr. Chairman, to Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Stark. And let me thank this entire panel for the contribution that you have made, especially you, Ms. Kellogg, for your very forceful testimony.

Exactly what is it that you are doing at the stress center?

Ms. KELLOGG. What do I do at the stress center? Well, I am a small business, and, as I said, I have been for 12 years. I teach people how to manage their stress, how to deal with the stress of life, and that that stress source can be anything. Everything in life can be stressful.

Mr. RANGEL. You indicated you also work with some people that have been on welfare. Do you have these as your clients?

Ms. KELLOGG. Yes. I have had a contract through Prince George's County, Md., for the past 5, 6 years helping welfare clients to become self-sufficient, teaching them empowerment, teaching them how to overcome barriers to self-sufficiency.

Mr. RANGEL. How many of your clients are welfare recipients or former welfare recipients?

Ms. KELLOGG. Have I had?

Mr. RANGEL. Right now. What percentage of your students or clients are welfare recipients?

Ms. KELLOGG. What percentage? Well, up until this year, I would say 90 percent of my clients were. Up until this year.

Mr. RANGEL. And with these contracts, you get it from a county in Maryland, I mean these are county contracts that you get?

Ms. KELLOGG. Well, the way the system is set up, it is through the Private Industry Council through the economic development with the State of Maryland, through the Department of Human Resources, through the Federal Government.

Mr. RANGEL. I guess what I am asking is 90 percent of what you receive in terms of funds are public funds?

Ms. KELLOGG. Ninety percent of the funds that I received came from public funds, yes.

Mr. RANGEL. So indeed, your institute is dependent on the government for survival?

Ms. KELLOGG. No, my institute is not. As a matter of fact, I have no contracts with the welfare project at this time. So my institute is—my institute is open to the general public and it has never ever been dependent in the 12 years on government.

Mr. RANGEL. I am misunderstanding you.

Ms. KELLOGG. Yes, I think you are.

Mr. RANGEL. I am trying to find out—how many of the people that you alleviate stress—what do you do for the welfare recipients to alleviate the stress?

Ms. KELLOGG. What I do for the welfare is to help them to understand what it is going to take for them to become self-sufficient.

Mr. RANGEL. Now, my question, which I probably didn't word correctly, was how many of the people that attend your institute come to your institute under contract from local government? That was my question. I misunderstood you. I thought you said 90 percent.

Ms. KELLOGG. Let me explain to you what my business is all about for just 1 minute, please.

I contract with Federal Government, State and local governments, private industry, anyone who is willing to pay to come——

Mr. RANGEL. Ms. Kellogg——

Ms. KELLOGG [continuing]. To help me to train them. So I go to them.

Mr. RANGEL. I understand. They got to cut me off and I just want to find out if you had to add up all of your clients that come to you for you to train or alleviate the stress, I am trying to find out how many of them come from under contract from any type of government.

Ms. KELLOGG. 1994—by 1995, I would say almost zero.

Mr. RANGEL. In 19—when you said 90 percent, what were you referring to?

Ms. KELLOGG. I was referring to a period from 1989 until 1993. I had a contract with the Private Industry Council of Prince George's County to provide for Project Independence which came under the JOBS program to help——

Mr. RANGEL. Right now who are your clients, because when you said——

Ms. KELLOGG. Right now?

Mr. RANGEL. Right now who comes to you for help?

Ms. KELLOGG. Anybody who can pay for my services.

Mr. RANGEL. How are you paid for—no government money is involved right now with your services, right?

Ms. KELLOGG. Well, I—no government moneys are involved in the U.S. Postal Service——

Mr. RANGEL. You are not under contract——

Ms. KELLOGG. I get—I do a lot of work for them and——

Mr. RANGEL. You are not under contract with any local, Federal, State, or government agencies, are you?

Ms. KELLOGG. No, sir, I am not.

Mr. RANGEL. So the individuals who come to you are private-sector people coming to you for your services.

Ms. KELLOGG. All people. Private sector. Individuals. I have done work for the Federal Government——

Mr. RANGEL. You don't deal with welfare recipients any longer?

Ms. KELLOGG. I do not have a contract with welfare recipients in 1994. I did up until 1993.

Mr. RANGEL. But all your people come from the private sector. What I am trying to find out is whether or not you do business with any type of government. The answer is no.

Ms. KELLOGG. Sir, I think I said I do business with anybody who is willing to pay for my services.

Mr. RANGEL. I am not saying would you. I am trying to ask, Ms. Kellogg, and maybe you can——

Ms. KELLOGG. I am not understanding you.

Mr. RANGEL. At this point in 1995, or in 1994, did your institute receive any payment from any government agency for services provided?

Ms. KELLOGG. If so, very little.

Mr. RANGEL. Thank you.

Chairman ARCHER. The gentleman's time has expired.

Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman. I want to thank all of these witnesses. It is very refreshing to receive real world input, which this Congress needs a lot more of, and I certainly appreciate hearing about your experiences and your real world knowledge.

Let me ask you, Ms. Kellogg, and despite my good friend's attempt to impeach, I think you certainly are experienced and have some very valuable insights that this committee and this Congress needs to put into our reforms as we attempt to do something about the welfare mess in America, a system that is doing a disservice to the underclass as well to as to the taxpayers.

Let me ask you, if I may, Ms. Kellogg, how long in your judgment should welfare, especially AFDC cash payments, how long should these benefits be available to families in need?

Ms. KELLOGG. Two years. I tested this with about 2,500 to 3,500 welfare recipients and that is what they said, 2 years.

Mr. RAMSTAD. Two years is an adequate amount of time?

Ms. KELLOGG. Yes, it is.

Mr. RAMSTAD. Do you agree or disagree that some form of a lifetime cap is necessary to force people off of welfare and on to the work force?

Ms. KELLOGG. When you say a lifetime cap, you mean to say you can receive services for 2 years, 3 years, 4 years, 5 years?

Mr. RAMSTAD. A maximum number of benefits.

Ms. KELLOGG. A maximum amount of benefit years?

Mr. RAMSTAD. Right.

Ms. KELLOGG. I would say in many cases, yes, but I think we always have to look at some unusual circumstances and we always have to make allowances for unforeseeable or unusual circumstances so there should be something that would allow people for unforeseeable kinds of things occurring, but for basically—absolutely, yes.

Mr. RAMSTAD. My final question to you, Ms. Kellogg, assuming we can reform welfare to actually promote family unity instead of providing disincentives for families to stay together, and assuming we can reform welfare to a workfare system of incentives to work rather than the present system which has built-in disincentives to work and be a productive taxpaying member of our private sector, how long will it take for these reforms to translate into recognizable behavioral changes?

Ms. KELLOGG. Well, you know, as much experience as I have had, I have seen behavior changes in as little as 3 months and some it took longer. So it depends on where the person is. I don't

know if that answers your question. But many people already, I mean they just don't know how to get out of the trap. What kind of life can welfare offer one?

Mr. RAMSTAD. Thank you very much, Ms. Kellogg.

Mr. Chairman, I think you said it. All people are ready. They want to get out of this trap and it is a trap.

As a former criminal justice act attorney who represented indigent people exclusively for over 5 years, and one who understands this problem, I recognize it as such, and hopefully the majority of this committee will and of this Congress, so thank you again, all of you, for this really helpful testimony.

Chairman ARCHER. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. I also would like to welcome the panelists and thank you for your testimony.

Mr. Willett, in your testimony you indicated that you think that we ought to change the Tax Code and perhaps reduce taxes, and that we ought to pay for that by reducing spending.

If we pass a balanced budget amendment, we are going to have to reduce spending by over $1 trillion by the year 2002. We need help in finding ways to cut spending if that is enacted, and I wonder what your suggestions would be for any kind of reduction in spending programs?

Mr. WILLETT. I can figure out—in my professional life I can figure out the Tax Code but I have a hard time figuring out all of the government programs and what the Federal Government is really all about.

On the plane out here I read an article that indicated 300 welfare programs are being proposed to be reduced to 8 programs. I know in my business that if my revenues were to decrease next month, I know the first five areas that I would cut and how much I would cut those.

I am not an expert on Federal spending. I am willing to help look at areas and analyze and tell you what I would like to see as a citizen, and I think the voters are out there saying what they would like to see, and I think we need to listen, but I don't have particular programs that I would recommend cutting.

Mr. COYNE. OK.

Mr. WILLETT. But I think it could be analyzed and I think that is your job and I think you will do a good job in the next several months looking at that particular spending cut area.

Mr. COYNE. Thank you.

Ms. Kellogg, you indicated that you think, in response to Mr. Ramstad, that 2 years is a sufficient period for people to be on welfare and after that they ought to be off. I was just wondering what would happen to those people after 2 years? What do you think would happen if we just cut them off at the end of 2 years?

Ms. KELLOGG. I don't think that we just cut them off at the end of 2 years. I think what has presently started and what hopefully will come will be continuing education, skills training, in a 2-year period. A person would be able to start fending for themselves. So it is not just cutting you off with no skills, no education. It is a continuation of some of the jobs training education programs that are going on now, but they need to be a lot more practical, and if they are a lot more practical then people understand and you do some

self-esteem building and some motivating and some reality therapy, then people tend to get their acts pretty well together.

Let me just tell you this, during the time I was working with the welfare mothers when I had a contract—and I never give them up because I work with them all the time, now they are my friends, too—one of the things that I asked them, 1 day I walked into the classroom and I said, if welfare was cut—if welfare were cut off today, that was Friday, what would you do Monday? I had everyone raise their hands and say they would get a job.

Now what does that tell me and what does that tell you?

Mr. COYNE. Well, from my experience we have college graduates walking all over this country that can't find employment today, and to the extent that we are unable to train people in a 2-year period, I just don't think that we ought to be in the position of knocking people off welfare if after the 2 years for no reason of their own, no cause of their own they can't find employment.

But I guess that is not what you are suggesting. You are not suggesting that if at the end of 2 years a welfare recipient can't find employment we ought to cut them off the welfare rolls, are you?

Ms. KELLOGG. I am implying that I asked my class members, if you were cut off of welfare today what would you do Monday morning and they said, I would get a job. So I can only say I am a firm believer that we don't make decisions, certain decisions for people. People have to—there are certain responsibilities that we as human beings have for survival. We have more survival instincts than we give people credit for. People do have survival instincts.

Mr. COYNE. Certainly that ought to be the goal of welfare reform—to train people and get them on the work rolls, but, as you know, the health care reform plan that failed last year didn't lend itself to doing that for welfare recipients. In other words, if they have obligations and they need to provide health care for their families, it is very difficult for them to leave if they don't have employment.

Thank you.

Chairman ARCHER. Mr. Zimmer will inquire.

Mr. ZIMMER. Mrs. Semler, Mr. Stark began his testimony by saying that he was interested in the financial wherewithal of all of our witnesses. Could I ask without your having to be more specific than you would like whether you and your husband have a large portfolio of stocks, bonds, and other capital investments?

Mrs. BARBARA SEMLER. I will defer to my husband on that. He takes care of those matters.

Mr. PHILIP SEMLER. Sir, I don't know what you consider a large portion. Yes, we do have some stocks and we—hopefully they will pay back with a good return. As to large amount, I don't think it is.

Mr. ZIMMER. Do you get much income from those investments?

Mr. PHILIP SEMLER. Right now because of our both working and with what we get from Social Security and being prudent, we leave it in to reinvest.

Mr. ZIMMER. The reason I raise this issue is because of what I consider an anomaly in the earnings test and that is that the—earnings that you make from your own employment are subject to

the earnings test, but dividends, interest, and other income that Mr. Stark would call unearned are free from that test.

Do you see any justice in a situation where someone can sit back, not work at all and clip coupons and have hundreds of thousands of dollars of income not subject to the earnings test while somebody who is really struggling and scraping has to pay up above the very nominal limit on earnings?

Mr. PHILIP SEMLER. I try—in all honesty, I try to balance the people who sit back and clip out coupons, if they by their own initiative, so-called work habits and everything else, obtain that kind of wealth, I admire them. I sometimes have a little trouble if it was inherited and they didn't really have to do anything to get that wealth.

How much should that be taxed? I don't know, I will be honest with you.

Mr. ZIMMER. Do you think it should be on a preferred basis compared to earned income as it currently is?

Mr. PHILIP SEMLER. I am not sure I understand the question.

Mr. ZIMMER. OK. Currently dividends, interest, and other such forms of income are not counted toward establishing the fact that you have earned a sufficient amount to start having to give back some of your Social Security. But from the very first dollar of your wages that you earn, you start reaching that threshold at which you have to start giving back your Social Security.

Do you see any logical reason for treating the two forms of income differently?

Mr. PHILIP SEMLER. I am not sure, sir. I will be honest with you. I really haven't given it much thought as far as that. I would hope that—I would hope that you don't still keep taxing one and now add tax to the other. Let's put it that way. I think some study ought to be given to that, maybe, that maybe some fair tax, and again if the money is used right, and used in good intentions and everything in our government, I don't think any of us begrudge paying taxes to have the kind of government and the way we live and everything else. I really don't. I think we are very proud of that.

Mr. ZIMMER. Mr. Willett, you had something you wanted to say?

Mr. WILLETT. If I may offer a different perspective. This past year I haven't able to contribute to any type of retirement savings for myself out of the income I earn, and I think we are looking at the problem from the end rather than the beginning. And in order to qualify for Social Security benefits you have to have had earned income during your life and contributed into the program.

I look at it if I were able to access the funds that are currently—that I am currently paying to the U.S. Government for Social Security that—or the Social Security Administration on my behalf, if I had those and were able to invest them, we wouldn't have a problem of an income test at the end of whether it is private funds that you have been able to save for retirement or whether it is earned income when you retire and take a second job.

I think the issue really is, you know, what is the purpose of the tax from the beginning and are we using it for what it should be and are these funds that we are setting aside that we are taking away, maybe some day I hope I never have to draw on Social Secu-

rity, and I would like to not and maybe not have to go through the income test, and I would like to offer it to other people who may have more of a need, if that is the case.

But I am still young. I don't know what is going to happen in the next 30 years before I do retire. I would like to know that if I am putting that in that I have some security, that it is going to be there, and if I am able to save some other things, I don't want the money that I could have had and saved for my own retirement taken away from me because I have been able to be successful or fortunate enough to have some other assets that I may be able to rely on.

Mr. ZIMMER. I know my time is up. I would like the record to reflect I am not urging that unearned income be subject to the limit. I am pointing out the disparity of the treatment between earned income and unearned income. Thank you.

Chairman ARCHER. Ms. Dunn will inquire.

Ms. DUNN. Thank you, Mr. Chairman.

Mr. Willett, I would like to ask you a couple of questions having to do with small business. I am especially interested in the inheritance tax and I come from a district in Washington State where almost all the businesses are very small businesses or small timber farms, small farms, that sort of thing, and the inheritance tax becomes very important at the death of the patriarch and the turning over to the family of that business.

I am wondering—as you have seen in our proposal in the Contract, we would lift the lid from $600,000 to $750,000 that would be exempt. I am wondering if that even makes a difference.

What is your thought on that inheritance tax issue?

Mr. WILLETT. Well, two things. I think it is proposed to be indexed for inflation, the exemption, the exclusion, the $750,000, but I don't know if it makes up from the time of the $600,000 to now $750,000 whether that $150,000 is actually what inflation would have adjusted it. I haven't studied that but I would think that it is not enough.

For small businesses, I think there should be an exclusion from the estate tax. My understanding is it is not a large part of Federal Government revenue in the first place. And second, the time and the distractions that small business owners have to go through to do some estate planning and then on top of that, as I was explaining to Mr. Hancock, they have got the problem of paying the tax after the death and then they are jeopardizing their stability to maintain their business and keep the employment of the people that are with them. And we wonder why there is a 7 percent success rate beyond the second generation. Maybe the estate tax has something to do with that.

I think we need to analyze that. I also think we should look at an exclusion for small businesses based on an asset size, employee size, kind of a three-prong test: Asset size, employee size, and gross revenue. And if they meet two of the three requirements, exclude them from the provisions of the Income Tax Code section.

Ms. DUNN. Good suggestions. And moving to the capital gains tax, I was interested in your comments how would you see our structuring a capital gains tax that would make it helpful to small business?

Mr. WILLETT. Well, currently in the Tax Code you can have a 50-percent exclusion of capital gains if you hold an investment that was originally funded for under $50 million with a whole bunch of exclusions, which kind of really narrows down the type of investment that would qualify for 5 years or more.

I think long-term investment is good. I think it should be encouraged but also I don't think that attaching a whole bunch of regulations to it and qualifications will help small business because it will be hard for a lot of them to even qualify.

Now, if this committee is able to act on a 50-percent reduction in capital gains, then small business won't have the current favorable treatment that they are supposed to have under the current Tax Code. If that is the case, I would ask this committee to consider a total exclusion for small business on capital gains held for 5 years and lower the limit instead of $50 million of initial capitalization to somewhere closer to $10 million, take away a lot of these exclusions which include my clients who are on the main street of America starting businesses with nothing and risking everything they have to start a career and create their own stability in life.

Ms. DUNN. Thank you for that.

Mr. and Mrs. Semler, I enjoyed your testimony a lot and I like your suggestion of lifting the earnings limit completely. I am told over the first 5 years that would cost the Federal Government $5 billion but after 5 years it would be a wash, and I see so many benefits to that I think it is well worth our exploring.

There is one complaint that comes often from people who oppose lifting the earnings limit and that is that seniors are taking jobs away from younger people in the work force.

Have you run into that as a problem among your friends?

Mr. PHILIP SEMLER. I really haven't per se. I think there are a lot of jobs out there that the older people are fitted to do that young people either don't want or could not be capable of. Maybe in the years from now they would be.

I just feel that we do have as older people with experience and knowledge and everything, and as my wife pointed out, being some role models to people, that we are able to work. We don't want to sit on the porch in a rocking chair. And we enjoy life and we enjoy this country and hope we can add to it for many years to come.

Mrs. BARBARA SEMLER. May I say that in my field of at this point substitute teaching, we are desperately in need of good substitutes who can deal with the young people, and if we don't have experienced teachers in there coming in as a substitute, it is chaos. And if you can encourage older people to substitute in these classes, you will not have it all fall apart while the teacher is gone.

These are the people we need but if they say—well, our insurance man the other day said his father had decided not to substitute because he was going to have to pay back money after he earned a certain amount and he said, I am just not going to do it. Male teacher. That is what we need, are the males and the expert females. We need them all.

Ms. DUNN. You make very good points. Thank you. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman, and like my colleagues I enjoyed your testimony.

Let me just ask Mr. and Mrs. Semler, this issue that kind of underlies some of the discussion about the earnings test, the average income for people over 65 is about $13,000 and about half of the cost of the proposal to raise it would go to families with an income over $55,000.

Do you think that is something we ought to take into account? Mr. Hancock, I don't think he was recommending it, but he talked about some proposals to means test Social Security or Medicare, which are indeed very controversial, but do you think it is relevant that half of the costs would go to families with incomes over $55,000?

Mr. PHILIP SEMLER. I am sorry, sir. I didn't quite understand you.

Mr. LEVIN. The proposals that are before us to change the earnings limit, about half of that would go to families that have an income over $55,000. In other words, people——

Mr. PHILIP SEMLER. In other words, if we raise the limit——

Mr. LEVIN. Right, right, right. I mean is that relevant at all? Should we take that into account?

Mr. PHILIP SEMLER. If I was in that bracket, I would probably say very definitely, let it go, that we should enjoy it, too. And I am just saying that in all fairness, by raising the limit and allowing people to work—I read an article here not too long ago about a bunch of doctors down here, I think in the Carolinas, that were doing all this work for nothing. I would hope they would do it again, but let's say we want to try to get doctors back into the work force. We well know that $50,000 to a doctor in many cases is not that much so we might not entice these doctors or high-paid professionals to come back into the work force. I just feel that they say, how much money it is going to cost by raising this limit, and what Mr. Bunning said that you had somebody testify from the Social Security—the head of it said let's raise it $200 a year. To me, that is ridiculous.

Mr. LEVIN. That isn't admittedly much of a raise. The $7 billion cost takes into account the amount of additional income tax that would be received. I just think that we ought to take a look at all these factors when we do something. And I don't know if you agree with that.

Let me ask Ms. Kellogg, you say in your testimony many African-Americans migrated to northern cities from the South just to find that good government job. Maybe the experience in Michigan was very different from other States.

Do you have any idea how many African-Americans migrated from the South over the last 50 years and went into public employment?

Ms. KELLOGG. Do I have any idea of the number?

Mr. LEVIN. Yes. What percentage of the African-Americans who migrated from the South went into the public sector? Do you have any idea?

Ms. KELLOGG. I have no idea, but I would say, just from what I know, basically a lot of them. I would say to a large degree. Over the past 50 years.

Mr. LEVIN. Like 50 percent, do you think?

Ms. KELLOGG. Or more, or less; 40, 50, 60. I have—really I have no idea. I just know a lot of people when I was growing up——

Mr. LEVIN. Look, I don't know either, but I think we want to avoid stereotyping, and I am going to try to get that fact and send it to you. My guess is that the number of African-Americans who came from the South who went into government jobs was far less than 50 or 40 percent.

Ms. KELLOGG. I don't think I was concentrating so much on the number as to make another point.

Mr. LEVIN. Which is?

Ms. KELLOGG. It was—a point that I was making was the relationship between dependency, welfare dependency and government dependency.

Mr. LEVIN. But if a fraction of what you say percentagewise of those who immigrated from the South went into the public sector, a fraction, then it would have something to say with your theory. I mean, in most—I think most of the migration from the South involved people who went into industrial jobs and to some extent service jobs unrelated to government service.

Ms. KELLOGG. I would have to say as I grew up I remember what I heard, and I remember until this day what I hear, and in my community——

Mr. LEVIN. All right. I will try to have that fact obtained. If you don't mind, I will send it to you.

Ms. KELLOGG. I don't mind, but as I said, I was not concentrating on percentages.

Chairman ARCHER. The gentleman's time has expired.

Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. Willett, we appreciate you being here today and testifying on behalf of yourself as a small businessperson, also representing your clients who are many other small businesspeople or maybe even large business. But you and your clients do the same thing, that is, you invest, you take a risk, you take a chance and you create jobs, jobs that provide income for a lot of middle-income families, I am sure, and a lot of low-income families and jobs that would be beneficial to a lot of welfare recipients.

Mr. and Mrs. Semler, we appreciate your comments. It is very touching about the fact that you lost your job at the age of 58 and then the stress of trying to find additional work. I am glad things worked out.

Just a couple of days ago, Mr. Bunning mentioned, we had a Subcommittee on Social Security hearing with the Administrator from the Social Security Administration here, and, again, we discussed the cost to the government should we increase the earnings limit. Ms. Chater did finally agree that this would not be a loss of Social Security trust funds, funds that are collected from taxes that are levied on people who work, but the loss would actually come from the loss of penalties that are assessed on people like you who are working.

I appreciate the fact that you want to continue to work and that there are several hundred thousand of you who also want to work. I appreciate the fact that when you do work and you draw a pay-

check and you have an income on which you pay Social Security taxes, you are paying Medicare tax, you are paying unemployment, your employer is paying unemployment, you are paying an income tax, you are paying a State tax, you are paying a sales and use tax, you are just paying plenty of tax, so we are deriving income from you at all levels and all areas of government.

Ms. Kellogg, I am very moved by your statement. I plan to share your statement with a number of people in the Third District of Georgia. I agree that the Contract With America is here to restore States' rights. It is also to free people from the slavery of Federalism, which I think is long overdue.

I agree with you that welfare is driving fathers from homes. Mr. Gibbons' comment is well taken that here in the Congress it was addressed early on. Maybe we can ensure through block grants down to the State governments that that provision will be adhered to and we will stop driving fathers from homes.

Jobs are the answer to a lot of those who are on welfare. But jobs come from people like you, a small businessperson, they come from Mr. Willett, a small businessperson, and many millions of small businesspeople and people across this country who are willing to take a risk and to invest.

The only risk that a lot of Members of Congress take is when they put that voting card in that slot and punch the button. They are risking their rear back home. Every time a provision is mentioned in this Chamber or this Congress that will encourage private-sector investments it is criticized time and time again as being merely incentives for fat cat, greedy people trying to make more. In essence, creating private-sector investment opportunities will create jobs for many others.

We do need to drive up the stake on welfare. We need to set a point out in the future that this is what it is going to be, this is how it is going to be, you need to get yourself prepared so you can get off of welfare.

I appreciate the job you do. I appreciate the business you are in, and I appreciate the fact that your funds are actually derived from clients who are distressed because of government interference. Thank you.

Ms. KELLOGG. Thank you.

Chairman ARCHER. Dr. McDermott.

Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Mr. Willett, in your testimony I believe I heard that, and I will paraphrase you, you indicated that the neutral cost recovery system in one of the tax bills pending before the committee is skewed to large corporations. You followed up indicating we should look at a higher expense figure for small business.

Is that accurate?

Mr. WILLETT. That is correct.

Mr. KLECZKA. What I would like to do is get your thoughts on this thing we call neutral cost recovery. It seems if you use an example of a piece of machine with a life expectancy of 10 years and depreciable life of 10 years, if in fact you depreciate that, plus the additional inflation that is going to be provided for, plus a factor of some 3.5 percent, which is to reflect your costs of losing that as

an investment over a period of 10 years on a piece of equipment, a corporation could actually depreciate or deduct more than the actual cost of the item, of the asset.

Could you respond to that?

Mr. WILLETT. Actually, the concept is not so much a principle as it is a good concept. I mean, I have actually taken these numbers and run a test, and I looked at my office building and I will recover—under current tax law, I will recover 34 percent of my original investment by the year 2035, taking into account the effects of inflation.

Mr. KLECZKA. That is because of the long period for a building when——

Mr. WILLETT. The long——

Mr. KLECZKA. But use another example, like the piece of machinery with a 10-year depreciable——

Mr. WILLETT. Most of my clients I would prefer address it as 5 years because most of my clients buy 5-year property. But in the case of 5-year property, still you lose because of the effects of inflation. However, it is still marginal, probably closer to 87 to 81—somewhere between 81 and 87 percent because of effects of inflation over a 5-year period, but they are going to pay for that asset in probably 1 or 2 years. My proposal was to even shorten that depreciation more.

Mr. KLECZKA. Give me the rationale for a corporation being able to deduct more than the actual cost. That is compounded if the corporation borrowed to buy the piece of equipment and took advantage of the interest business expense.

Mr. WILLETT. But the interest is actual cash that they are paying, so the effect is the dollars that they invested today are either cash or moneys that they borrowed, and if they invest that cash today, sure they should be entitled to—I think they should be entitled to a greater deduction than what they actually paid given the effects of inflation, because we are in a cash flow economy. You talk to any investor, you talk to any Wall Street analyst, you talk to any business owner, and what they run their business on is cash flow.

So when the effects of inflation take away the value of your dollars and you are not able to get the benefit, you are paying higher taxes and taking more costs in the form of taxes because you are not able to take the real, true cost to yourself as a deduction for your investment and that investment probably created a job.

Mr. KLECZKA. OK. That might be true for inflation but to add on an additional 3.5-percent kicker, as I call it, I think escapes some logic.

Mr. WILLETT. I think you are right, it may well be. I don't know. But my question—my recommendation was that we shorten the depreciation schedule closer to the financing so that it more matches cash flow. Then you don't have the problem of indexing and adding kickers to it. If it is closer to cash flow, you don't have the problem, and that is where when you went from 15 years depreciation on a real estate asset in I believe 1978 to somewhere to 1984, you are able to do that, after that it has gone steadily up, it goes to 29½ years and now it is 40 years. It doesn't make sense. Going 3 years

on a computer to 5 years doesn't make sense, especially when the computer is outmoded probably in 1 year.

Mr. KLECZKA. I think the proposal we will be looking at and marking up in the committee will actually elongate those periods at the onset because of the revenue loss that would occur if you shorten, as you indicate.

Let me ask a quick question to Ms. Kellogg. We had a lot of the discussion yesterday before the committee on the welfare proposal, and one of the items that disturbed some of the members of the committee was the fact that for a teenage mother, she would automatically lose any welfare benefit and those dollars would be given to the States in a block grant wherein the State can form group homes and pay for orphanages and things of that nature.

And my concern was for the teenage mother. I think what we should try to provide is that, one, she stay in the family and, two, finish school. And under the proposal we are looking at, that probably won't occur.

Would you be supportive of continuing some payment for the child, not the teenage mother, but the child, to encourage that teenage mother to stay home and finish school versus giving it to the State and having that mother and child put into a group home?

Ms. KELLOGG. I would support that teenage mothers should stay home with their parents.

Mr. KLECZKA. OK.

Ms. KELLOGG. And I certainly do not think they should get benefits because I think that encourages them to be, from the South where I come from, "grown before they are ready," and they certainly are not ready to parent. So I certainly do not support them being on their own parenting because I am a socialworker, a licensed certified socialworker, MSW, and of course I have seen—I am 51 years old, so I have worked for a long time now, but I have seen a lot and some of the things I have seen, we do a lot more damage to children. We do not want to encourage that.

Mr. KLECZKA. A teenage mother has no income so it——

Chairman ARCHER. The gentleman's time has expired.

Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

Mr. Willett, as you know, the bulk of the new jobs that are created in the economy are created in small business.

I was wondering from your experience could you comment on the likely impact on the survival rate of small business and particularly small manufacturers from passage of a more liberal approach to a cost recovery like envisioned in the Contract bill, and also comment on the likely impact on small business and small manufacturers of increasing, as you suggest, the section 179 expense election to, say, $100,000.

Mr. WILLETT. On the first question, as far as the neutral cost recovery issue that you are addressing right now, I think that manufacturers, obviously small manufacturers will have the greater chance of survival because they will get a greater deduction which more closely reflects the economic reality that they are buying an asset that may have a 15-year life, that they are able to take that depreciation, and the money they are investing today, they are still able to get the value of those dollars in the future rather than some

percentage somewhere, 60 or 50 percent of what that investment really was.

Mr. ENGLISH. I know this is a great concern in my area because we have a lot of particularly small manufacturers who are internationally competitive who are constantly having to make major capital investments, and it is extremely difficult for them to do that, and I think you note in your testimony that this is a very broad-based concern in small business.

Mr. WILLETT. I have some clients who to stay involved they sell their product in Australia, in Russia, and they are a manufacturer. They sell all over the United States, Canada, and they invest every year in quite a bit of equipment and they invest cash because they don't believe in borrowing money, and I think the section 179 expense election by increasing that up to $100,000 will more closely reflect reality for them.

They are investing their hard-earned money this year. Why should they pay tax on it when they are creating jobs and investing for the future and improving their competitive edge and maintaining their business in a very competitive environment?

Mr. ENGLISH. Thank you, Mr. Willett.

Ms. Kellogg, Mr. and Mrs. Semler, I very much appreciate your commentary and your contribution in this hearing. I know we have adduced testimony in other hearings already this week, including before the Social Security Subcommittee where we learned that working seniors face extremely high effective tax rates.

We have also heard and will be hearing tomorrow in greater detail in another hearing that the working poor face I believe over a 70 percent effective tax rate. In view of some of the eloquent statements that have been made by members in the hearing today about the equity implications of the Contract, I wonder if you would comment on in your view how equitable it is that these groups, working poor and working seniors, are facing a higher real tax rate in this system than millionaires?

Ms. Kellogg, would you like to comment on that?

Ms. KELLOGG. Well, I don't think I really would. Thank you.

Mr. ENGLISH. Very good. For the Semlers, how does it feel to you to be facing a higher real tax rate than millionaires?

Mr. PHILIP SEMLER. I don't like it. I really feel it is unjust and I don't think it is necessary that we pay this tax in a sense because I think it loses its effect, and I have talked to some people off the record from the Social Security office who have commented to me, saying that it takes more of their time and the money involved in actually doing the collecting or supervising of getting this money back from the senior citizens than it is really worth to really collect it.

No, I don't like to be in the highest tax bracket and I think it discourages a lot of other people who have commented before. I just tell you I am not going to get into it. When I reach the limit, I just wait until next year or never get into it to begin with, and I think we have discouraged a lot of good people.

Mr. ENGLISH. Thank you very much. I think your comments reflect on the subject of the real equity issues that this panel has to address.

Thank you very much, Mr. Chairman.

Chairman ARCHER. Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

As was stated earlier, approximately half of the savings if we raise the earnings limitation will go to people who make over $55,000 a year. I say, great. That means half of the savings go to people who make under $55,000 a year. So I think that the problem that we have and with a lot of the testimony before this committee is that we look at our economy as a zero sum game. We look at those who want to get their share of the pie instead of looking how can we make this pie larger. And we get into this class warfare where we preach young against old, we preach rich against poor, certain ethnic groups against other ethnic groups, and I think that is a large mistake that we make in our society and that it can be even dangerous, especially when times get tough.

I think that we need to look as a body at proposals that will benefit all classes of people and, Mr. Willett, I would like you to comment on capital gains and whatever other proposals that you commented on and comment how those proposals can reach across class, whether it is income lines or whatever it is, how those can benefit all segments of our society.

Mr. WILLETT. I think all too often on capital gains, it is viewed as a tax break for the rich. My feeling is and from practical experience I have a client who left employment, had a very good salary, left employment, wasn't able to accumulate much when he was in employment and decided to start a business. For 2 years he was the only employee of this business and the next 5 years there were two employees of the business. He ran into some tax trouble, came and talked to me, I helped him out.

Today, his company is owned by one of the large multinational international companies that is traded on the New York exchange. They have a 30-percent interest in his company. If you were to look at his personal net worth today compared to 7 years ago, he is worth a lot more. He employs 150 people who wouldn't otherwise have jobs and he has come up with a new technology and a new way and a new application in the 3–D animation area. So I think it reaches across classes. He is employing people that are graduated from school now that otherwise would have difficulty finding employment. He has also created a whole new arena of potential job opportunities because he has pioneered a new area in data exchange.

Mr. ENSIGN. Thank you, Mr. Willett.

Mr. Semler, and Mrs. Semler, I appreciate your comments very much because I have been in the private sector my entire life and employed many seniors at the last job that I held, and the constant comment to me was, geez, I can't take any more hours right now because I will start getting into penalties.

It was very disheartening to me at that time. Obviously, I don't think that anybody that thinks that making up to $30,000 a year is a lot of money, especially if you live in any type of an urban district in this country of ours, and so I appreciate your comments today showing that we need to reward people as they get into their years where we want them to be more productive.

People are healthier; they are living longer. If we are going to have a society that cares about people as they get older and want

to be more productive—I don't think a lot of people like to retire. A lot of people love working, and I appreciate your comments very much today.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman, and I want to thank all the panelists who are here today and thank you for your testimony. It has been very helpful to us.

Mr. and Mrs. Semler, I wanted to just comment on your testimony because I thought it was very good and very compelling. We, as Chairman Bunning had mentioned, had a hearing earlier this week on this subject in his subcommittee, the Social Security Subcommittee. And I think the conclusion there, and perhaps the conclusion on this committee, would be that we are all trying to work together to do the right thing for working seniors.

As we look at exactly what that is, we have to be aware of the fact that we have a responsibility here not only to the present recipients but to those people who are now working and paying into the system who intend to be recipients in the future.

And so that we have to maintain the integrity of this trust fund. What that means is that when it is said to us that over a 5-year period a provision like this will cost, after taking into account additional taxes that will be paid, about $7 billion over a 5-year period, we have to look at that and accept responsibility to try to determine how we maintain the integrity of the fund. Certainly Chairman Bunning in the committee meeting, expressed his interest and the necessity of doing that, and witnesses there, the AARP witnesses and so forth, said that they wanted to work to that end.

I want to ask you how you think we ought to maintain the fund integrity because I think that is our job, how to determine how we should best do that. But I do want to say that we all want to do the right thing for working seniors, and your testimony has certainly helped us to understand the issue better.

Mr. Willett, you were talking about section 179 and this is an issue that certainly I have a great interest in. In 1993, we increased the amount from $10,000 to $25,000 in this committee. Subsequently, it changed and it became then not $10,000 but $17,500.

I think for people who have small businesses, a number of people who are my constituents had commented that this was helpful to them to the extent that the limit was increased. And I think it would be helpful if you might comment to us, based on that increase, which at that time was a 75-percent increase, has that been helpful to your clients and others you have spoken to, and to what extent has that proven to be a good move?

Mr. WILLETT. I think it has been helpful. Section 179, though, I don't think is just intended for small business. I think it is intended for all businesses and raising it 75 percent to $17,500 has made a difference for some people, but if you look at the numbers I have submitted in my testimony today, most of my clients were already purchasing in excess of $17,500 before that was passed in 1993. And so all they are doing is getting an additional tax benefit, which is a nice relief.

But to create further investments and to let them make the next decision, I want to buy a larger piece of equipment, I am going to expand my plant or my manufacturing facility, and do I do it or do I not do it, if I am going to get a tax break and I am going to save dollars today, those taxes, the $20,000 or $30,000 I may be paying in taxes or $10,000 or $5,000 that I may save by investing an additional $10, $20, $30, $40, $50, $60,000 than maybe I otherwise would is a good incentive.

I think that is where you are going to hit most small businesses. Startup business, $17,500 was good, but if you are in your second or third year, if you are buying any type of computers nowadays and you have more than two or three around the office, you are spending that to maintain your computers.

Mr. PAYNE. As a small businessman myself who ran a business before I came here, I certainly understand that. But please understand from our perspective one of the responsibilities we have is to ensure that we are reducing the budget deficit, and consequently as we look at the amount of money we can make available for expensing and other reduced taxes, we have to do that in such a way that we don't increase our budget deficit, and that is a constraint we are dealing with.

Mr. WILLETT. I can appreciate that, and I kind of allude in my testimony to the fact that, you know, not being an expert on government spending but maybe it could be an alternative to neutral cost recovery for smaller businesses, because in the first 3 years under neutral cost recovery the small business will actually be hurt.

And if they pass neutral cost recovery, there has got to be something given to the small business so there is going to be money picked up through neutral cost recovery by reducing and stretching out that length of time in the first couple of years. So to offset that effect, you need to have the 179 either coupled with or as a substitute for neutral cost recovery.

Mr. PAYNE. I see my time is up. Thank you very much.

Mrs. JOHNSON OF CONNECTICUT [presiding]. The gentleman's time has expired.

Mr. Nussle.

Mr. NUSSLE. Thank you, Madam Chairman. I really appreciate the practical advice that you have been giving in this panel and I want to continue with that vein.

Ms. Kellogg, you mentioned that if somebody on Friday discovers that the welfare system has been eliminated there is this instant reaction, at least in the people that you have dealt with, that they need to go out and get a job, they recognize that.

Do you think—I mean, is there any variation on that theme? Is it that instinctive, if you will, that somebody knows that now that they lack that dependency in one vein that they know that by Monday they have got to figure out a way to pull themselves up? Because I have to say that there is some concern, and I have to say I share it, that because we have been locked into this system for so long that that reaction may not be automatic in all circumstances.

How wide ranging do you think that reaction is?

Ms. KELLOGG. I can only tell you what I—the question I proposed to my class and the response that I got. As far as going beyond that point, I have not, but when I posed that question to them, they said that they would go out and one person said, well, I would get—she said, I could get a landscaping job until I learned how to do other kinds of things or when I am able to get some training. She said, I would like to work outside; I would go and ask and knock on doors and see if I could cut grass.

So it was an instinctive kind of survival thing, but as I said, I posed a question on, this is Friday and welfare is cut off today, what will you do Monday morning. They said, I will have a job.

Now, that is a little optimistic, too, sometimes, but as I said, she said, I will go cut grass.

Mr. NUSSLE. What happens on Saturday and Sunday? What struggles are they going through and is there a role for government? In other words, between the reaction that they recognize that, look, this is going to end and I have got to go do something about it, I mean what struggle are they going through, what practical struggle?

Ms. KELLOGG. They are going through lots of struggles because they bring a lot of baggage with them. They have learned a lot of behaviors and attitudes that are not conducive to success, so they need a lot of help. They need a lot of practical help as well as some skills training and things of that nature. But I am not at all suggesting that welfare should be just cut off and people not receive the help to become self-sufficient.

Mr. NUSSLE. And I recognize that, but this is a scenario that you are playing through, and the other part of this, and I want to go to Mr. Willett, too, because Monday night when they come back and they find out that they didn't get a job because there may not be jobs available, and they are wondering why and we are wondering why, and to close the loop, and I hear this from a lot of small businesspeople in particular, they say—we can't—what is our incentive to create a job for this type of a person who has just come into the work force who has been locked into dependency, who doesn't necessarily have the work ethic yet, doesn't necessarily have the skills, how do we go about creating that job?

And I guess from a practical standpoint, because this really does close the loop, what can we do in order to help? Because welfare reform, everybody says let's end welfare as we know it, that is fine, but there are some practical problems with this person, whether it is cutting the grass or whatever it might be, how do we make sure that that is available for them on Monday when they go out and look?

Mr. WILLETT. In addition to just the person who may be coming off of welfare, how about the person who just lost a job? Some of those people consider even starting a business, and how nice would it be instead of taking on the risk of already investing everything they have, commit their time, that is their most valuable asset. In addition to that, they are asked to risk and borrow money from a relative because they don't have any source to borrow from a bank and have the prospect of having to pay that back, that is a lot of risk all at once.

What if they were to have the incentive or access to capital where they could have somebody invest in the equity and say, I believe in what you are doing, I believe in your idea and concept, and I think it will be successful and have that capital basically free?

It comes in and the person is willing to do because they have some incentive to make that type of investment to create the jobs because they are not going to be taxed at a high tax rate on a return if the business is successful.

And so the individual that is starting the business is taking a big risk, investing all their time. They don't have capital. Why penalize the person who is going to give the capital to add the stability, take the stress away from the person that is starting that business and allow them to be successful?

Mr. NUSSLE. So this is the loop we have got to close. You can't just eliminate welfare. We have got to work on the opposite side. I think that is right. That is one of the reasons that the Semlers said, because you went through this at 58 years old, if I understand from your testimony you had to start all over from ground zero, and that challenge will be there regardless of whether it is welfare or whether it is losing a job, so that is why this loop has to be closed.

Mrs. JOHNSON OF CONNECTICUT. The gentleman's time has expired.

Mr. Neal of Massachusetts.

Mr. NEAL. Thank you, Madam Chairman. I am hearing I think more opportunity for common ground, even through Mr. Nussle's testimony, than I think many of us assumed on the outset of this debate on the issue of welfare.

And one of the things I would like to ask, Ms. Kellogg, if I could, you did indicate great emphasis on individual responsibility, and I thought the testimony was very instructive this morning in that sense that I think many of us can identify with the arguments that you offered to the committee this morning. But you do say in the next breath that there has got to be training.

Ms. KELLOGG. I beg your pardon?

Mr. NEAL. You do say in the next breath about that individual who says, I will get a job on Monday, that the reality is that she may well not get a job on Monday.

Ms. KELLOGG. What I said on Monday was just I posed a question to a group of welfare recipients that I was working with through a contract I had. And I posed that question to them just to see what their response was. What I gave to you was the response that I got. I am a firm believer that they need training and educational opportunities.

Mr. NEAL. Who provides that training and educational opportunity?

Ms. KELLOGG. Well, I certainly think the funds that are going to go to the States through the block grants to the States or the people——

Mr. NEAL. Do you accept a role for government in that?

Ms. KELLOGG. Absolutely.

Mr. NEAL. OK. Let me ask you this, and maybe you could describe for the committee an issue which I have focused on for a long time and I think it is the most painful part of the welfare de-

bate. It is the out-of-wedlock birth rate in America. And the truth is that a young woman at 14 or 15 years old who has a child, that is the person who stays on welfare for a lifetime. It is not, as Secretary Shalala said yesterday, the overwhelming number of welfare recipients who move into the system and out of the system in a relatively brief period of time. It is, however, that young woman who has that child at 14 or 15 or 16 who stays on the system.

But the debate that we are going to undertake here, and I think again it ought to be a vigorous debate, is going to be over at least paternity establishment in some measure. And many of the clients that you have had, do they readily cooperate with the authorities on the issue of establishing paternity? Are they reluctant?

Ms. KELLOGG. Clients that I have worked with? Now, I have none at this point. And I am not sure if the committee quite understands the role that I have played in this. But I tell——

Mr. NEAL. Let me flip the question. Do you think in the social contract or the contract that has been offered, the Contract With America, do you think that overall welfare reform ought to include a rigid requirement for paternity establishment, child support?

Ms. KELLOGG. Well, I keep hearing that on the news and reading in the newspaper, and the question that keeps coming to my mind is when some of these children are being fathered by 13, 14, 15, 16 year olds, where are they going to get the funds, you know? You can establish paternity but where are they going to get the funds to pay child support?

So we only enslave more because then what are we going to do, put them in jail or are we going to say, by the time you get 21 you are going to owe the State or the Federal Government $250,000? We just blocked them off again. We just enslaved again.

Mr. NEAL. Let me indicate——

Ms. KELLOGG. Who is fathering these children? What age group? I think we need to look at that and do a study to see is it going to be effective, what we are saying now.

Mr. NEAL. Do we let that young man at 14 or 15, does he skate free from any sort of obligation to that child for the rest of his life?

Ms. KELLOGG. I am not saying that. I am saying is it realistic to think just because we establish paternity and go after him for child support, where is he going to get the money to support the child? He has no jobs, no skills, no education. Who are fathering these children? I think we need to look at that; we need to do a study there. We need to see where are they coming from.

Now, if it is a person, a father with an income and education, absolutely. But my thinking is from what I see is a lot of young, 18 and under fathers.

Mr. NEAL. Well, can we not make a constructive argument that if you are old enough to father a child, you certainly have some role in supporting the child?

Ms. KELLOGG. Well, now, that is ideal, but I don't think that is being very realistic with what we are dealing with in today's society.

Mr. NEAL. In the testimony we heard today, if we are not going to try to effectively close the loop, as Mr. Nussle said, how do we go about restraining antisocial behavior?

Ms. KELLOGG. Maybe we can require—if we can require a 14 year old, a 15 year old, a 16 year old to get a job at McDonald's and then we say, we are going to take 50 percent of what you are earning to contribute to this, we can do that kind of thing, but we have to look at what we are dealing with.

Mrs. JOHNSON OF CONNECTICUT. The gentleman's time has expired. Mr. Shaw will inquire.

Mr. SHAW. Thank you, Madam Chairman.

I would like to pursue just a moment the questioning and the line of questioning that my friend from Massachusetts has been following, because I think that is an interesting question, and I know that much of what he is doing, Ms. Kellogg, is outside of your scope of expertise.

But I would just like to throw this in. I think the establishment of paternalism is tremendously important and I think placing the responsibility is tremendously important. I think you are correct that you can't get blood out of a turnip, but these young men grow up, too, and I think there must be a sense of responsibility in themselves. This may in itself be a deterrent from them getting these young girls pregnant.

We all know that there are many of these fellows that are having five and six kids with that many women, and it is wrong, and they have no sense of responsibility because they have never been called upon, and I think that is a very important facet in welfare reform.

It is not included in the Republican bill at this particular point. However, I said yesterday and I will say again that we are going to have a bill out very shortly. In fact, I would say we would have it out there before we have welfare reform completed, and we are going to schedule hearings on it, and it is an issue about which there is great bipartisan support, and we can push a bill through very, very quickly, and I think male accountability here is desperately missing as part of the formula.

Ms. KELLOGG. When it comes down to accountability or declaring that I am the father of that child, there is no lacking of that.

Mr. SHAW. As a matter of fact, a lot of them turn up at the hospital handing out cigars.

Ms. KELLOGG. Absolutely. There is no lacking of that. Much of what I am saying is, I think—and to chase that, I think, is important, but I also think you are almost chasing—beating a dead horse to death, because what we are looking at, many of these young men are dead that have fathered children.

What I discovered and my expertise is quite broad, what I discovered, I have discovered that many of the same fathers have fathered two or three children with the same age group girls at the same time. I don't know if I made myself clear. I know what I am saying, but did you understand what I am saying?

Mr. SHAW. I understand what you are saying.

Ms. KELLOGG. Many of them are dead and they are being shot and killed daily in the streets. So I am saying how much we need to know, first of all, as far as the teenage—the teenage girls are not going out there and mating with men who are mature, educated, and skilled. I am thinking that oftentimes it is coming from that 18 year old and under, unskilled, and the only thing we have there is a another welfare population of people who need help.

Mr. SHAW. Let me go to another area in which you were very eloquent, and I would like to pursue that because with welfare reform we are obviously going to need a tremendous attitude change among people in government, I am talking now about the bureaucrats who are counseling these young people, instead of continuously just telling them how much they can get, they should tell them what they have got to do. You need a motivational type of person rather than just a bureaucrat who is handing out fliers with information on where they can get this service and that service.

What do you see as far as the role of the counselor in the new welfare reform package with respect to how that person would proceed in dealing particularly with these young people who have never really even had a person in the house, no one really to look up to to show them how they should model themselves?

Ms. KELLOGG. An empowerment role. It is no longer—it is an empowerment role. I find if people are motivated, if their self-esteem is good, then they put forth the initiative. So what if I have to go to night school and hold a job during the day and take care of the babies? If I am motivated from within—I am a businesswoman. I have been in business 12 years. I raised two sons. I never went on welfare. I could have. There were times, 12 years of blood, sweat, and tears, and I will still get into it at this time.

So the initiative, the motivation, the self-esteem is that I have a mission and purpose in life, that there is a place for me in life, that I am somebody, that I can make a contribution. This is the kind of thing, because we spend too much time on trying to tell people where if you get this, you can get there. We need to motivate. The counselor's role is to empower them to go out and realize that they can develop to their fullest potential.

Mr. SHAW. And it is your testimony that the present welfare system is destroying the potential for motivation that is within these people?

Ms. KELLOGG. Yes. It creates dependency.

Mr. SHAW. Thank you.

Mrs. JOHNSON OF CONNECTICUT. The gentleman, Mr. Rangel, is recognized to inquire.

Mr. RANGEL. Thank you, Madam Chair.

Ms. Kellogg, could you give me based on your experience a profile of this teenager? I would kind of think——

Ms. KELLOGG. What teenager?

Mr. RANGEL [continuing]. That she is irresponsible, that she is a high school dropout, that she probably comes from a family that has had no male in the house, that she should be second, third, or fourth generation welfare, that she comes from a community with very high unemployment, that one of the things that her problem is that probably you never face is that she doesn't really find a stigma to getting pregnant, she doesn't really have a hope that there is some fellow in the community that she would fall in love with and marry and raise a family because, as you pointed out, he is shooting somebody or shooting up drugs.

This person has very little self-esteem, but more importantly, very little hope that her life is going to be a part of the American dream and lacks that motivation to try to do any better because she doesn't think that she can. Is that generally——

Ms. KELLOGG. Yes. And you know, going back to the question that Mr. Shaw asked, what should the role of the counselor be? The role of a counselor should be to walk into that person, look that person in the eyes, and say, you might not know your potential, but I do, so get up.

Mr. RANGEL. My point is to keep them away from counselors and see what they do.

Now, the fellow that is in this block, as you said, 13, 14, 15, irresponsible, no job, no skills, and no hope to make a contribution, and I would check out those older people that hang around with a couple of dollars on the corner, too, with the longer cars and the boom boxes and that thing, but generally speaking, this kid comes from the same environment, doesn't have any training at all, really doesn't care if he gets arrested, obviously they do time and they go right back to jail, and it is this person that doesn't mind shooting up a block knowing that someone will come looking for him, so that even the question of life isn't that important to him. Talk about lack of self-esteem.

Would you not say in this same community this is what the teenage mother is faced with?

Ms. KELLOGG. The same profile that you just gave of the teenage mother, to a large degree, too, somewhat. Somewhat.

Mr. RANGEL. And in all probability his mother was a teenage mother.

Ms. KELLOGG. One of the things I find about the teenage mother they do "love their children." So when I work with them, I use that.

Mr. RANGEL. No, no, I am trying to see——

Ms. KELLOGG. Because sometimes——

Mr. RANGEL. When you were working with them, you had a government contract. I am trying to get government out of this. I want to see whether we can have these kids inspired where they don't need us in their environment, because in this community, and you stop me if I am wrong, you got the highest unemployment, probably double the national average. You got to have the highest high school dropout, the highest drug involvement, the highest criminal activity, the highest AIDS, the highest tuberculosis, the highest number of homeless, in other words, if you didn't get special counseling, you are almost destined to be despondent and unmotivated because you don't see where when they talk about America, they don't know you, they don't know me, they don't know anyone in the community, and so they say, you don't mean me when you talk about high-tech, high-paying jobs. So the whole community here is lacking something, isn't it?

Ms. KELLOGG. Well, what I am saying is where did we get this community from? We get the community partly from the welfare system. We have been talking welfare for over 40 years, so we have had plenty of time to create this, because mothers—as a single mother, I divorced my husband when my twin sons were 5½. They are now 24 years old. Now, that——

Mr. RANGEL. I am trying to——

Ms. KELLOGG. What I am saying is I know a woman cannot raise a child on her own, so we have created these communities and partly because of welfare.

Mr. RANGEL. Didn't you agree that government has some role in providing the education and the job training?

Ms. KELLOGG. Absolutely, yes.

Mr. RANGEL. That is what I am trying to say, Ms. Kellogg. I am trying to say that don't you agree when a youngster is motivated toward getting a job, that that job in and of itself brings a sense of pride and a sense that they want to do better, just that job?

Ms. KELLOGG. Absolutely.

Mr. RANGEL. Just working, just getting that check. So if we could tie up the educational system with a job, not just a diploma, do you believe this would go a long way to motivate that child not to have children, not to try to make children but to improve his or her life?

Ms. KELLOGG. Absolutely.

Mr. RANGEL. And the government must participate in providing that——

Ms. KELLOGG. Absolutely.

Mr. RANGEL. Thank you.

Mrs. JOHNSON OF CONNECTICUT. The gentleman's time has expired.

The gentlelady from Connecticut will inquire.

Mrs. KENNELLY. Thank you, Madam Chairman.

Thank you very much, Ms. Kellogg. We are certainly putting you to the test.

We have been doing studies and we are all very interested in this and, unfortunately, we are finding that often the very young teenager's, and I think you know this, first pregnancy can often be an older man in the community who already has established relationships or isn't there as a partner. I know you say you are not in the business of having clients per se, but you have had an awful lot of experience.

Could you just enlighten us at all as we talk about this? We see the teenage mother is the problem; she hasn't got the skills. Yes, she might try to get a job on Monday. That is youthful optimism. But, there often isn't a job there. Can you help us at all on how to avoid teenage pregnancy? That is really what we are wrestling with.

Ms. KELLOGG. How we would avoid it?

Mrs. KENNELLY. Talk to us about that, what you just told us. Is there any other conversation about how they could have possibly avoided this, to help us?

The key problem here is we have got young women without skills having children that they have trouble supporting and being independent with, and the root cause is pregnancy, teenage pregnancy, which Charlie says has become very acceptable in the community.

Have you, with your years of experience, figured out any way we can help avoid teenage pregnancy?

Ms. KELLOGG. I can tell you, one of the ways that we can help avoid teenage pregnancy is to stop paying cash benefits for teenagers to have babies.

Now, if I, as a teenager, or my daughter or my niece or my friend's daughter, knew that I can have this baby; I don't have to worry about how I am going to support it. When I was growing up, I knew I couldn't have a baby. It would not be tolerated, number one, from the family point of view. But let's go beyond that.

How would I support it? Because, number one, chances are from where I came, I would have been put out. So my common sense says absolutely no, because you don't want to be out there, but we have made it easy because there is no question. So that is one way.

Now that doesn't say we are going to wipe it out, because human nature is human nature. We have had unwed pregnancies—pregnancy out of wedlock since the beginning of time.

Mrs. KENNELLY. Thank you.

Quickly to Mr. Willett, I notice you are in favor of the flat tax, and I know you have been down here and busy, but have you had a chance to look at—yesterday Minority Leader, Mr. Gephardt, came out with a different flat tax that unearned income is, in fact, taxed where with Mr. Armey, the majority leader, unearned income is not taxed.

Would you look at this as a better possibility or in competition or possible support?

Mr. WILLETT. First off, I want to clarify. I don't think my testimony indicates that I am in favor of a flat tax.

Mrs. KENNELLY. Oh, I thought it did.

Mr. WILLETT. No. I haven't had a chance to study Mr. Gephardt's proposal. I am interested in it. I studied somewhat Mr. Armey's proposal on the flat tax concept. As an accountant, I read that my industry is not in favor of it. Personally, I formulated an opinion on it. Anything that would help make it simpler and would reward investment and give incentives for jobs and take away some of the decline of the moral character, because that is part of the problem that we have been discussing here today, you know.

We are too dependent. The welfare system should have been a safety net and not a hammock, and it has become a hammock and that has caused immoral character and now we got a vicious circle. We are trying to say how do we get out of it.

You have got to change the strength of the moral character of the people in our country. That is the problem. We have taken that away. We have given them a hammock to sleep on when they do something that may not be morally correct. Now we have to help them out of the situation. We need to prevent them from getting there.

I have a 6-month-old, a 3-year-old and a 6-year-old son, and I sit here today and I wonder what is going to happen with them, their responsibilities as taxes, will they have a retirement. My father lost his wife when he was in his fifties. He is on Social Security today. It took his desire away to work. He had his own business. He lost his business. He is dependent on Social Security. He needed the safety net. And I went to lunch with him the other day. He told me that he would rather not be on Social Security. He would hope and it was his dream during his life that he wouldn't be dependent on it, but he is.

Sometimes it needs to be there as a safety net but when it becomes our sole goal and becomes the focus of our community because there are programs that we can rely on that take away the consequences of things that we have control over, that we have responsibility for actions that we take, then we have a problem in our country.

And that is the issue that really needs to be resolved, is the moral character of our families, and that will resolve the welfare problem, not all the programs, not all the spending because it is not working. It has created the decline of moral character, in my opinion. And so——

Mrs. KENNELLY. Thank you, Mr. Willett. And I think we all wish we could be and hope we could be independent in life, but I am glad your father has got Social Security and I know if in fact things don't go totally right for you, you have Social Security.

Thank you for your testimony.

Mrs. JOHNSON OF CONNECTICUT. I have two questions I would like to pose. First of all, I would like to thank the panel for their very thoughtful input and their ability to enlarge on their experience and the experience of those they have had contact with over the years. It has been very helpful.

Mr. Willett, two questions. First of all, is expensing more important or neutral cost recovery?

Mr. WILLETT. For small business, expensing is more important.

Mrs. JOHNSON OF CONNECTICUT. Your chart shows that expensing up to $50,000 is very helpful and I appreciate that.

Mr. WILLETT. Thank you.

Mrs. JOHNSON OF CONNECTICUT. Why is it in your testimony that you say your health insurance is $413 a month but without the deductibility it is $688 a month? That is more than a 50-percent increase.

Mr. WILLETT. That is a typo. In my oral testimony I said $578. It is a typographical error. The six and the eight should have been a five and a seven.

Mrs. JOHNSON OF CONNECTICUT. OK. Still that is a very significant increase, and I do want you to know that this committee at least is committed to trying to reinstate the 25 percent retroactively to its expiration date by April 15. Now whether we will be able to get the cooperation of both Chambers and move this through——

Mr. WILLETT. Well, I know a lot of my clients would be appreciative.

Mrs. JOHNSON OF CONNECTICUT. We are working very hard to attain that goal and that thereafter it was certainly part of the Republican health care initiative to move that deductibility up toward 100 percent. We used 100 percent but considering the copayments that everyone has assumed, probably working to a lower percent makes greater sense.

One last question. We have had testimony that the neutral cost recovery provisions in the Contract could open up an exploitation and the steering of capital similar to the shelter law. Do you share that concern?

Mr. WILLETT. I didn't hear the exact testimony. I don't know if they are referring to some type of leasing organizations that acquires assets and then loses them and takes some type of benefit and is able to take some cash benefits from accelerating deductions or keeping deductions higher than cash flow. That—it is conceivable that that would be the case, but I think if we are worried about gaming with the tax laws and that, maybe there is some burden that the tax rates are too high already.

If the tax rates weren't so high, people wouldn't spend so much time trying to shelter that. I think you would avoid the problem by looking at other proposals and other aspects, and I think an income tax rate deduction, and that is why I proposed that today, would eliminate some of what I hear when I come to Washington about gaming with the tax law.

Mrs. JOHNSON OF CONNECTICUT. I thought that was a very good point that you made in your testimony.

Would you reflect on this? The testimony that we received was not specific in terms of what kinds of exploitations they foresaw. But the concern arose from the fact that you would not only be able to write off the cost of the equipment and its inflated value but also the interest on any borrowed funds. So it is a rather rich reward for those needing to invest in capital environment. The thought was that that would lead to different kinds of deductions than are currently made.

Mr. WILLETT. I think if that is the emphasis of the testimony, it may not be totally correct, but currently you can deduct the interest that you pay on the acquisition of capital equipment already, so it is not expanding it beyond that. All it is doing is indexing it, so you are getting real dollars, which is a concept that accountants are trying to do, is get today's 1994 dollars for your investment and still being able to take the benefit of that investment in the year 2035. For example, though those dollars are invested today, if you are actually going for long term, and less match to long term so people have the incentive to investment longer term rather than short term.

We had problems in the seventies and eighties because we were too short-term focused. If we are going to do that, I think neutral cost recovery effectively helps people make a better longer term decision, because as accountants today—I know I sit down with a client and I analyze what is the payback period on this investment, can you recoup the dollars you are investing today within a reasonable period of time and I have to counter the effects of inflation. If we can offset that with a deduction, it would help.

Mrs. JOHNSON OF CONNECTICUT. Given your experience with business, is it as important in terms of revitalizing our economy to provide better incentives for machinery and equipment and preferencing capital investment the way the neutral cost recovery provisions do or is it more important to strengthen expensing to allow much smaller businesses to grow?

Mr. WILLETT. From a small business perspective, I would say it is more important that those companies that don't have access to capital markets as easily as the large companies to get financing where it is a lot more available at a lower rate, because a small business owner starting up with no capital, if he borrows from the bank he is going to pay prime plus 3 or 4 percent, where the Fortune 500s can borrow it at prime, or do an equity offering and pay nothing other than the cost of the offering for that money and maybe potential future dividends, but that is—the small business owner is in a disproportionate situation. He has a higher cost of capital no matter what, and if you were to lower that cost of the capital whether it be through capital gains incentives, whether it

be through greater expensing or neutral cost recovery, I think he has greater chance of survival.

They are the ones that become the Fortune 500 companies of tomorrow. And we have seen the decline of a lot of the Nation's largest companies and probably some of the largest capitalized stocks in the New York Stock Exchange have gone through some major restructuring in the last few years.

Mrs. JOHNSON OF CONNECTICUT. Thank you very much, and I thank the panel for their testimony.

Chairman ARCHER. Thank you again very much for spending this time with us and for the excellent input that you have given us. You are excused and the committee will stand in recess for about 5 minutes until the next panel is assembled.

[Brief recess.]

Chairman ARCHER. Would our next witnesses take their seats at the witness table so we can continue with these hearings.

Our next panel is composed of individuals who have extremely excellent credentials, both academically and experiencewise, and we are looking forward to your testimony.

I would like to begin with Michael Novak. He is a theologian, historian, and social concept writer. He has written a great deal about the welfare system and many other subjects and, Mr. Novak, we welcome you to the committee and we would be pleased to hear your testimony. If you can reduce your oral commentaries to 5 minutes and insert the balance of your testimony in writing in the record, we would appreciate that.

STATEMENT OF MICHAEL NOVAK, GEORGE FREDERICK JEWETT CHAIR IN RELIGION AND PUBLIC POLICY, AMERICAN ENTERPRISE INSTITUTE

Mr. NOVAK. Thank you, Mr. Chairman.

It is an honor to be present for the opening debate on the Contract With America. The debate about the items in this Contract may prove to be a major turning point in American life.

When our Founders spoke of the American Revolution, they used the term "revolution" in its ancient sense to mean the Latin word "revolvere," to turn back. To revolve is to turn back to first principles. Also, that is what they meant, to return to the first principle on which the whole revolution and the whole later Constitution were established.

Two-thirds of the country now says that this Nation is on the wrong track so it may be time to turn back to first principles, that is, to the principles of our Founders since that is certainly the right track. And that is the track in the light of which Americans tend to judge whether we are going right or wrong.

As a theologian and longtime seeker for the first principles of the American Republic, I find no better text than one by a former President. The last time I quoted from this text, I warn you, many who heard me thought I was quoting President Reagan but the words actually are those of Thomas Jefferson's first inaugural address, March 4, 1801. I believe you can hear the accents both of the founder of the Democratic Party, Thomas Jefferson, and of Ronald Reagan in the same principles.

In Jefferson's words, "Every difference of opinion is not a difference of principle. We have called by different names brethren of the same principle. We are all Republicans. We are all Federalists." So as our first principles are bipartisan, I hope the debate to come will also be bipartisan and there are good signs that that is the case.

Mr. Chairman, there follow now the words of Thomas Jefferson about the original contract between the people of the United States and their government. This is his statement which he calls the creed of our political faith, the bright constellation of our first principles, and now the rest I will quote from him:

> Let us, then, with courage and confidence,

he said in a moment of cynicism,

> pursue our own Federal and Republican principles, our attachment to union and representative government. Kindly separated by nature and wide ocean from the exterminating havoc of one-quarter of the globe; too high-minded to endure the degradations of the others; possessing a chosen country, with room enough for our descendants to the thousandth and thousandth generation; entertaining a due sense of our equal right to the use of our own faculties, to the acquisitions of our own industry, to honor and confidence from our fellow citizens, resulting not from birth, but from our actions and their sense of them; enlightened by a benign religion, professed, indeed, and practiced in various forms, yet all of them inculcating honesty, truth, temperance, gratitude, and the love of man; acknowledging and adoring an overruling Providence, which by all its dispensations proves that it delights in the happiness of man here and his greater happiness hereafter; with all these blessings, what more is necessary to make us a happy and a prosperous people?
>
> Still one thing more, fellow citizens—a wise and frugal Government, which shall restrain men from injuring one another, shall leave them otherwise free to regulate their own pursuits of industry and improvement, and shall not take from the mouth of labor the bread it has earned. This is the sum of good government, and this is necessary to close the circle of our felicities.

Mr. Chairman, it is no long stretch from these felicitous sentences of Thomas Jefferson to our debate today about the balanced budget amendment, the line item veto, the application of the laws that bind other citizens to the laws that bind this Congress, to welfare reform, and the other items of the new Contract. All of these are small steps toward a more wise and frugal government.

Mr. Chairman, it is not in my power to state better than Thomas Jefferson did the principles on which this Nation was once built. We have wandered far from these principles. We have lost sight of them.

Jefferson had an image of minimal government and a maximum of self-government, of industry, of honesty, and of the citizenry who are free and independent because for what they receive, they make their own contributions. There is a kind of covenant, such as President Clinton spoke of, whereby those who receive from the public good must also contribute to the public good.

If the debate of the next weeks leads this Nation to retrace its steps back to the tracks on which it began, this shall have been a great and historic debate. As Jefferson said: "Should we wander from these principles in moments of error or alarm, let us hasten to retrace our steps and to regain the road which alone leads to peace, liberty and safety."

Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, Mr. Novak.

Our next witness is Dr. Michael Boskin, professor and senior fellow at the Hoover Institute at Stanford University in California and former chairman of the Council of Economic Advisers to the President of the United States.

Dr. Boskin.

STATEMENT OF HON. MICHAEL J. BOSKIN, PH.D., T.M. FRIEDMAN PROFESSOR OF ECONOMICS AND SENIOR FELLOW, HOOVER INSTITUTE, STANFORD UNIVERSITY, STANFORD, CALIF.

Mr. BOSKIN. Chairman Archer, Ranking Member Gibbons, and other distinguished members of the panel, and especially to the new members of the panel I was just introduced to, congratulations on joining the panel. I look forward to working with you, and I appreciate the opportunity to share with you my thoughts on the Contract With America.

The Contract is a commitment to bring to a vote in the House 10 bills, each of which contains several provisions designed to achieve important objectives. Not all of those provisions are within the purview of the committee, but I would just make a few general comments on the general issues in the Contract and then speak briefly on the tax provisions.

The broad basic theme of the Contract With America is that while America is the strongest, freest, and richest major industrial economy in the world, it does confront serious problems and challenges. Important and bold policy reforms are necessary to strengthen the economy and our society more generally.

Most of these reforms have in common the theme that the Federal Government has overreached in a variety of areas and programs and that on balance it is either not achieving the goals of those programs in a cost-effective way, not achieving them at all and/or it is preventing the private sector, families, and businesses from realizing their full potential.

Taxes are too high. The government spends too much and inefficiently. The government borrows too much and in general should not be borrowing except in extreme circumstances. The Federal Government's rules and regulations put far too many restrictions on private activity, imposing large compliance costs and stifling innovation. Too much power has been centralized in Washington and not devolved to the States and localities and America's households.

It is important to understand that while every elected official who has been speaking recently in both parties, and in the executive and legislative branch, has been calling for increased personal responsibility, that the greater accountabilities for Congress called for with the Contract on which a very impressive downpayment was made the first day, I believe is an enormously important item in restoring confidence and trust in a leaner, more efficient, more effective government.

While people have argued items in the Contract and the Contract as a whole will cause problems, I believe in general that these criticisms are exaggerated and in part based on a faulty reading of history, which if my full testimony can be incorporated in the record of the hearing, I go into in my full testimony and I would be happy to take questions on.

Chairman ARCHER. Your full testimony will be in the written record of the committee proceedings.

Mr. BOSKIN. Thank you, Mr. Chairman.

But I believe a combination of economic analysis, common sense, and historical experience validates the general approach. And I also, with my good friend Michael Novak to my side, the moral intent and content of the items in the Contract I believe is heading in the right direction as well.

I want to spend just the rest of my brief introductory time talking about the items which are most important to this committee, which are tax items, and I would begin with a parable: When the Federal Government collects $1 of taxes from the private sector, it costs the private economy more than $1, because people out there will shelter their income or they will change their behavior, they will have to comply, and private economists have estimated these costs may be $1.40 per dollar. Maybe that is a little high, maybe a little low, but you should know that for each dollar you are imposing, $1.40 in costs on the private sector and it gets put into a bucket and it is on the way to trying to solve some problem and the bucket leaks.

There are administrative costs, bureaucratic costs. Some of these admittedly occur in the private sector as well, but they then go ahead and maybe by the end there are 70 cents or 50 cents left to address the problem. Some of those programs work well, some don't. Many of them can't be redesigned and should be scaled back efficiently. And I think if you keep that parable in mind it will be a major source of zero-based budgeting analysis.

Very briefly, the major tax items in the Contract I believe are important but could be divided into two categories. Those are designed primarily to strengthen the economy, strengthen economic growth, and those that are designed to serve other social and equity and fairness objectives.

In the former category, I would put things like capital gains depreciation, IRAs; in the latter category, things like child credits and so on. Elected officials will have to decide which of those we can afford and which to push most rapidly and what spending should be cut in order to pay for them.

I would just say that, in my view, short of a comprehensive overhaul of the income tax system of the United States, which may be something that this committee should turn its attention to in the future because the current system has so many problems, so costly, so hard to comply, so complex, but short of that, I believe the single most important item to be the capital gains reform.

The Contract calls for a 50-percent reduction in the rate and indexing and I will just make two points. Failure to index capital gains means that we are confiscating wealth. I don't think there is any Member of Congress who on an up or down vote would vote to confiscate wealth, but when people have purely inflationary gains and we are levying a capital gains tax on them, we are confiscating their real wealth. And the tax rates on their real wealth become exorbitant.

I give a simple example of 280 percent on a real gain in the text. So I would say that is by far the highest priority.

I also believe that America saves too little, that properly designed IRAs can help increase the savings rate. If we are not going to make a fundamental overhaul of the tax system—I strongly support greater opportunities for tax-deferred savings.

I would also argue that depreciation is, in my opinion, in many industries an inappropriate neutral capital. Cost recovery has certain advantages and disadvantages. My view is you ought to be moving toward a system in which there is a combination of depreciation allowances and interest deductibility that provides the equivalent of expensing.

My conclusion is simple, then. These are all highly desirable. They should be combined with sufficient spending restraint enacted either simultaneously or previously, that when combined with prudent, careful, and open estimates of any revenue reflow from the additional growth would make sure the deficit is not increased and hopefully reduced.

So I commend the Contract, its comprehensiveness. I hope this committee will work with the other committees on things like regulatory reform and other things which are hidden taxes not in the purview of this committee but are like a hidden payroll tax or excise tax and so on, the excess regulation. And I hope that the Congress will be able to move forward and enact the spirit and in some cases the letter of the Contract.

Thank you.

Chairman ARCHER. Thank you, Dr. Boskin, for your oral testimony. And as I said, without objection, your entire written testimony will be inserted in the record and the same shall apply to the other witnesses.

[The prepared statement follows:]

TESTIMONY OF HON. MICHAEL J. BOSKIN
STANFORD UNIVERSITY, STANFORD, CALIF.

Chairman Archer, Ranking Member Gibbons, and other distinguished members of the Committee, I appreciate the opportunity to share my thoughts on the "Contract with America," with you today. The "Contract" is a commitment to bring to a bring to a vote in the House ten bills, each of which contains several provisions designed to achieve important objectives. Many of these provisions are within the direct purview of this committee; still others will indirectly affect areas and issues within the jurisdiction of this committee; whereas others will have little or no impact on issues within the jurisdiction of this committee. Before beginning to discuss some of the most important items in the "Contract," especially tax provisions, within your purview, let me first make a few general remarks about the "Contract with America"; these general remarks would apply equally to the proposals put foreword before the election by Senate Republicans in their "Seven More in '94" proposals.

The broad basic theme of the "Contract with America," is that while America is the strongest, freest and richest major industrial economy in the world, it does confront serious problems, and that important, sometimes bold, policy reforms are necessary to strengthen the economy and our society. Most of these reforms have in common the theme that the federal government has overreached in a variety of programs and policies, and that, on balance, it is either not achieving the goals of those programs in a cost effective way, not achieving them at all, and/or that it is preventing the private sector--families and businesses--from realizing their full potential. Taxes are too high. The government spends too much, and inefficiently. The government borrows too much, and in general should not borrow at all except in extreme circumstances. Federal government rules and regulations put far too many restrictions on private activity, imposing large compliance costs and stifling innovation. Too much power has been centralized in Washington, and not enough devolved to the states and localities, and America's households.

Whatever disagreement with any specific item in the "Contract with America" anyone may have I believe its general analysis and prescription is exactly correct. I myself would not dot every i and cross every t exactly as in the Contract. But I believe a combination of economic analysis, common sense, and historical experience validates the general approach.

Critics have said the costs will be huge, deficits will balloon, the programs cannot work, they will be unfair, this will be a return to trickle-down economics, and ballooning budget deficits like the 1980's. While, of course, there is a risk that what comes out in the end could justify these dire predictions, I believe that they are extraordinarily exaggerated. They are also based on a faulty reading of history. Let me give a couple of examples.

Some critics argue that tax cuts in the 1980's caused the deficits to balloon, and as a corollary, that Reaganomics was predicated on the assumption that the tax rate cuts would pay for themselves by generating so much economic activity that the tax base would expand enough to compensate for the lower rates and that the deficits of the 1980's are proof that they did not. These criticisms are conventionally wisdom in some quarters. They are, however, simply incorrect.

In addition, the 1980's were quite a successful economic decade. While the deficit did balloon, 20 million jobs were created, 5 million businesses were started, the economic status of women improved relative to men for the first time ever, and most importantly, private wealth increased five times as much as the national debt. Concern about deficits is warranted under certain circumstances, but it should not blind us to the broader picture of the nation's balance sheet which improved enormously in the 1980's.

First, taxes were not reduced in the 1980's While tax rates were reduced, the share of taxes in GDP remains roughly constant at around 19 percent of GDP, about the average in the 1970's. It is true that by the end of 1980 and early 1981, the tax share and GDP rose to well over 20 percent, but that was because of roaring double-digit inflation driving people into higher tax brackets at a time when the tax system was not indexed. So a comparison to that year which was a particularly bad aberration is highly misleading. And most of the estimates of how much the tax rate reductions contributed to deficits compare to a baseline where the tax share and GDP would have gone still higher because of continued inflation, and lack of indexing. Some may accept that as the appropriate baseline, I do not. It is fair to say that the tax mix was changed some in the 1980's, with slightly higher payroll taxes and slightly lower income taxes. Second, President

Reagan never assumed in any campaign document, or budget submission, that tax reductions would "pay for themselves," despite all of the claims to the contrary. In fact, it was assumed that there would be a 17 percent revenue reflow, i.e. that when you added up all of the "static" revenue losses, that improvement in the economy from the tax cuts would generate enough activity to compensate for slightly less than one-fifth of the revenue lost. Third, the reductions in the top marginal tax rates did pay for themselves. This is well-documented in Treasury data. Some combination of increased work, saving, investment, work intensity, and importantly, desheltering, led to a situation where revenues went up, not down, from the highest income groups. It is not correct that the early 1980's tax rate reductions "paid for themselves"; the broad across-the-board rate cuts only paid for themselves in the top brackets.

Thus, purely static scoring would miss this effect, and is I believe one problem with the current methods used to evaluate major policy changes such as President Clinton's large increase in the top personal income tax rates.

So if there was some partial revenue reflow, and the tax share was stable because some modest increases in payroll taxes offset some very modest reductions in personal and corporate income taxes relative to GDP (the falloff in corporate income taxes had more to do with the decline in corporate profits relative to GDP than to any change in the effective corporate rate), why do the deficits increase? The answer is very simple: spending grew and rapidly. Relative to the size of the economy, the very large budget deficits of the early to mid-1980's were due to the fact that the spending share grew, while the tax share was stabilized.

Undoubtedly, there are many reasons this occurred. There some who believe that the most important thing for the economy is to have low tax rates; others who believe the most important thing is to keep spending under control; still others look virtually exclusively at the budget deficit. I believe all three are important, and all three are too high.

But most of all, the lesson from the 1980's is that spending grew out of control, and that in order permanently to reduce the budget deficit and, indeed, balance the budget, spending must be controlled and the economy must grow as rapidly as possible without accelerating inflation. To do that, tax rates must be as low as possible, regulation must be less extensive and more flexible, etc.

While only some of government spending falls within the purview of this committee, my first general comment with respect to delivering on the contract is to make sure that spending is cut first, or least simultaneously with taxes. Some of the tax reductions proposed in the "Contract with America" will strengthen the economy. A strong case can be made that the current methods for scoring such tax proposals bias the case against them. (Indeed, I made such a case yesterday in testimony before a joint session of the House and Senate Budget Committees). But this is not true of all tax cuts, and in general, it is important to distinguish between tax reductions which are designed to serve other purposes which have little impact on the overall economy, tax reductions which may help the economy somewhat and offset a modest amount of the static revenue lost (such as the 17 percent assumed in the original Reagan program); and those few instances where the failure to use any dynamic scoring is likely to seriously underestimate the aggregate supply response over time. The later occurs in such cases as major revisions in capital gains tax rates, saving and investment incentives, and, major changes in marginal tax rates (income, payroll, or corporate taxes).

To the criticism that exploring the idea of using, prudently, some dynamic scoring is cooking the books, my reaction would be nobody wants to cook the books, rather, they should be opened, and any changes made in methodology should be done carefully, openly, and be well within the grounds of professional estimates of the effects involved. As I mentioned in my testimony to the budget committees yesterday, it would be a mistake to start from the assumption that the books are in good shape now (for they contain many accounting problems).

In the examination of spending (and I would hope regulation as well) I would hope the committee would follow up the spirit of the change in baseline budgeting to year-over-year budgeting by examining every feature of every program. There are many government programs that ought to be reduced, eliminated, restructured or privatized, even if the government was running a surplus. So ask the tough questions: Is there a legitimate need being addressed? Is it

plausible that a government program is likely to achieve this objective? Is the existing program cost-conscious and target effective? Is it justified today, not just was a good idea when implemented years or decades ago?

In asking these questions it is useful to have the following parable of the taxpayers' dollar in mind. When the government raises a dollar in taxes, it costs the private economy more than a dollar. Some taxpayer, an individual or business, sends a dollar to Washington, but the taxes distort behavior--they may lead to sheltering, reduced effort, movement of activity overseas, etc. The extra cost of these distortions, as near as economists can tell, add up to a considerable amount, perhaps 40 cents or more at the margin. So the government collects a dollar in a manner that costs the private economy $1.40. And now deposits that government dollar into a bucket. Unfortunately, the bucket leaks. It springs a leak because of administrative costs and overhead, which in general are worse in government than in the private sector. It springs another leak because of bureaucracy and political compromises, perhaps due to historical accident. In any event, by the time it gets to dealing with goal of the program, there is considerably less than a dollar left in the bucket. Perhaps it is only 50 cents, perhaps it is only 75 cents, depending on which program we are talking about. Now the 50 or 75 cents that is left over after administrative costs, overhead, etc. douses the problem. Whether transfer payments to people apparently in need, or government purchases of goods and services that it is presumed are insufficiently or in other ways inadequately provided by the private sector. Some of these funds will not go to the group for which it was originally intended. Or will only be partially successful in solving the problem. Thus, we are costing the private sector $1.40, to apply perhaps one-third to one-half of that amount to achieving the objective. That means the need must be great, and the program quite effective, to make the bang for the buck worth it from society's point of view. Of course, there are many important functions government should serve and finance, from defense to a safety net. My point is only that while it has been politically painful to try and reduce spending, I believe that a thorough examination of the government's activities will reveal far fewer programs that pass a serious hard-headed, but compassionate, social cost-benefit test.

Therefore, I support proposals and mechanisms which will force a more thorough and demanding test of desirability and acceptability.

The Major Tax Items in the "Contract with America

The major tax items in the "Contract with America" include a 50 percent reduction in the capital gains tax rate, plus prospective indexing for inflation; expansion of Individual retirement Accounts; a $500 per child tax credit; repealing the increase in the percentage of Social Security benefits subject to income taxes for elderly Americans above some modest income threshold; neutral capital cost recovery; elimination of the marriage penalty; small business incentives; and several other features which are important in and of themselves, but perhaps not as important as these to the functioning of the economy.

I would like to begin with some general remarks, then go into slightly more detail on the capital gains proposal, IRAs, depreciation, the child credit.

The tax proposals in the "Contract with America" seek to achieve a variety of objectives. Many are designed to strengthen the economy by increasing saving, investment and entrepreneurship, thereby increasing productivity and future living standards. Others are designed to redress some perceived inequity or deal with some other social problem. e.g. penalizing marriage or the historically eroded value (by inflation) of the personal exemption/child deduction/ credit. While I am sympathetic to the pro-family tax provisions, and would like to see them enacted if sufficient spending cuts and pro-growth tax incentives are enacted to pay for them, from the standpoint of economic growth, they are less important than capital gains, IRAs, depreciation, etc. I would mention that it may be possible to assist those families in a way that additionally helps incentives by lowering their marginal tax rates instead, but that is perhaps a less direct and obvious solution to the issues promoting these features of the tax code have in mind. Again, I am sympathetic to their objectives, but I believe it is important to keep distinct what is likely to lead to a healthier economy, and from what may be more desirable on other grounds.

Capital Gains Reform

In my view, short of a comprehensive overhaul of the corporate and personal income tax system, capital gains reform is the highest priority tax policy to strengthen economic growth.

The "Contract with America" calls for a 50 percent reduction plus prospective indexing. Let me start with indexing. The fact that citizens are taxes on purely inflationary gains is simply outrageous. This amounts to a confiscation of their real wealth. I doubt there is a single member of Congress who, on an up or down vote, would favor some other form of wealth confiscation. It is inconsistent with our basic democratic institutions and economic principles. Because we tax purely inflationary gains, it is possible for taxpayers to face immense effective tax rates on real gains. If a family bought an asset for $10,000, and sold it for $20,000, and hence had a $10,000 gain during a period when the price level tripled, they would be paying capital gains taxes on a $10,000 real loss! If the price level had only gone up 90 percent, they would be paying capital gains taxes on $10,000 of nominal gains, when their real gain was only $1,000. This would convert (at the 28 percent maximum rate) a capital gains tax of $2,800 into a 280 percent tax on their real gain. I would hope that every single member of Congress would agree to some straight-forward simple method of indexing capital gains. It should not be a political football, it is a simple question of fairness and efficiency in the tax code.

The capital gains tax is, in part, a tax on entrepreneurship and creating wealth. It stifles the flow of capital to new businesses that are an important source of new job growth, new innovations and products for American and the world's consumers. Worse yet, it locks capital in place. To sell an asset that has appreciated in value (even if it is only an inflationary increase!), the taxpayer must pay the tax in order to free up the funds to invest in other productive activities. Worse yet, they must pay a certain tax today, to seek out opportunities for higher gains to tomorrow, which are, in the very nature of economy, uncertain. So the extent of the lockin is even more powerful than the rate itself would suggest, because people have to be rewarded with a risk premium in higher expected returns to sell an appreciated asset, pay the capital gains tax now, and take the chance on a better investment down the road. There are numerous estimates of the extent of the lock-in effect, and I believe it is conceptually quite difficult to measure how much capital is locked in and the full effect. I do believe it is trillions of dollars. Whether it is two or three, or six or seven, trillion, is hard to say, but the beneficial effects from unlocking this capital would be substantial.

Next, reducing the capital gains tax rate would increase the prices of all assets eventually subjected to capital gains taxes. All economic models predict, theoretically and econometrically, that this would lead to an expansion of economic activity. By the way, this asset price effect is not included in the micro-economic behavioral responses estimated by the Treasury and the Joint Tax Committee.

Finally, and most importantly, a reduction in the capital gains tax would increase the supply of entrepreneurs, and perhaps also the supply of capital into entrepreneurial activity (although much of that is provided from currently tax free institutions). This effect is the most difficult to quantify in econometric models, but probably the most important from the standpoint of the long-term health of the economy.

Finally, traditional business investment would increase with a reduction in the capital gains tax rate, because the cost of capital would be reduced.

The estimates currently available on the cost of the capital gains proposals in the "Contract with America" are, in my opinion, seriously distorted. I believe the revenue lost would be substantially less, for all the reasons noted above.

I recall during the Bush Administration, when we proposed a 30 percent capital gains tax rate cut, that in my testimony I estimated how small the beneficial impact on the economy would have to be to overcome the Joint Tax Committees estimate of the static revenue lost (the Bush Treasury estimated a small static revenue gain). The result may surprise you. It only took an improvement in the economy of four one-hundredths of one percent per year to overcome the (perhaps cautiously estimated) static revenue lost. Even that modest rate cut would have had far greater beneficial impact on the economy.

So I urge you to move forward with capital gains tax reform: rate reduction and indexation. It is extremely important to the efficient functioning of our capital markets, the supply of capital to new businesses, and most importantly, greater entrepreneurship, innovation, and job creating investment in the economy.

IRAs

I strongly support proposals to reduce the double (and in the case of corporate equity, sometimes triple) taxation of saving in our tax system. America saves too little as a nation. The national saving rate--the sum of saving done by households, businesses, and governmental units--is far below that than any other industrialized country. Because America is such a strong, large, flexible, open, and dynamic economy, we have been able to finance considerable investment with foreign capital. It would be better still if the saving rate were higher, which would increase the investment rate still further, at least in the long-run (in the short-run, it may primarily reduce our current account deficit).

Further, numerous studies suggest that a large fraction of Americans are not saving adequately for their retirement. This combines with demographic trends to suggest even greater pressure on governmentally financed retirement support. We should be moving in the other direction, enabling people to save more for their own retirement (and other purposes).

Unfortunately, recent tax changes have clobbered private saving. I am a strong proponent of low marginal tax rates, and would have opposed the large increased in marginal tax rates in 1993 in any event. But it is important to understand the deficit only becomes a problem if it decreases the amount of saving available to finance private investment of various types. Thus, whatever other reasons to object to the higher income tax rates--and there are many--it is purely circular to raise taxes that heavily hit private saving in order to reduce the deficit in order to reduce the drain on private saving! The 1993 tax rate increases heavily hit private saving because it tends to hit households in their peak earning and saving years, very high income people with high propensities to save--and small business profits. Eighty percent of American businesses are unincorporated and, if their profits are high enough, pay the new higher tax rates and the personal income tax. The same is true of the 42 percent of corporations which are subchapter S corporations. While the Treasury estimates that only two or three percent of small businesses are so affected, the share of small business profits--available to finance job-creating investment--is much larger. It is also true that the number of such small businesses that are subject to the higher tax rates over a span of years, rather than any single year, is much higher. Not surprisingly, the personal saving rate has declined at about a $60 billion annual rate following the 1993 tax increases.

Finally, there are those who argue that IRA-type vehicles merely result in people shifting taxable funds into tax-deferred funds. While undoubtedly some of this occurred in the early 1980's, my reading of the evidence is that most American households would only be able to do this for a short period of tine, and that just as IRAs were limited in 1986, we were approaching a time when a much larger fraction of saving in IRAs was net new saving, rather than tax arbitrage saving.

I might also add that the accounting in the budget for tax-deferred saving would be illegal if these sort of books were part of a publicly-traded private corporation. The taxes are deferred, not forgiven. Treasury counts as static revenue lost, even ignoring for the moment the potential improvement in the economy, and the revenue feedback that may flow therefrom if the inside buildup in IRAs is at a higher rate than the Treasury's borrowing rate, which is quite likely given a large fraction will be invested in private securities. The present value of revenue to the Treasury may actually increase whereas the conventional accounting records a loss and no corresponding deferred taxes due asset.

Depreciation

Proper depreciation has been a subject of debate for decades among economists and policymakers. My own view is that it is extremely difficult to measure true economic depreciation, as would be required in a hypothetically-ideal income tax. That is because in today's

economy a large fraction of the decline in the value of assets has to do with technological obsolescence, not just wear and tear. This is conceptually measurable only for those products with extremely active second hand markets. The product life cycles are so rapid for many products, that second-hand markets barely exist. In any event, from a purely tax theoretic point of view, I believe the appropriate tax treatment would be any combination of interest deductions and depreciation which is the equivalent to expensing. This would result in neutrality across asset types, and between investment and consumption. It would also greatly simplify the tax code. However, tax policy reforms in the past have stumbled over the proper treatment of interest deductibility. It is possible that the tax code could wind up subsidizing investment if depreciation is rapid and is debt-financed with full deductibility of nominal interest.

Conclusion

My conclusion is simple. The tax proposals contained in the "Contract with America" are all highly desirably. They should be combined with sufficient spending restraint--enacted either first or simultaneously--that combined with prudent, careful and open estimates of any revenue reflow from additional growth would make sure that the deficit is not increased and indeed, hopefully reduced substantially over time. While elected officials should decide on priorities among types of issues, from social policy, to economic growth, let me repeat what I said above: the capital gains reforms, IRAs, depreciation reform, are the components which are likely to contribute to stronger economic growth. The other reforms are desirable to redress inequities if sufficient spending cuts can be found to finance them.

Let me also repeat that the comprehensive nature of economic reform contained in the "Contract with America" is to be commended. The answers to many of the problems constraining America's economic potential do not rest exclusively in the tax code. Regulatory reform, tort reform, spending control and reduction, welfare reform are all quite important. In fact, the spending on many of these items--whether through the public purse or by the private sector in compliance costs foregone innovation--can be thought of as a large hidden tax on the American economy. Just for federal regulatory compliance, private estimates run four to five hundred billion dollars a year, the annual yield of federal payroll or personal income taxes, respectively. In addition to the important work you do on tax reform and reduction, I hope you work along with your colleagues on other committees in the House, and your colleagues in the Senate to push forward the broader reform agenda as well.

Chairman ARCHER. Our next witness is Kate O'Beirne with The Heritage Foundation. Welcome. We are pleased to hear your testimony.

STATEMENT OF KATE WALSH O'BEIRNE, VICE PRESIDENT, GOVERNMENT RELATIONS, THE HERITAGE FOUNDATION

Ms. O'BEIRNE. Thank you, Mr. Chairman. I am delighted to be here. I come before you as a frustrated Washington welfare reformer, as the Chairman might remember. We tackle welfare reform in Washington on a cyclical basis, and when we last tackled welfare reform in 1986, I was at HHS. My primary responsibility on behalf of the administration was welfare reform.

Mrs. Johnson and the Chairman worked tirelessly to actually have a proposal that met the high-blown rhetoric of radically reforming the welfare system. We spent countless hours, as I said, with Mrs. Johnson's tireless energy. Notwithstanding the talent of such people, in a typical Washington fashion, we spent billions of dollars of new money, less than 1 percent of the caseload 6 years later is working. In fact, within 1 month of passing that bill, of President Reagan signing this bill, CBO estimated that its net effect would be to increase the welfare rolls. This passes for welfare reform in Washington.

I am truly delighted, given my past frustrations, that the Personal Responsibility Act in your Contract holds the promise to truly revolutionize our welfare system and begin to end the cycle of dependency. To achieve this, welfare costs must be controlled. Illegitimacy must be reduced, serious work requirements must be established, all of these things your Contract plainly addresses.

In accomplishing these objectives, State flexibility with very few Federal requirements must be greatly expanded. Governors must be free from Federal micromanagement in order to reform their own State welfare bureaucracies. To begin with, the cost of welfare, policymakers should recognize one overriding fact. The war on poverty has failed. You will not find anybody defending it here in Washington, not openly defending it. It has been 25 years since it was launched. The $5.3 trillion spent on welfare to date has only exacerbated what Senator Moynihan has aptly called behavioral poverty.

During this period, since the war on poverty was launched, the official poverty rate has remained virtually unchanged, the family has collapsed, illegitimacy has skyrocketed, and crime has escalated in direct proportion with welfare spending.

The total annual cost of welfare spending now exceeds Federal and State spending, $324 billion a year. After adjusting for inflation, welfare spending is now nine times greater than when the war on poverty was launched in the midsixties. The notion that the United States would spend $5.3 trillion on the war on poverty would have dumfounded Washington in the midsixties.

In launching the war on poverty, it was nobody's intent that such spending was in the future. President Johnson promised nobody open-ended entitlements and constant expansion of the welfare state. He spoke instead of a temporary investment much like the talk you hear today from some quarters that would help the poor to become self-sufficient and join mainstream society. The growth

of the welfare state is unending and relentless. The theme has been spend more and demand less.

According to the Congressional Budget Office, total annual welfare spending will rise to $538 billion, 6 percent of GNP by 1999. By that year, the United States will be spending $2 on welfare for every $1 spent on national defense. Welfare spending has to be front and center of any attempts to begin controlling this monster inadvertently created 25 years ago.

The Contract also recognizes the key cause for long-term dependency, and that is the illegitimate birth rate. Currently, as you know, one in three children nationwide is born to a single parent. The welfare problem is not merely the high level of spending, it is that all welfare expenditure is replete with perverse incentives that promote self-destructive behavior among the poor, such as illegitimacy. Out-of-wedlock births are at the core of the expansion of the welfare state as well as many other social problems.

The most important behavioral change to emphasize in reforms should be the promotion of stable two-parent families. As Jack Kemp has noted, homes headed by one parent have a poverty rate of 55 percent, while with two-parent families it is merely 7 percent. The collapse of the family and the rise of illegitimacy is the number one social and economic problem facing America and should remain front and center in your welfare reform efforts.

The Federal Government simply must get out of the business of subsidizing illegitimacy. Money should be shifted to new programs and the Governors given flexibility to care for these young families which would lead to higher quality of life without directly subsidizing such self-destructive behavior.

Serious work requirements must be addressed. Your Contract makes a terrific step in this direction. The growth of the welfare state has coincided with the decline in labor force participation and in 1960, among the lowest income quintile of the population, nearly two-thirds of households were headed by persons who worked. By 1991, this had fallen to about one-third, with only 11 percent working full time.

Welfare payments have a direct correlation, solid research tells us, between welfare spending and work disincentives. The major effect of cash welfare payments is to decrease the work effort. If able-bodied recipients can't find a job, they should be required to perform community service. Some of our most successful county experiments have been these community service jobs.

I am anxious to take questions from the committee and engage on the full range of issues I have addressed in my direct testimony.

Let me just make a quick point to underscore the point that Michael Novak has made. We cannot forget who our true allies are in this fight to help low-income children and families to help begin to rebuild families and save children.

Dealing with social problems through greater reliance on nongovernmental social institutions is nothing new. It is a return to the fundamental political philosophy upon which the American republic was established. Our Founding Fathers placed little reliance on government as a cure for social ills. The wisdom is reflected in the writings of Alexis de Tocqueville. He placed a crucial emphasis on the roll in American society of "private association such as reli-

gious institutions, private philanthropy clubs, fellowships, voluntary civic organizations, and private moral and educational institutions." According to de Tocqueville, these private associations or civil institutions which bad government policy has driven out were more important than America's political and economic institutions.

The welfare system desperately needs reform, real reform, and this time we have an opportunity to truly meet the promise of real reform. We can convert welfare from a one-way handout into a system of mutual responsibilities in which welfare recipients would be given aid but would be expected to contribute back.

A reform system must strongly discourage dependency and the irresponsible behavior it is currently subsidizing. It must permit the Governors to begin to work with private groups in their States to rebuild a civic society where families, neighbors, churches, and communities commit their energies and resources to helping the poor in their midst.

We have to control welfare costs. I shared with you what is going to happen over the next 4 years if we fail to do so. And welfare reform must seek to reduce the illegitimate birth rate in the United States and promote the formation of two-parent families.

I look forward to any questions you might have. Thank you, Mr. Chairman.

[The prepared statement follows:]

Testimony Before
The Committee on Ways and Means
U.S. House of Representatives
January 11, 1995

Kate O'Beirne
The Heritage Foundation
(202-546-4400)

The Personal Responsibility Act is aimed at revolutionizing the welfare system and ending the cycle of welfare dependency. To achieve this, Members of Congress must: 1) control welfare costs; 2) reduce illegitimacy; and 3) institute serious work requirements. In accomplishing these objectives, state flexibility with federal requirements must be greatly expanded.

CONTROL WELFARE COSTS:

To begin with, policy makers should recognize one overriding fact: the " War on Poverty" has failed. It has been over 25 years since President Lyndon Johnson launched his "unconditional war." The $5.3 trillion spent on welfare to date has exacerbated what Senator Moynihan has called "behavioral poverty." Instead, during this period, the official poverty rate has remained virtually unchanged, the family has collapsed, illegitimacy has skyrocketed, and crime has escalated in direct proportion to the growth in welfare spending. The total annual cost of U.S. welfare spending now exceeds $324 billion, with spending since the mid-sixties increasing in every year except one. Welfare spending in FY 1991, FY 1992 and FY 1993 exceeded defense spending for the first time since the 1930's, with spending per capita today being five times as high as during the Great Depression, when a quarter of the work force was unemployed. After adjusting for inflation, welfare spending is now nine times greater than when Lyndon Johnson launched the "War on Poverty" in the mid-sixties.

The notion that the U.S. would spend $5.3 trillion on the "War on Poverty" would have dumbfounded the Washington Community in Lyndon Johnson's day. In launching the "War on Poverty," President Johnson did not promise an open-ended expansion of the welfare state. Instead, he spoke of a temporary investment that would help the poor to become self-sufficient and join mainstream society. But the growth of the welfare state is unending and relentless. The theme has been spend more and demand less. Moreover, there is not even the faintest glimmer of "light at the end of the tunnel" for the end of the "War on Poverty." According to the Congressional Budget Office figures, total annual welfare spending will rise to $538 billion and six percent of GNP by 1999. By that year, the U.S. will be spending more than two dollars on welfare for each dollar spent on national defense.

The long history of bogus welfare reforms, all of which were promised to save money but did not, leads to one obvious conclusion. The only way to limit the growth of welfare spending is to do just that: limit the growth of welfare spending. For example, consideration should be given to capping the future growth of aggregate federal spending on these welfare programs (excluding Medicaid) at 3.5 percent per annum. This cap on aggregate welfare spending would save the federal government more than $70 billion over the next five years. Under the cap, individual programs could grow by more than 3.5 percent as long as total spending growth on all programs does not exceed 3.5 percent.

With a cap on future federal funds, state governments would, for the first time, be forced to adopt innovative and aggressive policies that would reduce the welfare rolls. Under the cap, federal welfare funds should be given to each state government as a block grant. The state would be required to use the funds to aid low-income persons, but would be given broad authority to set eligibility standards for all welfare programs. States also would be given authority to shift funds between programs (today they have only limited authority if granted a federal waiver). For example, a state should be able to use housing funds for job training or vice versa, according to state priorities. Similarly, states should be able to use the funds to operate new welfare programs of their own design. For example, if a state wished, it might operate one food program of its own design in lieu of ten separate federal programs.

REDUCE ILLEGITIMACY

The welfare problem is not merely the very high level of spending; it is that nearly all welfare expenditure is replete with perverse incentives that promote self-destructive behavior among the poor, such as illegitimacy. Out-of-wedlock births are at the core of the expansion of the welfare state as well as many other social problems. The most important behavioral change to emphasize in reforms should be the promotion of stable two-parent families. As Jack Kemp has noted, "Homes headed by one parent have a poverty rate of 55 percent, while with two-parent families it is just 7 percent.

The collapse of the family and rise of illegitimacy is the number one social and economic problem facing America. Family disintegration is the primary underlying factor driving a whole range of other social problems, including crime, poverty, welfare dependence, drug use, and school failure. A future welfare system in which half of all children are born out of wedlock while their mothers are placed in government make-work jobs and their children are raised in government daycare centers will be more expensive than the current welfare system and will not stem the other crucial problems arising from family collapse.

Under current law, having a child out of wedlock is directly subsidized by the federal government. The federal government should never have been in the business of saying, in effect, to an 18-year-old girl: "If, and only if, you have a child out of wedlock, we will send you a check in the mail." The present welfare system, by paying young women to have children out of wedlock, encourages them in a course of action that in the

long term proves self-defeating to the mothers and harmful to both the children and society. If you got pregnant in 1960, you received a welfare package worth about $5,000 per year, mostly in cash. But if you got pregnant in 1970, you received a package worth over $12,000 per year, including cash, food, and medical care -- all absolutely guaranteed by the federal government. All you have to do to get the $12,000 is agree not to work and not to get married. Is it surprising then that the illegitimacy rate went from about 4 per 100 births in 1960 to about 10 per 100 in 1970, more than doubling in 10 years -- just as the value of the welfare package more than doubled?

Our current system is based on perverse incentives which effectively block the formation of intact, two-parent families. According to Nick Zill of Child Trends, Inc., 43 percent of long-term welfare recipients started their families as unwed teens. They are **long-term** recipients because the system does not offer them a way out through marriage (where the poverty rate is only seven percent). It is recognized increasingly that only by making illegitimacy more inconvenient, what economists would call raising its opportunity cost, will the out-of-wedlock birthrate be reduced.

The federal government must get out of the business of subsidizing illegitimacy. Money should be shifted into new programs to care for future illegitimate children, leading to a higher quality of life for those children without retaining the incentives which induce out-of-wedlock births in the first place.

Conventional welfare for young women who, in the future, have children out of wedlock must be eliminated. However, the government should not simply abandon all aid to children born out of wedlock. Funds currently given directly to young unwed mothers should be converted into block grants to the states, and the states should be prohibited from using these funds for conventional welfare payments. Instead, states could use the funds for a wide variety of alternative programs designed to discourage illegitimate births and to care for the remaining children born out of wedlock. Funds could be used for such things as promoting adoption, closely supervised group homes caring for unmarried mothers and their children, pregnancy prevention programs , or any other program devised by the state to cope with the crisis of illegitimacy.

Also under the current welfare system, if a mother enrolled in AFDC bears additional children, she receives an automatic increase in her AFDC and Food Stamp benefits. No other family in U.S. society receives an automatic increase in its family income if it has more children. There is no reason to provide expanded welfare benefits to single mothers who have additional illegitimate children after they are already dependent on welfare.

Current law requires that an AFDC mother must make a "good faith" effort to identify the father of the child in order to receive AFDC. This law is ignored. The government should require, for children born after January 1994, that the mother must identify the father of the child in order to receive AFDC or Food Stamps. Exceptions to this rule in a few hardship cases could be given, but the exceptions should not exceed ten

percent. Once the mother has identified the father and paternity has been established, the father can be required to pay child support to offset welfare costs. If the father claims he cannot pay any child support because he cannot find a job, the government may require community service work from him to fulfill his obligation.

Experiments with this approach in Wisconsin have led to surprising increases in the ability of absent fathers to locate private sector employment and pay child support. Moreover, the definite expectation among young men that they will be identified as fathers and required to pay child support for their children may put an end to the ethos in some communities where young men assert their masculinity by fathering children they have no intention to support.

INSTITUTE SERIOUS WORK REQUIREMENTS

The growth of the welfare state has coincided with a decline in labor force attachment. In 1960, among the lowest income quintile of population, nearly two-thirds of households were headed by persons who worked. By 1991 this figure had fallen to around one-third, and only 11 percent had household heads who worked full time throughout the year. Par of this decline in employment can be attributed to the increasing number of retired elderly households in this income group, but an equally important factor is the decline in labor force participation among non-elderly heads of households.

For a growing number of poor Americans, the existence of generous welfare programs makes not working a reasonable alternative to long-term employment. During the late 1960s and early 1970s, social scientists at the Office of Economic Opportunity (OEO) conducted a series of controlled experiments to examine the effect of welfare benefits on work effort. The longest running and most comprehensive of these experiments was conducted between 1971 and 1978 in Seattle and Denver, and became known as the Seattle/Denver Income Maintenance Experiment, or "SIME/DIME."

Advocates of expanding welfare had hoped that SIME/DIME, and similar experiments conducted in other cities, would prove that generous welfare benefits did not adversely affect "work effort." Instead, the SIME/DIME experiment found that every $1.00 of extra welfare given to low-income persons reduced labor and earnings by $0.80. The significant anti-work effects of welfare benefits were shown in all social groups, including married women, single mothers, and husbands. The effects were particularly pronounced among young unmarried males; among this group the number of hours worked per week declined 43 percent for those who remained unmarried throughout the experiment and 33 percent for those who married. The results of the SIME/DIME study are directly applicable to existing welfare programs: Nearly all have strong anti-work effects like those studied in the SIME/DIME experiment.

Recent research by Dr. June O'Neill of Baruch College in New York City has confirmed that higher welfare benefits increase the number of individuals who leave the labor force and enroll in welfare. A 50 percent increase in monthly AFDC and Food

Stamp benefit levels was found to lead to a 75 percent increase both in the number of women enrolling in AFDC and in the number of years spent on AFDC. In other words, increases in benefits' value causes a dramatic expansion in welfare caseloads.

An extremely important research discovery by Dr. O'Neill is that high AFDC benefits reduce the employment of young adult men in a community even though few, if any, of these men are direct beneficiaries of AFDC payments. High AFDC benefits were found to reduce the employment of young adult men in a community by some 50 percent. The high AFDC benefit levels apparently affect the work behavior of young men in two ways. First, high benefits reduce the probability of marriage and thereby reduce the necessity for a young man to work to support a family. Second, it is likely that many young single men who are boyfriends to single mothers on AFDC indirectly share in the mother's welfare benefits; higher benefits thereby reduce the male's need for work.

Real reform would convert welfare from a one-way handout into a system of mutual responsibility in which welfare recipients would be given aid, but would be expected to give something back to society for that assistance. Many welfare recipients themselves see nothing wrong with this. Jennifer Allen, a welfare single mother in Wisconsin's Learnfare, commented in a March 15, 1992 "Insight" magazine article that "if people are motivated and they want to get off welfare, get a job and support themselves and their families -- then those are the people welfare should try to help. If people are lazy and don't want to be helped, then fine, cut their benefits. If they don't want to help themselves, why should anyone else help them?"

If able-bodied welfare recipients cannot find a job, they should be required to perform community service. Requiring recipients to work for their benefits would eliminate the work disincentives of welfare. No longer would welfare subsidize and encourage non-work; nor would it continue to discourage recipients from taking available private employment, because they would have to work in any event. Marvin Olasky emphasizes this in his Fall 1990 Policy Review article when he stated, "Poverty fighters 100 years ago...made moral demands on recipients of aid. They saw family, work, freedom, and faith as central to our being, not as life-style options. They did not allow anyone to eat and run."

The key to successful workfare lies with five rules:

1) Require single males, fathers on welfare, and single mothers with older children to work before requiring mothers with pre-school children to work. It is important for these people to work before mothers with pre-school children, not only because it is a sound social policy, but because the program is 60 to 80 percent less expensive to operate without high daycare costs.

2) Require at least half of all AFDC parents to work in exchange for existing benefits. In the past there has been much talk, little action. And again, emphasis should be placed on fathers and those women with older children.

3) Do not provide a two year exemption from work requirements. Up front work requirements are the most cost-effective of all dependency reducing measures.

4) Establish effective workfare programs requiring continuous full-time participation and linking payment of welfare benefits to successful work performance. The work requirement should be in place as long as the recipient receives welfare, and the work should be continuous, not sporadic.

5) Recognize the ineffectiveness of government training programs. Despite over three decades of experience, the government has never been able to run training programs that raise the wage rates of welfare recipients by more than a tiny amount. The U.S. Department of Labor's own evaluation of the Job Training Partnership Act program showed the program had little effect on the wages of trainees. The average hourly wage of female trainees was raised by 3.4 percent; the hourly wages of males were not increased at all. To the extent training is provided, all programs should undergo scientific evaluation, and the programs which do not produce significant increase in hourly wage rates should be terminated.

Research on pilot projects in Ohio shows that rigorous workfare programs dramatically reduced welfare dependence. Designated welfare recipients were required to perform community service for at least 20 hours per week. This work requirement was continued as long as the individual received welfare benefits. This approach differed greatly from conventional short term workfare programs which require recipients to work for a few months but then suspend the work obligation and allow the recipient to continue to receive benefits without further work obligation.

In the Ohio programs, around 25 percent of single mothers on AFDC were required to perform community service (workfare) in exchange for the welfare benefits they received. The requirement resulted in an overall reduction in the AFDC single mother caseload of 11.3 percent.

Similar reductions were seen in the Aid to Families with Dependent Children-Unemployed Parent program (AFDC-UP), which provides welfare to two parent families. Eighty percent of AFDC-UP fathers were required to participate in workfare, resulting in a 34 percent reduction in the AFDC-UP caseload.

The Ohio workfare programs are, by far, the most successful dependency reduction programs so far evaluated. The effects on both AFDC and AFDC-UP caseloads are far larger than the effects reported for conventional job search and training programs elsewhere in the country. (Source: Bradley R. Schiller and C. Nelson Brasher, "Effects of Workfare Saturation on AFDC Caseloads," Contemporary Policy Issues, Spring 1993.)

Other states have shown that work requirements can dramatically reduce welfare dependence, at least in the AFDC-UP program. In 1983, Utah established the Emergency Work Program (EWP) in place of traditional AFDC-UP program for two parent families. EWP established one of the most stringent and comprehensive workfare systems yet known. Male parents of welfare families were required to participate in organized activities for 40 hours per week: 8 hours of job search and 32 hours of community service work or education and training. These requirements were rigorously enforced.

EWP offered some education and skills training in addition to community service work and job search. However, education and training did not increase the employability of welfare recipients relative to participation in other activities. A final unusual feature of EWP was a work/job search requirement imposed on both spouses in some families. Work requirements on both spouses rose from 5 percent of caseload initially to 61 percent in EWP's third year.

The Utah experience shows the clear effectiveness of serious work requirements in dissuading individuals from enrolling in welfare and becoming dependent. Despite eligibility criteria which were identical to Utah's prior AFDC-UP program, average monthly caseload during the first four years of EWP was 194 compared to an average caseload of 1,800 under AFDC-UP. These dramatic caseload differences were achieved despite the overall similarity in economic conditions between periods of comparison. EWP also shows the effect of required work in promoting quick exits among families who become enrolled in welfare. The average length of stay of families on EWP was 2.5 months compared to 10 months in Utah's AFDC-UP program. Overall, the EWP program with its firm work and job search requirements reduced welfare costs by 92 percent compared to the prior AFDC-UP program which had only minimal work requirements. (Source: Frederick V. Janzen, and Mary Jane Taylor, Emergency Welfare Work and Employment: an Independent Evaluation of Utah's Emergency Work Program Final Report 1984-1991. Salt Lake City: The Social Research Institute, Graduate School of Social Work, University of Utah, June 13, 1991.)

Finally, much of this spending is simply extravagant. A clear example of waste in the welfare system is the growing number of non-citizens receiving welfare. Immigration should be open to individuals who wish to come to the United States to work and be self-sufficient, but it should not become an avenue to welfare dependence. Prudent restrictions on providing welfare to recent immigrants has long been part of the American tradition. Immigration laws passed by Congress in 1882 instructed immigration officials to deport any person who, in their opinion, might become a public charge. Today, the Immigration and Nationality Act declares unequivocally "any alien who, within five years after the date of entry, has become a public charge from causes not affirmatively shown to have arisen since entry is deportable."

Today, non-citizens are among the fastest growing groups of welfare dependents. In 1993, there were nearly 700,000 lawful resident aliens receiving aid from the SSI program. This was up from 128,000 in 1982: a 430 percent increase in just ten years.

Total welfare costs for non-citizens in the SSI program now approach $7 billion per year. The overwhelming majority of non-citizen SSI recipients are elderly. Most apply for welfare within five years of arriving in the U.S.. These SSI recipients are concentrated in a few states. Five states alone (California, New York, Florida, Texas, and New Jersey) account for nearly 80 percent of the total.

The presence of large numbers of elderly immigrants on welfare is a clear violation of the spirit, if not the letter, of U.S. immigration law. The relatives who sponsored the entry of these individuals into the U.S. implicitly promised that the new immigrants would not become a burden to the U.S. taxpayer. But many, if not most, sponsors are enrolling their elderly immigrant relatives on welfare soon after the end of the three year waiting period. Once on SSI, there is every indication that these immigrants will remain on welfare indefinitely.

While we all greatly sympathize with those individuals who have suffered from political oppression and economic failure inherent to communist regimes, we must not attempt to use U.S. welfare programs to redress that suffering. Just as the U.S. military cannot serve as a global policeman, U.S. welfare programs cannot serve as a global retirement system. This should be the role of churches and community service organizations, such as the Indochinese Community Center, where a former Laos immigrant (now a U.S. citizen) established a place where immigrants receive help in demystifying the immigration process; take classes in history, civics and English; receive emergency food and clothing; and receive job training and job placement for senior citizens who have been political prisoners.

Congress should eliminate welfare eligibility for all non-citizens. Congress should also ensure that the sponsoring individuals who were responsible for bringing elderly relatives to the U.S. in the first place bear the full and permanent responsibility of supporting their immigrating family members. In a limited number of cases in might be necessary to continue some form of federal aid. Some non-citizens on SSI may lack relatives to support them, and may be unable to return to the politically oppressive nations from which they emigrated. Such elderly individuals, who are true political refugees, who are incapable of self-support, and who lack supporting relatives should receive aid under federal refugee programs.

EDUCATIONAL CHOICE

Even before the "War on Poverty" began, receiving an education was recognized as the best way to avoid poverty. Students who drop out of high school or who receive public assistance at an early age are much more likely to become welfare dependent than students who complete their education. To address this problem, some states have enacted a Learnfare program. Learnfare requires school-aged children receiving AFDC benefits to attend school regularly or face a reduction in AFDC benefits. It also requires teenage mothers on AFDC to continue school unless they have completed high school or have received an equivalency degree. Failure to meet attendance requirements results in

the mother or child being removed from the AFDC until regular attendance is re-established. The threat of reduced welfare benefits gives parents an incentive to make sure their children regularly attend school. The Learnfare program also ensures that young mothers on welfare complete their education and thus reduces the likelihood of prolonged welfare dependency.

Unlike nearly half of all Chicago public school teachers who send their own children to private schools, the poor do not have the choice to "opt out" of dismal public schools. And unlike middle - and upper-class Americans, who can afford to either purchase homes in the suburbs or choose private schools, the poor are "left behind" with an increasingly sub-standard education. The poor's inability to choose alternative providers of education leaves them little or no leverage in dealing with the public school bureaucracy. But poor children and their parents will gain leverage only when their status with the public school monopoly changes from "guaranteed clients" to "education consumers." The poor must be given the opportunity to take their business elsewhere.

The welfare system desperately needs reform. Real reform would convert welfare from a one way hand-out into a system of mutual responsibility in which welfare recipients would be given aid but would be expected to contribute back to society for assistance given. A reformed system must strongly discourage dependency and irresponsible behavior and encourage constructive behavior. It must firmly control soaring welfare costs. Finally, and most importantly, welfare reform must seek to reduce the illegitimate birth rate in the U.S. and promote the formation of stable two parent families. Any reform which does not dramatically reduce the illegitimate birth rate will not save money and will fail to truly help America's children.

Chairman ARCHER. Thank you, Ms. O'Beirne.

Our next witness and last witness on this panel is a man who has been before this committee a number of times, Dr. Barry Bosworth, senior fellow at the Brookings Institution.

Dr. Bosworth, we would be pleased to hear your testimony.

STATEMENT OF BARRY P. BOSWORTH, PH.D., SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. BOSWORTH. Thank you, Mr. Chairman. I wish to thank this committee for this invitation to comment on the economic consequences of the budgetary changes embodied in the Republican Contract. The last election truly initiated a momentous change in the structure of the Congress and our new leadership and many new Members. I think hopes are very high in this country that this Congress will finally begin to deal with the enormous fiscal problems that this country faces.

I, too, have observed the election outcomes and I agree that American voters have voted for a smaller and more efficient government. There are too many government programs that are not working well. Some programs will need to be eliminated and others will need to be redesigned to be more efficient.

But where I strongly disagree both with President Clinton and with the Republican Contract is in their promotion of the idea that this whole process can be preceded by another round of tax reductions. I think the priority has to be to reduce the public-sector budget deficit. It is the fundamental problem that is destroying the economic condition of the American economy.

I am not going to review all the arguments for or against the various proposals to reduce expenditures, except to note that they are certainly smaller and far less specific than the proposals to cut taxes. We have been down this road before with vague targets for expenditure cuts and hard commitments for tax reductions. We would do well not to forget the missing expenditure cuts of 1981 or the futility in the mideighties of the Gramm-Rudman-Hollings legislation that set targets to the budget deficit reduction that were never realized.

We would all like to pay less taxes and tax cuts will always be politically popular, but given the deficit and the vague promises of expenditure cuts, the focus on tax cuts instead of deficit reduction is a serious distortion of the priorities that this Congress has to address.

We have to look beyond the next year and beyond the next election and reflect on the cost of our actions to future generations. I understand the attractiveness to families with children of another round of tax reductions, but what they really ought to be concerned about is the inheritance they are passing on to those children. A future burdened down by massive public deficits, an astoundingly low rate of national saving in this country, and continued increases in interest rates that put the price of a home beyond the reach of an increasing number of young Americans.

Second, the elderly already receive benefits through this budget that absorb nearly half of all expenditures. Given the extent to which those benefits exceed any past contribution, I think their case for special treatment and concessions on the tax side is par-

ticularly weak. They ought to be far more concerned about the exploding financial problems that are occurring in our social programs for the elderly and particularly the looming deficit that is emerging in the Medicare program.

Third, I believe that the proposals for tax relief on the business side are a serious misdiagnosis of the problem of capital formation in the United States. There is no shortage of incentives for new investment. In fact, business investment in the last 2 years has been booming. The problem is there is no saving to finance it. And so when investment takes place in this country, in fact it is financed by borrowing from foreigners. And Americans are just steadily running up debts with the rest of the world, our own public sector, and our personal accounts trying to pay for a consumption binge that can't be sustained, and I think this Congress has to address this fundamental problem of reducing the deficit, and it should be the first and only priority of the new Congress.

Let me just end with a couple of things about some other provisions. I, too, at times like the idea of a balanced budget amendment. I get very frustrated with the inability of this Congress to sit down and do its job over the last decade. And I might be willing to promote it, except that fundamentally I guess it is going to turn out like prohibition: It won't work. And what really worries me about it is it will be ineffective and is being used as a device to postpone taking action. Frankly, the year 2002 is forever when it comes to dealing with the budget deficit. It is way too far in the future.

I will stop with those remarks and take questions. Thank you.

[The prepared statement and attachments follow:]

Testimony of
Barry P. Bosworth[1]
before the
Ways and Means Committee
of
the United States House of Representatives

I wish to thank this committee for the invitation to comment on the economic consequences of the budgetary changes embodied in the Republican contract. The last election initiated a momentous change in the structure of the Congress with a new leadership and many new members. Hopes are high that the new Congress will address the enormous fiscal problems of the federal government that have been a core cause of the deterioration in the performance of the economy over the past two decades.

I, too, have observed the election outcome and agree that the American voters have expressed a desire for a smaller and more efficient government. There are too many government programs that are not working well: some programs that need to be eliminated and others which need to be redesigned to increase their effectiveness. Where I disagree strongly with both President Clinton and the Republican contract is in their promotion of the idea that the savings from reduced spending should go to cut taxes rather than slashing the budget deficit. I am not going to review the arguments for and against the various proposals to reduce expenditures, except to note that they are certainly smaller and far less specific than the promises to cut taxes. We have been down this road before with vague targets for expenditure cuts that never materialized. We would do well not to forget the missing expenditure cuts of 1981 nor the futility of the Gramm-Rudman-Hollings budget legislation of the mid-1980s.

While real progress was made with the 1990 and 1993 budget acts, much of the commitment to reduce expenditures remains unfulfilled. And, the actions taken in 1990 and 1993 were already far too small to get the job done. This Congress should remember that it will be very difficult, if not impossible, to come up with $250 billion in reduced annual outlays to match its promise to eliminate the budget deficit. It will be doubly hard if the Congress uses the first round of spending cuts to finance a tax reduction; or even worse, if it fails to reflect on full magnitude of the long-run revenue loss.

Frankly speaking, given a $250 billion federal budget deficit, if there is one thing Americans don't deserve, it's a tax cut. We would all like to pay less taxes, and tax cuts will always be politically popular; but, given the current deficit and vague promises of expenditure cuts, we cannot afford a tax reduction. The focus on tax cuts instead of deficit reduction is a serious distortion of the priorities that this Congress must address. We have to be willing to look beyond the next year or the next election and reflect on the costs of our actions for future generations. The primary concern of families with children should not be with the temporary benefits of a small tax credit, but with the long-run costs of the economic inheritance that they, as a group, are leaving to those same children: a future burdened down by continued massive increases in public debt, an astoundingly low rate of national saving, and rising interest rates that threaten to again put a home beyond the reach of many young families. This may be a tax reduction for those of us with children, but the deficit is a large tax burden on our grandchildren.

Second, the elderly already receive benefits through the budget that absorb nearly half of all program outlays. Given the extent to which those benefits exceed any past contribution, I think their case for special treatment and concessions on the tax side is particularly weak. Furthermore, from their perspective, a short-term tax cut that further endangers the financing position of the Medicare program seems a particularly poor bargain. Since the revenues from the 1993 tax increase were funneled into the Medicare trust fund, their elimination will precipitate an immediate financial crisis.

Third, I believe the proposals for business tax relief reflect an equally serious mis-diagnosis of the problem of capital formation. There is no shortage of incentives for investment in this economy, and business equipment spending, adjusted for inflation, has increased by 40 percent, three times the growth of the overall economy, in the last two years. The problem is financing. The shortage of resources in a booming economy has raised interest rates from 7.5 to 9 percent in the last year alone, and they are undoubtedly heading higher in view of the latest economic news. Americans are notorious for their low rate of private saving, but the real problem today is that two-thirds of what little private saving does occur must go to finance the budget deficit, leaving only 3 to 4 percent of the nation's income available for capital formation. To date, the increase in investment has been financed by an expansion of foreign borrowing, and the U.S. current account deficit has soared from $70 billion to $160 billion in the past year. But, when foreigners provide the financing, they also receive most of the benefits. Nor can the United States continue to borrow at present rates from the rest of the world without encountering serious financial problems. We

---

[1]Senior Fellow at the Brookings Insutitution. The views expressed do not necessarily reflect tose of staff members, officers, or trustees of the Brookings Institution.

have already shifted, in the brief span of one decade from the world's largest creditor nation to its largest debtor. In summary, anything the Congress should do in the near future to stimulate business investment, not financed by a matching increase in national saving, will simply be offset by the Federal Reserve as it seeks to contain inflation, or spill over into a larger deficit with the rest of the world.

Finally, the specific provisions embodied in the Republican contract are particularly threatening to the budget deficit because so many of them are back-loaded. That is, they are structured so as to make the near-term cost appear low, but it will increase rapidly in the future. For example, the tax changes embodied in the contract are estimated to cost about $42billion per year in the first five years, but a whopping $107billion per year over the next five years. This is, of course, not new: Democrats used the same gimmick of a low initial cost to introduce a variety of new entitlement plans such as Medicare and Medicaid. The President's proposal is equally guilty in this regard as it incorporated various gimmicks, such as defining children as those under 14 years of age, that call for a broadening of the tax credits in the future. The President's proposal also shares with the Republican contract a proposed expansion of Individual Retirement Accounts that would appear to be costless in the short run, but rapidly escalate in the future. The loopholes are so broad as to practically rule out any stimulus to net saving.

Current Economic Conditions

I believe that the current economic situation should have a strong influence on this Congress as it considers what to do about the fiscal situation over the next year. In the near term we are faced with an overheated economy in which the major risk has become a revival of inflation, as the expansion of demand outruns growth in the economy's productive capacity. That situation has worsened despite repeated efforts of the Federal Reserve to slow the expansion with sharp constraints on the supply of credit. Thus far, business and households have been indifferent to the higher interest rates, and the Federal Reserve probably has little choice but to raise rates again within the next few weeks. The risks here are either that inflation will again begin to accelerate (and past experience suggests that these risks are very real now that the unemployment rate has dropped below 5.5 percent), or that in its efforts to slow the expansion, the Fed will overshoot and put the economy back into a recession. In such a situation, we can ill-afford any fiscal stimulus because it will simply translate into even higher interest rates and make the task of the Fed even more difficult. They cannot allow a further expansion of demand in an economy already at capacity output.

In fact, this Congress is faced with an absolutely ideal opportunity, a booming demand situation, to reduce the budget deficit with only benefits for the domestic economy. Two years ago we heard that deficit reduction would endanger the economic recovery and precipitate a recession. Nothing could be further from the truth. The deficit has declined by about $100 billion ($50 billion on a high-employment basis) since 1992; while the economy has boomed. Similarly, the largest effect of a reduced deficit today would be lower interest rates, higher investment, and a smaller trade deficit with the rest of the world.

I realize that Americans are very dissatisfied with the deterioration of their economic situation. More and more Americans are beginning to realize that their children probably will not live better than they do, and others are very concerned about a deterioration of their own immediate income. There are two dimensions to this problem: the stagnation of average real income growth, and a worsening of the distribution as wages fall dramatically at the bottom end of the income distribution. We are gradually becoming a dual economy of the rich and the poor rather than a society dominated by a large middle class of people in roughly similar economic circumstances.

I have tried to illustrate both of these problems with the attached figures. First, average income growth is slowing for a very simple reason -- the productivity of the average American worker is no longer growing at the rate of past decades. In fact, average take-home pay has been stagnate for over twenty years after adjusting for inflation. What little productivity growth does occur is soaked up by increased deductions for social security taxes, medical insurance and pensions. This is a dramatic change for Americans who are used to thinking that tomorrow will be better than today. The reason is not hard to identify. After nearly two decades of investing very little in the future, we should not be surprised to find that the future looks a little grim. For too long this country has been on a consumption binge and it is now beginning to feel the consequences. Real wages are no longer rising because the productivity of the average American worker is rising at a fraction of the pre-1972 rate.

This is not something that is susceptible to a quick fix -- in particular, it will not be improved by another binge of consumer spending. Americans can obtain higher incomes only by increasing their productivity; and that, in turn, can only be achieved by shifting resources from consumption, both public and private, into increased physical capital formation, greater efforts in research and development, and improvements in the education and job skills of American workers. In a sense, the solution to our economic problems is quite simple: we must increase investment across a wide range of activities. The difficult part is that increased investment requires greater saving and that can only be achieved by the sacrifice of reduced consumption. It is in that sense I believe proposals for tax cuts send precisely the wrong message about what is required to rebuild our economy.

The second problem is reflected in the sharp widening of the wage distribution since 1970,

shown in figure 2. Prior to the 1970s, there was a modest tendency for wage inequality to decline over time, as those at the bottom achieved slightly higher percentage wage increases than those at the top. Since the mid-1970s, there has been a dramatic reversal and the average wage of men in the bottom fifth of the wage distribution has fallen by an astounding 25 percent, while those in the top fifth have seen increases of about 15 percent after adjusting for inflation. The cause of that dramatic reversal of relative wage trends is the major subject of current research. It appears to reflect a growing mismatch of the demand and supply of the workers of different skill levels: an increased demand for high-skilled workers versus a surplus of those at the bottom of the skill distribution. We also know that the wage differences are closely related to differences in educational attainment, and the pattern of change correlates closely with the growing public perception of a failure of the educational system serving those who do not go on to college. Again, the prescription is that we must devote more investment-type resources to improving the education and job skills of those workers who are not going to obtain a college education. By most available measures, the system still works very well for those with a college degree.

The need to scale back consumption and increase our investments in physical capital, research and development, and education stands out as the overwhelmingly most important challenge to our country. And in this regard, the need to end the fiscal dissaving of government and remove it as a drain on national saving stands out as the most important near-term goal. Elimination of the deficit is not enough -- we also need to improve the efficiency of the programs that remain and reorient them away from consumption -- but elimination of the deficit would be a major part of the solution.

The Budgetary Implications of Tax Reduction

In the attached table I have summarized the available estimates of the cost of the tax proposals. The tax reductions for families, the elderly, and business will average about $40 billion for the first five years, with the predominate portion of the cost being the child tax credit. However, the costs in future years increase dramatically to an annual revenue loss in excess of $100 billion. The sharp increase in costs is mainly due to the structure of the business tax changes. At first, the new depreciation proposal will actually raise revenues, but once it is fully implemented the costs rise dramatically. A similar large distinction between short and long-run costs is evident for the capital gains and back-loaded IRA proposals.

To put these costs in context, the latest estimates of the Congressional Budget Office show a budget deficit, exclusive of Social Security, that will be about $250 billion in FY1995 and it will rise to about $380 billion by the end of the decade. That projection already assumes no new government programs, a lower rate of health cost inflation than assumed in prior projections, and reductions in the inflation-adjusted level discretionary spending of about 3 percent annually out to 1998 as called for in the 1993 budget agreement. Since the contract exempts defense spending from further cuts, the reductions in non-defense discretionary spending would have to be about 6 percent annually just to meet the current baseline.

Let us use the year 2002 as the target date for achieving a balanced budget under the proposed amendment to the Constitution, even though it is so far in the future as to be almost meaningless as a guide for current policy. Budget outlays will have to be cut by $325 billion from the baseline to meet the objectives of the balanced-budget amendment if it is interpreted as allowing the government to continue to borrow from the social security fund, and by $430 billion if such borrowing is prohibited. The total of expenditure cuts rises to $530 billion per year if the Congress goes ahead with the full magnitude of the current tax reduction. That represents a 25 percent reduction in the projected level of total government outlays.

But that is not the end of it because the contract exempts Social Security and national defense and the government must pay interest on the public debt. These three programs will account for 52 percent of all spending. Thus, achievement of a balanced budget by the target year of 2002 would require a 50 percent reduction in the remaining programs. That strikes me as extremely unrealistic, and a promise to achieve it as even worse than Voodoo economics.

As an example, the options for painless reductions in programs such as Medicare are extremely limited. With or without a public program, health care costs rise dramatically in the later years of peoples' lives. The health care costs of persons in their sixties is 4 to 5 times that of a 20 year-old, and technological innovations which promote the extension of life are exacerbating that trend. Under current practice, a large share of the costs of medicare patients is being shifted onto those with private insurance -- Medicare is estimated to pay only about 90 percent of full hospital costs, with private patients being charged 130 percent. It is difficult to see further cost-shifting as a mechanism for offsetting future cost increases, and I detected in last year's debate no support for the rationing of health care. Of course, the government could simply cut back Medicare and limit health care to those who can afford to pay, but this is an option that many Americans will reject.

The Balanced-Budget Amendment

Unlike many other economists, I am not strongly opposed to a balance-budget amendment. I believe a public sector that constrains itself to live within its means is vital to the long term health of the economy. And at times my frustration with the Congress' unwillingness to adhere to this simple principle drives me toward proposals that would make you do it. But fundamentally, I do not think that the amendment will work. I would compare it to the 18th amendment to the

Constitution, which initiated prohibition. You cannot pass a law to make people do what the do not want to do. If Americans are not willing to accept the discipline of paying for their public services, no constitutional amendment is going to change that.

In addition, I do not understand its rationale. We shouldn't need a constitutional amendment to tell the Congress to do its job. Nor should voters need a constitutional amendment to understand the costs of sustained deficit finance. You now have a strong majority that professes support of the principle of reducing spending to the level of revenues. Why don't you do it. The idea of pushing the whole issue off until the next century seems to me to be just more temporizing, reflecting a desire of politicians to avoid the hard choice that they were sent here to make.

For nearly 200 years -- up to the 1980s -- the United States operated quite well without such an amendment. Three times we ran up large debts in wartime and fully paid them off. The public debt steadily declined from 110 percent of GDP at the end of World War II to 27 percent in 1980. Since then it has increased five-fold and doubled as a share of the GDP. What happened in the last decade that necessitates a constitutional amendment?

Nor do I have any confidence that the measure will actually pass the states. Grants-in-aid to the states currently represent about $250 billion. Given the broad exemption of payment to retirees, national defense, and net interest, grants represent 50 percent of the remaining outlays which would seem to be at the core of the proposals for expenditure reductions. Once the state legislatures do their arithmetic, they may very likely vote against the proposal.

I admit to some concern about the cyclical consequences of a rigid constitutional requirement. I would hate to see the government cutting programs and raising taxes in the midst of a recession, thus aggravating the decline. But this issue does not seem fundamental since a provision could be included for the Congress to over-ride the requirement in recessions or periods of national emergency.

In any case I am opposed to the version of the amendment as put forth by the Congressional leadership. They have used the subject of the balanced budget to introduce a completely separate issue of prohibiting future tax increases. The size of government, the question of whether it should provide a broad or narrow range of programs, is quite appropriately a subject for political debate, and the answer has depended on the circumstances of the moment. But it cannot, and should not, be settled for all time through an amendment to the Constitution. The Congress should remember that this was an election, not a revolution. The proposal raises the specter of a slew of constitutional amendments after every election as the winners try to impose their views on future generations. We have already been subjected to the unfortunate politicization of Supreme Court appointments as every interest group tries to ensure that the nominee will support their political agenda. Is the Constitution now to be subjected to the same process?

Capital Gains Taxation

Gresham's Law if often summarized as "Bad money drives out good." Apparently.,a similar law applies to tax policy as witnessed by the renewed advocacy of a reduced tax rate on capital gains income, despite the evident superiority of alternative reforms of capital income taxation. Its continuing appeal may stem from the illusory notion of a free lunch: the assertion that a reduction in the capital gains tax rate will actually raise government revenues. This issue is inherently difficult to resolve because of the problems of distinguishing between temporary and permanent responses. Initially, a tax rate reduction may raise revenues because investors can speed up or postpone realizations to take advantage of the expected rate change. Over the long-term, the preponderance of research suggests that the net effect on revenues will be significantly negative. Furthermore, a capital gains tax reduction is widely desired by large wealth holders precisely because they believe it will reduce their taxes. I think they are right.

Proposals for reform of capital income taxation should be evaluated, however, from the perspective of whether they are good for the economy. Here, the continued emphasis on reducing the tax rate on capital gains is particularly unfortunate because it is the wrong answer to a significant problem, thereby diverting attention from more fundamental solutions. The taxation of all forms of capital income is distorted because of the failure to adjust the measure of taxable income for inflation. This problem is actually most severe for forms of capital income other than capital gains, interest and dividends, and it is not resolved by simply reducing the capital gains tax rate. It could be readily fixed by indexing all forms of capital income for inflation and taxing the income as it accrues. Similar adjustments should be made for interest expenses. Under such a reform all income would be taxed equivalently, regardless of its source, eliminating a significant shortfall of the 1986 Tax Reform Act.

Instead, the focus is on restoring much of the special-interest legislation that created the real estate, and other financial market problems that burdened the U.S. economy just a few years ago. In the past, too many investments were undertaken with an eye to their tax advantages rather than in terms of their economic merits. The 1986 reforms aimed at creating a level playing field; and, while not all the distortions were eliminated, it provides a base on which to build future reforms. We should not try to go back to the old discredited system.

Recipients of capital gains already receive highly favorable tax treatment because they can postpone the realization of their gains and the tax is completely eluded when the assets are transferred through inheritance. Compared to other forms of income, which are taxed on an accrual basis, the effective tax on capital gains is estimated to be only about 5 percent. A reduced

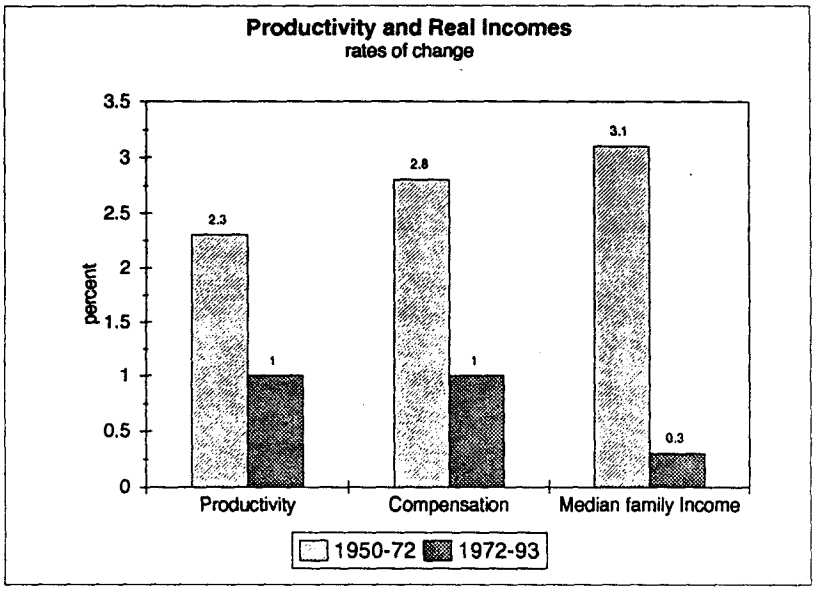
capital gains tax rate is also a highly distorted response to the problem raised by inflation. At low rates of inflation it is an excessive compensation, and at high rates it is not enough. Yet, if capital gains are indexed and other forms of capital income and interest expense are not, there are large opportunities for pure tax arbitrage.

Some advocates of a capital gains tax reduction promote it as a means of stimulating new economic ventures. Yet, studies have repeatedly shown that about three-quarters of the funds available for new firms are provided by investors not subject to capital gains taxation, principally pension funds. Second, the vast majority of capital gains results from activities that have nothing to do with new ventures. As a means of stimulating venture capital investments, the capital gains tax reduction is ineffective. This conclusion was amply demonstrated in a 1989 study by James Poterba of Harvard University.

The U.S. economy is suffering from a severe shortage of new capital. That reflects two problems. First, there is very little national saving to finance capital formation. The most blatant part of that problem could be resolved by simply reducing public sector dissaving.

Second, an unfortunate result of the 1986 tax reform was that it shifted the tax on capital from capital income earned by Americans to the income from capital employed in the United States, penalizing domestic investment. The capital gains tax proposal is inherently inferior as a method of reversing that situation because so much of the tax incentive would accrue to old capital and to capital gains that have little or nothing to do with new investment. A 1990 study by John Shoven of Stanford University found that a reduction of the capital gains tax to 20 percent would have a minuscule impact on the cost of capital.

There are ways to expand investment incentives without reintroducing the old tax distortions and that avoid the divisive issues of tax equity raised by the capital gains proposal. I would most favor conversion of the corporate income tax to a cash flow tax. This involved allowing businesses to deduct all investment outlays in the year in which they are made financed in part by elimination of the tax deductibility of interest payments on debt. The result would be a far more powerful incentive for investment and provide immediate funds for new firms.


Productivity and Real Incomes
rates of change
percent
3.5
3
2.5
2
1.5
1
0.5
0
2.3
1
2.8
1
3.1
0.3
Productivity
Compensation
Median family Income
1950-72
1972-93

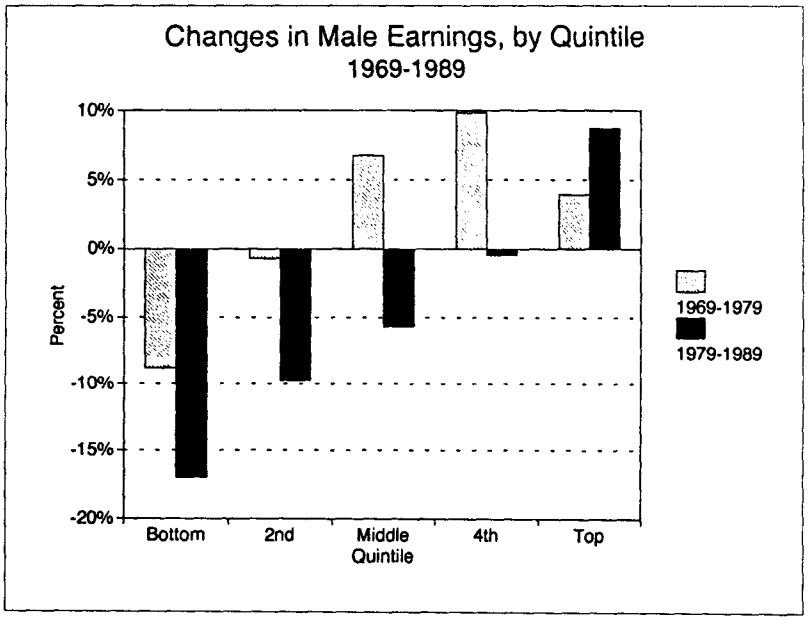

Changes in Male Earnings, by Quintile
1969-1989
Percent
10%
5%
0%
-5%
-10%
-15%
-20%
Bottom
2nd
Middle
4th
Top
Quintile
1969-1979
1979-1989

Table 1. Identifiable Costs of the Republican Contract (in billions).

	fiscal years	
	1995-2000	2001-2005
Families		
$500 per child tax credit for families with AGI < $200,000	-124.1	-164.4
Refundable $5,000 tax credit for adoption expenses	-1.4	-1.9
Refundable $500 tax credit for eldercare expenses	-1.2	-1.4
Reduce marriage penalty	-9.0	-10.0
Back-loaded IRA	+5.0	-22.7
subtotal	*-130.7*	*-200.4*
Senior Citizens		
Raise social security earnings limit to $30,000	-6.5	-17.0
Phase-in repeal of new SS thresholds (85%) enacted in 1993	-15.0	-33.5
Long-term care tax incentives	-6.0	-9.7
subtotal	*-27.5*	*-60.2*
Business		
50% exclusion for indexed capital gains	-60.9	-122.2
Expand depreciation allowance	18.4	138.8
Small business tax reductions	-11.3	-15.4
subtotal	*-53.8*	*-276.4*
Total	**-211.9**	**-537.0**
Annual Average	**-42.4**	**-107.4**
Percent of GDP	**0.5**	**1.0**

Source: Treasury staff estimates as published by Bureau of National Affairs; plus subsequent revisions.

Table 2. Deficit Reduction Targets (in billions)

	fiscal years	
	1996	2002
Overall Expenditures	1625	2200
Revenues	1420	1880
Budget Deficit:	-205	-320
operating fund	-280	-430
social security	75	110
Tax reductions		-100
Required reductions:		
Overall balance		-420
Operating budget balance		-530
Exclusions:		
National Defense	270	325
Social Security	350	480
Net Interest	235	345
subtotal	*855*	*1150*
Targeted outlays	**770**	**1050**
Medicare	195	345
Medicaid	100	180
Nondefense discretionary	280	300
Other entitlements	195	225
Deficit target (operating budget), percent of:		
Total outlays		24%
Targeted outlays		51%

Source: CBO baseline projections.

Chairman ARCHER. Thank you, Dr. Bosworth.

I thank each member of the panel. I am going to forgo my questioning at this point and yield to the ranking Democrat of the committee.

Mr. GIBBONS. Dr. Bosworth, I agree with you 100 percent, but I think we are pandering to our constituents when we promise them tax cuts and we have still got this huge budget deficit. We have got almost full employment. Really, I think we probably reached the full employment stage by now. We are reaching factory capacity or industrial capacity and we are talking about pumping more money into the consumer stream. That is, in my opinion, just totally ridiculous.

And so I agree that the first priority of this Congress should be at this time to not only continue reducing the budget deficit but to accelerate the reduction of budget deficit. That to me would seem to be the best economic medicine that we can take.

What do you think of that?

Mr. BOSKIN. I agree about reducing expenditures, particularly in the near term. I think you should be extremely nervous about the economic situation and the pressures that are being placed on the Federal Reserve.

We are at a full utilization of our resources. The biggest near term threat to this economy right now is inflation. And in view of the latest economic news, I think you are almost guaranteed that the next meeting of the Federal Reserve will initiate another major increase in special rates.

If this Congress should in any way at all inject additional fiscal stimulus on top of an already overheated economy, the only possible outcome could be higher rates of interest. But there is, as interest rates rachet up very rapidly, a major risk, because of the lags in the economy's response to those higher interest rates, of overreacting. That has been our history. Monetary restraint trying to stop the process and then it overshoots and we plunge into recession.

Mr. BOSWORTH. I think we run a very major risk right now that if we don't have a very responsible fiscal and monetary policy, we are going to miss this opportunity to slow things down and achieve a soft landing. So I think it is very important that the budget deficit shrink dramatically over the next couple of years. You will never have a better opportunity to cut the deficit than right now in the face of accelerating economic demands. There is no cost to the economy of deficit reduction now, only benefits.

Mr. GIBBONS. Yesterday the Assistant Secretary of the Treasury estimated that with the Contract plus the balanced budget amendment by the year 2000 this Congress must cut spending by $1.6 trillion. Suppose this Congress procrastinated, as it usually does, and didn't put us on that drastic reduction rate. What would happen to the economy as we come closer to the year 2000?

Mr. BOSWORTH. Right now of all private saving that occurs in this country, two-thirds of it goes to finance the deficit. And as you postpone action and the public debt mounts, and the increased interest costs get channeled back into the expenditure side, the only outcome of that is to further draw more potential savings away from business capital formation and residential construction.

I think in particular what will happen to the country is we will just accelerate the process of selling everything off to foreigners. We will have an ever larger current account deficit with other countries and try to borrow even more. But you cannot keep doing that forever. There will come a time that the rest of the world will not be willing to make the loan to the United States to finance our consumption.

You have to look forward to that, maybe not in my lifetime, but certainly in my children's lifetime, that this sort of process of running down the wealth of prior generations to finance our consumption just can't continue, and the longer we put off action, the harder it is going to be to get things back in balance again.

Mr. GIBBONS. Mr. Chairman, this is an excellent panel. My time has expired, but I would like to come back after everyone has had a chance to examine.

Chairman ARCHER. Mr. Bunning.

Mr. BUNNING. Thank you Mr. Chairman. I would like to ask just the general panel one question. We talked about welfare, about the problems with welfare and about our Tax Code, as such, and the complications of our Tax Code. If you had a choice to do one thing in the Tax Code to make it more family friendly, what would you do?

Ms. O'BEIRNE. Ultimately, beyond the parameters set down by the Contract, I think we have to move toward a family friendly flat tax. I think Mr. Armey's proposal begins to look like that.

We have to recognize, notwithstanding all of our concern for the family and all of our rhetoric about strengthening families, families with children are the lowest per capita income group in America. Washington normally forgets about these families. The median income family with two children is paying 40 percent of their income to government, Federal, State, and local taxes. They are being crushed. Family time is being crushed. It was never more important to spend time with our children in this hostile culture, and they are not able to because of the demands government places on families, a demand unheard of a generation ago.

So when people wonder how come when my parents were our age they owned a home, were able to save a little bit, mothers with preschoolers didn't have to work if they chose not to—why has that changed so dramatically?. Look no further than the tax burden that has been inadvertently placed on families.

Mr. BUNNING. You are saying that a flat tax would be family friendly. You wouldn't say to convert the Tax Code to a different type of tax rather than income-based to a consumption-based tax. I am trying to find out what each of you think should be the number one priority.

Ms. O'BEIRNE. I am a fan of the $500-per-child tax credit because it begins redressing this problem that specifically families with children face.

Mr. BOSKIN. I am not an expert on some of these social issues, but I have written on them and I have recognized one particular problem, which is we know from various studies that part of the problem is that second earners in families wind up paying very high marginal tax rates. Historically, perhaps it was the wife that

was thought of as the second earner, but that is equalizing as we move through time.

The second earner of the family on their first dollar of earnings pays the marginal tax rate of the last dollar of earnings of the first earner. They may come into the labor force and on their first dollar they are paying combined 30, 40 percent of income. If there was a move to shifting from an income, family pooled income-based tax to a consumed income tax or a transactions-based consumption tax, some of those kinds of issues could be reduced.

There are other issues, but I believe the very high tax burdens and marginal tax rates on second earners of families who are very responsive to them is a serious problem.

Mr. NOVAK. The highest tax we are paying now is not a material financial one, it is a behavioral tax. This comes from the sentence of Senator Moynihan that my colleague quoted awhile ago. The great difference in poverty in the last 30 years is how much of it is now caused by behavior, by behavior which has, if it has not been produced by our attempt to be compassionate and to help, at least has not been checked by that.

When I spoke in favor of the war on poverty or tried to argue for it 30 years ago, I didn't predict a 600-percent increase in illegitimacy or a 700-percent increase in crime. The American public cannot carry that load. That is the problem we have to begin to address. A cure that will not be induced only by tax policy.

Mr. BOSWORTH. I think that we have done some things like the earned income tax credit that seem to me go in the right direction. I think one central problem with the current welfare system is on tax and also the way the expenditure programs work. The incentives to try to earn a dollar once you are on welfare are about zero because for every dollar you earn in wages, you get a reduction in benefits.

Now, the problem is not just on the tax side. It is also on the expenditure side where we phase these programs out as income rises. I think closer consideration of the integration of the tax system on low-income people together with the benefit proposals—every separate program has its own sort of, in effect, marginal tax.

The biggest one of all is the poor people who the best opportunity they have to get a job is a job that almost never, never provides health care. So the biggest barrier to getting off welfare is if you are on welfare, you got Medicaid for your children. You get off it and get a job, almost never are those workers going to have access to health care.

So I think we have a set of screwy marginal incentives to get people back out working instead of taking public welfare. It is not just the tax side of it. It is also the way the benefit programs work.

Chairman ARCHER. The gentleman's time has expired. The gentlelady from Washington, Ms. Dunn, will inquire.

Ms. DUNN. Thank you, Mr. Chairman. I am new to this whole discussion being new on Ways and Means and on the subcommittee that will deal with welfare reform. I have noticed the discussion between static scoring and dynamic scoring. I wonder if you could comment on why this seems to be so badly misunderstood between political parties, but just in general, and what direction you think

we should take to be as realistic as possible as we project what is going to happen as a result of tax cuts?

Mr. NOVAK. Even though I don't speak as an economist, may I make a point on that? When Mr. Bosworth spoke a moment ago about incentives for behavior, that is making the same point. If you structure the benefits in welfare in a certain way without paying any attention to what the behavior of the recipient is, which is what we tried to do in the sixties, that is different from what we did in the thirties on welfare. If you let go of the incentive side of the picture, you miss something very important.

I will yield to those who can talk to the economics.

Mr. BOSKIN. Currently the revenue estimators, Joint Tax Committee, do make some estimate of behavioral responses. For example, if tax rates go up, they will estimate how much more tax-exempt bonds will be purchased and incorporate that. If there is a change in capital gains rates, they estimate whether there will be some induced realizations and how many.

When I was in the Bush administration, our Treasury scored our 30-percent capital gains rate reduction proposal as gaining $12 billion and the JTC as losing $12 billion. That is an important difference, but even the JTC had sizable induced realizations.

They don't take into effect the effects of stronger or weaker economic growth and rising incomes on corporate and personal payroll tax revenue.

If there were infinite resources and we had a precise model that could capture that, we should do that. There was a joint hearing of the Budget Committee yesterday, at which I testified, but I think it was the unanimous view that, if possible, we ought to be doing this. There are practical problems and practical considerations, but I do believe that progress can be made in a prudent serious way, consistent with getting more accurate information provided to you as decisionmakers that is not, as some charge, cooking the books and would not, and I would not use exactly the words Barry Bosworth did, but he is correct; we need to make further progress on deficit reduction and we don't want to use this as an excuse not to cut spending or reduce the deficit.

But I think progress can be made. I would ask that all the testimony be forwarded to you, and I think the Joint Tax Committee is going to try to evaluate what can be done in that regard.

Ms. O'BEIRNE. Yesterday I noticed the committee talked about a parallel, dynamic versus static modeling when the administration makes the absolutely ridiculous claim that 5 million poor children will be denied benefits under the Contract version of welfare reform as though nobody will ever change their behavior as a result of some very profound changes. This is provably untrue.

The American low-income population has profoundly changed their behavior over the last 25 years in response to welfare incentives. Teen pregnancy is not a new phenomena, but people used to get married because they had a need to. There wasn't a government moving in pretending to take the place of a husband and father. People make rational decisions.

So while the administration is denying that anybody would ever change their behavior based on some new powerful incentives, they also recognize that there is a problem of welfare migration between

States, that a high benefit State like Wisconsin has a problem being a magnet is the word the Secretary used, attracting people from Texas.

Isn't that a recognition that people make choices and that there is a dynamic within the welfare population responding to very powerful government incentives?

Mr. BOSWORTH. I basically agree with Michael that in principle I think we would like to take account of the dynamic consequences of government actions. We do adjust for people's behavior up to the point where it changes GDP. I think the concerns are there is a lot of uncertainty about precisely what the numbers are, one.

From a Democratic point of view, I guess, you might say they are alarmed by this suggestion because they are worried that a supply side extremist-type approach may come back and advocate that the whole problem will go away, and the tax cut will pay for itself.

On the Conservative side, I think there is an equal concern about some of the rhetoric of others that every benefit program pays for itself. For example, if I would just improve the health of children, they will be more productive in the future, they will contribute more to society, and it pays for itself.

It begins to sound like a gimmick that you don't have to pay for anything. It is the discipline that people worry that you would lose. Dynamic scoring is fine if it is done in a pragmatic, hardnosed manner.

One suggestion has been in fact that maybe the Congress should try to go outside to some sort of neutral group that might be willing to put together some methods of doing this, say, for example, the American Economic Association, someone who doesn't necessarily have a stake in the outcome.

But I would warn you, even among academics there is a wide disagreement on exactly how big these incentive effects will be. We don't have a lot of information on which to base the estimates and we are not allowed to undertake a lot of experimentation with people's lives just to see what would happen.

Chairman ARCHER. The gentlelady's time has expired. I would like to piggyback on that last comment Dr. Bosworth. If all the economists in the country believed there would be a positive macroeconomic effect on the GDP as a result of a tax change but disagreed as to magnitude—and that would probably be the case—would it not be appropriate for us to take the most conservative view and use that for estimating purposes?

For example, if one end of the spectrum was a one-tenth of 1 percent increase in the GDP and the other was a full 1 percent increase in the GDP, would it not be credible, valid, supportable to take the one-tenth of 1 percent as the basis for your estimating?

Mr. BOSWORTH. I think that sort of conservative approach is a positive way to think about moving maybe ahead with it. I would warn that it is not necessarily always true that the smallest response is the most correct response.

You might be able to do better than that and try to get some extant consensus about a more midpoint estimate. But the idea of looking at the range and following a conservative approach, I think, is one way you could go.

Chairman ARCHER. I have frequently been called a Conservative, so I would identify with that kind of approach. Today we are using a totally static model in which no changes are reflected as a result of a massive change in the Tax Code.

No change will be reflected insofar as its effects on the macroeconomy. It seems we are moving away from accuracy rather than moving toward accuracy by continuing to adhere to what I believe is an anachronistic approach, particularly with regard to computer modeling, which we didn't have when we first began to do this. I wanted to piggyback further questioning with the indulgence of the committee.

Mr. Levin will inquire.

Mr. LEVIN. Mr. Chairman, if we do that regarding tax proposals, then I suggest that we do the same on the benefit side; I am worried about opening that door. Let me ask Michael Boskin, take 1 minute because I want to ask Ms. O'Beirne some questions—in 1 minute or so tell me how much you agree or disagree with the thrust of Barry Bosworth's testimony.

Mr. BOSKIN. I believe deficit reduction is important. I don't believe it is the sole problem confronting the country. I wouldn't agree with some of the adjectives he used or hyperbole, and I would put the deficit in the broader context of the Nation's savings rate. He did that and then went on to focus on deficit reduction.

I think by focusing on deficit reduction outside that context, the Congress and the President last year made a bad mistake. I think they raised taxes in a manner that hit private saving very hard. I think that is a circular thing to do.

If the reason we want to reduce the budget deficit is to reduce its drain on the available supply of private saving available to finance productivity enhancing investment, the last thing you want to do is reduce the deficit in a manner that reduces private saving.

And the big increases in marginal tax rates and the limits on 401(k)s hit households in their peak earning and saving years very hard, hit wealthy people with a higher propensity to save, and hit small business, 80 percent of which are unincorporated and 42 percent of corporations are subchapter S corporations, particularly hard. The personal savings rate went down $60 billion a year. Nobody knows whether that is 20 percent because of taxes or 80 percent, but in the broader context of a higher national savings rate, I think we both need to reduce public borrowing and do it in a way that does not harm private-sector saving but raises private saving.

Mr. LEVIN. Dr. Bosworth, take a couple of seconds to respond and leave me a little time to ask Ms. O'Beirne a question.

Mr. BOSWORTH. I agree with both of those objectives. I would like to eliminate public-sector dissaving and would like to increase public-sector saving. We will add to national saving when we reduce the budget deficit. The private savings rate in the United States has basically been stable for a long period of time, has declined in the last 5 years, not with any particular timing of tax changes.

I think we should go for the sure thing, one positive way you will get 95 percent of all economists to agree—you want to increase national saving in this country, get the public sector to quit dissaving. That works. Then you say what should I do about private saving? My profession is all over the map. We don't agree on a thing about

how to stimulate private savings and what will work and what won't work.

Mr. LEVIN. Maybe someone else will pick that up because I want to ask Ms. O'Beirne, I hope one of my colleagues, because I think we don't have enough debate among panelists when we hear the testimony. It makes the hearings static. You say $324 billion spent on welfare. That figure includes, just so we are all clear, because I very much agree with you about breaking the cycle of dependency, that includes Head Start, does it not?

Ms. O'BEIRNE. Yes.

Mr. LEVIN. Pell grants?

Ms. O'BEIRNE. It is the Congressional Research Service's all means tested expenditures.

Mr. LEVIN. So when you say welfare, you are talking about Head Start, Pell grants, title I, JTPA programs, the JOBS programs, summer youth programs—are you talking about Medicaid?

Ms. O'BEIRNE. Medicaid yes, not Medicare.

Mr. LEVIN. Medicare low income you are talking about. So no one should think when you talk about welfare spending that we are talking primarily about AFDC. It includes all of the low-income-related programs?

Ms. O'BEIRNE. Yes.

Mr. LEVIN. Do you think each and every one of these has exacerbated behavioral poverty? For example, Head Start. Has that, do you think, exacerbated behavioral poverty?

Ms. O'BEIRNE. The general point we have to remember is virtually every one of these programs has as its purpose helping in some way to alleviate poverty in America. It comes out to $8,000 per poor person in overall spending.

Do they work at cross-purposes? Yes. Their benefit levels, rules, and regulations governing them frustrate the States, but these dollars have been appropriated by Congress trying to lick poverty. And they do operate as a package.

The typical woman on AFDC gets benefits from 10 to 12 programs. So with that population specifically in mind, we are not talking specifically about AFDC, food stamps, and Medicaid and housing. It winds up being roughly $15,000 per year on the condition that you have a child and not marry an employed man and not work. It is very much a system that young women have been trapped in.

Some of these programs are more destructive than others, but the overriding point is to remind the American public in their generosity and frustration with this problem, we are now spending over $300 billion a year, and I venture to say that far from getting our money's worth, they are now convinced that much of the spending has been destructive.

Chairman ARCHER. The gentleman's time has expired. Mr. Collins will inquire.

Mr. COLLINS. Thank you, Mr. Chairman. Ms. O'Beirne, I wanted to ask you about the earned income tax credit. I believe that is one of the entitlements of the $300-some billion that you referred to.

When the earned income tax credit was implemented in 1975, it had a twofold purpose, to cover the Social Security taxes for low income that were being removed from their paychecks, and the

other was to encourage people to work and to get off of welfare. Of course, the Social Security tax coverage, that has happened, but, in your opinion, has the earned income tax credit actually removed people from the welfare rolls?

Ms. O'BEIRNE. We have always broadly supported the earned income tax credit as a better use of welfare dollars because, as you noted, it subsidizes work rather than nonwork. I guess as recently as last year it was broadly expanded.

I would be delighted to get back to you with an analysis my colleague has done on whether or not we have begun yet to see the effects of that, but, as a general proposition, we have argued that it is better to subsidize work and marriage than to subsidize illegitimacy and nonwork.

One problem with overly fixating on that half of the equation to make work more attractive is that we have created a very seductive, attractive system that subsidizes destructive behavior, and then we spin our wheels trying to figure out how to tempt people out of the first mess we have created.

The emphasis was very much in 1987 and 1988 on trying to address that second half, and we did, child care benefits for 1 full year after you leave welfare, health coverage for 1 full year, trying to tempt people off. This round of welfare reform, hopefully our final from Washington because the Governors should be full partners and from here on in States should take a bigger role, has got to focus, I think, in a much more dramatic way on the first half of the equation and begin to make welfare unavailable for very young mothers with children. That is a child welfare problem. And most unattractive for able-bodied people who would rather be on welfare than work.

I would be happy to share with you any research my colleague has on whether or not we have seen the beneficial effects that we would like to.

Mr. COLLINS. It would be interesting to see your study because a study I have seen indicates that the welfare portion of it has not really worked. People have a tendency to earn up to a certain level and then they begin to not show up for work as often because they know they have peaked out as far as benefits received from the earned income tax credit.

Another question would be should we look at the formula for the earned income tax credit as to how we reward work similar to how we provide bonuses in the private sector for work, and should we look at a cap for earnings that it is applied to?

One question on block grants to States which you seem to support very much. Governor Miller of Georgia made a comment to me 3 or 4 weeks ago that if you will just send me the funds, even if you send me less, I will handle the welfare reform.

Does there seem to be a consensus among Governors on this issue?

Ms. O'BEIRNE. Yes. Your own Governor reflects broadly the experience I have had talking to Governors as recently as last month in Williamsburg. They appear to be totally convinced that the system designed in Washington, controlled by Washington, details of which are dictated by Washington, is a very costly proposition at the State level and that they could serve in at least as thoroughly,

and given their impulse to design different incentive systems far more beneficially, the same population at much less cost than Washington.

You don't talk to a State welfare director without hearing this frustration and there seems to be a critical mass of the Governors who are convinced they can do a better job at a cheaper price.

Mr. COLLINS. Thank you very much. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman and thank the panelists for a wealth of information you have provided us today. I want to focus my questions initially on my former colleague, Michael Boskin. I appreciate your coming here. I love your bucket analogy, you end up with 60 or 70 cents, which is less than 50 percent of where you start in terms of private-sector cost on taxes, and that is a point that I think needs to be reinforced.

You talked about a comprehensive overhaul of the Tax Code. I think our chairman would be sympathetic. I am not sure if you support the same comprehensive overhaul, but I think that is something that this committee, based on what the Chairman has said, is interested in taking up in the future. Focusing on the capital gains issue and the issue of saving, I think, there is evidence based on what happened in 1986 that this will be good for the economy and will increase rather than reduce revenue.

A few questions that I am getting as I deal with the capital gains issue or by way of devil's advocate. Why shouldn't interest income be indexed? You said not indexing capital gains was the same thing as confiscating wealth. What is the distinction to be made between an investment in a CD or a money market fund and assets that would receive the capital gains treatment?

Mr. BOSKIN. In a world where we were able to do all of it, there would be a case for fully indexing for everything, but it would help reduce the constituency to keep inflation low if everything were indexed. In the mideighties tax reform, the Treasury looked at various ways to try to index interest payments and interest deductions, and it is not an easy thing, but in principle it should be done.

The important thing is if you have debt finance and people are deducting nominal interest, you have to be careful you don't wind up creating vehicles for a big, new round of tax shelters if you have much more rapid depreciation and capital gains. My view is that the case is most direct for capital gains because for a larger fraction of assets, there wouldn't necessarily be a corresponding adjustment in nominal interest rates to compensate the people for the risk of inflation or the actual inflation as compared to indexing all interest income, which I think would have that risk.

In an ideal income tax, you would do that, but we are a long way from that and it is one reason the Chairman pointed out it is awfully complicated to get an ideal income tax.

Mr. PORTMAN. Let me ask as a followup, to avoid any of the possible tax shelters or other economic decisionmaking that might be motivated by this kind of a tax change, would you prefer to just see individual rates lowered overall, marginal rates reduced if you had a choice between capital gains and a rate decrease?

Mr. BOSKIN. I think we have a serious problem in capital gains because the amount of rate reduction if it was spread across the

board would be small, and I think would not have as beneficial an impact, as big a bang for the buck. However, as a general proposition, when you are talking about changes in the income tax, the lower the rates, the better.

Mr. PORTMAN. I have a question for Dr. Bosworth. Do you see any distinction between the homes that people live in, not second homes, but first homes and other assets? Doesn't it make sense to at least apply the capital gains differential to private residences which are not purchased as an investment and where people live in them. It does have the effect of keeping people in homes longer than they would like to be. Would that be an appropriate carve-out at least?

Mr. BOSWORTH. No. When it comes to residences, I think the basis for capital gains treatment is weakest because housing is already extremely favored under the tax system as it presently is, because people do not have to pay taxes on the income that you implicitly get from owning instead of renting your home.

I would worry with any sort of partial feature of reform of capital gains, that the issue that Michael Boskin mentioned as sort of an aside is absolutely central, which is that you can arbitrage the system and play games. What happened in the late eighties in real estate is a good example. If you could take interest deductions that are a nominal rate and put it into an asset in which you get an inflation adjustment, you just play games with the tax system, and it is very dangerous.

We have seen these collapses in our country and in other countries. Capital gains income needs reform. It is a serious distortion to include an inflation component in the definition of capital income. But partial measures will make the situation worse, and I think the most important one in fact is to deal with the interest, not with the capital gains.

Capital gains you get some adjustment, you can postpone, and a lot of people never end up paying the capital gains because you hang onto it for your whole life and borrow against it. The people who can't avoid it are low-income people who have interest income on their savings accounts and they get charged the inflation.

Chairman ARCHER. The gentleman's time has expired. Dr. McDermott.

Mr. MCDERMOTT. I would like to debate with the panel, but first I would like to point out some things about disincentives. Real wages have not increased since 1965, in fact, they have gone down. Less and less workers have benefit packages, pensions or health care benefits, and, if they do, they are less generous. Fifty percent of the people without benefits today are working full time and the employment market is going increasingly toward temporary workers.

Ms. O'Beirne, it seems you assume that poor people are stupid. They look at the incentives and say it is better to stay on welfare than to get a job where I can't pay for day care, I can't pay for health care, and I ultimately have no pension. There are some real incentive problems in society.

You said the mother must identify the father of the child in order to receive AFDC or food stamps with few exceptions for hardship

cases. That is your testimony. Let's say she identifies that father. Should she at that point be eligible for benefits?

Ms. O'BEIRNE. The current law, as you know, mandates that in order to qualify for AFDC, you have to fully cooperate with child support enforcement people. It is broadly ignored.

Mr. MCDERMOTT. If she identifies him, she says this is the father, she should be eligible for benefits or should she not? Does it depend on whether the State follows up and establishes it and gets the money from the father? She says this is the father. Is that sufficient for her?

Ms. O'BEIRNE. That is the status quo, and that has been insufficient. We have lavishly spent on child support enforcement——

Mr. MCDERMOTT. You are saying that a woman ought to be penalized because the State doesn't follow up on their responsibility to establish paternity?

Ms. O'BEIRNE. I am saying that experience teaches us there is a superficial cooperation level. "It was Michael Kelly, he lives on Third Street, I haven't seen him in 4 months," because the incentive is not to give his name to the child support enforcement people or there is a serious effort to cooperate and identify the absent father. At the moment, there is no real incentive to cooperate. I can give any name and if nobody can find him in a phonebook, that is the end of the trail.

Mr. MCDERMOTT. You are assuming that the problem with establishing paternity has been that the women have sort of picked a name out of the air and given it, and that was sufficient to meet this qualification to get welfare.

Ms. O'BEIRNE. There have been and it is a frustration of this committee a number of problems with the program. Many States don't take it particularly seriously, notwithstanding the incentives the Federal Government has provided to have them do so. Despite the $50 passthrough, many women do not take the responsibility seriously. It has been one of our thorniest problems trying to truly identify absent fathers.

Mr. MCDERMOTT. Let me go a step further. Now we have this child and the mother has given the name and the State has been lax and therefore the child isn't fed. Currently, when children are abused, they go into the child protective services, they become a ward of the State. Should the child be taken away from the mother because she was unable to feed that child? In your opinion, is that a part of the welfare reform that we should put in?

Ms. O'BEIRNE. That is not what I am advocating.

Mr. MCDERMOTT. What are you saying these grants to the State are going to be? I sat and read that and I guess you could contract out to the NRA to go out and perform shotgun marriages so that we would have everybody married.

I don't know what these programs are going to do when you have the child on the Earth hungry and not being cared for and the State has failed in their position, what happens to the kid if you are not going to take the kid away and put him in foster care?

In the State of Washington, welfare is $13,000, the care of a kid in an institution is $36,000. Now, you tell me if that is a cost savings.

Ms. O'BEIRNE. That is not what I am advocating. I advocate a system that doesn't destroy low-income kids who have been victims of the system for the past 25 years. Young women have to be responsible, and I think they are perfectly rational, and a young man who is not a good husband and father should no longer be in the purview of a young woman. If we make her more dependent upon him, it matters who fathers your baby.

It doesn't matter nowadays who fathers the baby. The child support enforcement system has been 15 years of frustration with sometimes States and counties not taking it seriously, and where they do, there are good results, and sometimes young mothers themselves not taking responsibility for identifying him, families have to become more engaged. These young women live in families who have to take a greater role, along with churches and communities.

Mr. MCDERMOTT. But it is not happening and the children still exist. You can sit here and say that you want the government to pick out the perfect marriage partner for these women, which seems to me terribly intrusive for people like you who don't believe the government should do anything——

Ms. O'BEIRNE. Which is why that is not what I am advocating.

Mr. MCDERMOTT. So then how do you make this happen when the divorce rate is that one out of two marriages ends in divorce, you have increasing illegitimacy, not only in lower classes, but also in the middle class. How do you deal with that when you have the kid that is not fed? You have to deal with that some way.

Ms. O'BEIRNE. In the name——

Chairman ARCHER. I am afraid the gentleman is going to have to pursue this at another time. The gentleman's time has expired.

The Chair recognizes Mr. English to inquire.

Mr. ENGLISH. Thank you, Mr. Chairman.

Ms. O'Beirne, I would like to pursue some of the things that I think you touched on in response to Mr. Collins' question having to do with State flexibility. I think we are familiar with Justice Brandeis' famous quote about States being laboratories of social policy.

I wonder where in your level of priorities of welfare reform is State flexibility as something to be included in a welfare reform bill, and do you anticipate that State flexibility will generate genuine policy innovation at the State level?

Ms. O'BEIRNE. It should be front and center in any Federal reform. It was a small piece of it in 1986, in 1987 when we last did this. It should be front and center this time, first of all because the Federal system has so profoundly failed.

There are energetic committed Governors who are ready, willing, and able to take on responsibility and there is so much we don't know because this one-size-fits-all policy we have been pursuing has not permitted much innovation. There is plenty we have to know and, at the moment, we have to look at, well, a county in Ohio ran a good program some years ago, and we have learned a lot from Governor Tommy Thompson, who fought with Washington in order to get the sort of flexibility he needs.

If we got to the position where there were 50 different systems and, once it is at the State level, counties trying different ap-

proaches, welfare debates in Washington would be better informed, and I am convinced that low-income Americans would be far better served.

Mr. ENGLISH. Thank you. Yesterday in our hearings Secretary Shalala spent a good deal of time commenting on the legislation pending before this committee and also advocating the Clinton proposal of last year.

I know your organization has done an analysis of the Clinton administration's proposal. Could you highlight what you think are your major reactions to it?

Ms. O'BEIRNE. I would be delighted to briefly and will share with committee members copies of a paper published by the Heritage Foundation not long ago on the Clinton proposal.

[The following was subsequently received:]

The Heritage Foundation Issue Bulletin

No. 200 | The Heritage Foundation • 214 Massachusetts Avenue N.E. Washington, D.C. 20002 (202) 546-4400

August 1, 1994

HOW CLINTON'S BILL EXTENDS WELFARE AS WE KNOW IT

INTRODUCTION

Americans are alarmed by the growth and effects of welfare. They correctly perceive the current system to be an extraordinarily expensive debacle which destroys the lives of those it is intended to help. And by promoting illegitimacy and undermining the family, they see welfare as threatening the foundation of society.

Campaigning for President, Bill Clinton acknowledged that the War on Poverty had failed. He promised to "end welfare." Now, more than two years later, President Clinton has unveiled the details of his "end" to welfare. But far from reform, the President's plan, called the Work and Responsibility Act of 1994, is simply a public relations facade intended to forestall real criticism and change. When the masquerade of "reform" is removed, the plan represents little more than a continuing rapid expansion of the current destructive system.

The cosmetic nature of the Clinton plan should not come as a surprise. Periodic sham reform has become the lifeblood of the welfare system. With each such reform the system grows larger and more expensive. Just a few years ago, Congress declared it had "ended welfare" with the Family Support Act of 1988. This act was touted in the press as a dramatic change in the foundations of the welfare state. In describing the 1988 act, Senator Daniel Patrick Moynihan (D-NY), its chief sponsor, declared:

> We're going to turn the welfare program upside down. We're going to take a payments program with a minor emphasis on jobs, and create a jobs program in which the income supplement is assumed to be temporary.[1]

1 Martin Tolchin, "Welfare Revision: Moynihan Seeking to Stand System on Its Head," *The New York Times*, June 12, 1988.

Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

The next day he added:

> This is the first time ever we're going to take a [income] maintenance program with a slight work component and turn it around to be a job program with income supplements until you're on your own.[2]

And later he declared:

> For the first time in [welfare's] half-century existence, the U.S. Senate has moved to an entire redefinition and overhaul of what we've come to know as our welfare system...[under the revised system] welfare will no longer be a permanent or extended condition.[3]

For good measure, Senator Howard Metzenbaum (D-OH) declared, "[t]his bill makes a dramatic step forward to encourage the stability of the family."[4]

At the time, conservatives said the act was a resounding lie, in that it did none of these things. They were right. The 1988 legislation did nothing to overhaul the welfare system. It did not introduce real work requirements: today, seven years after its passage, less than one percent of adult AFDC recipients are required to work. It did not curb the growth of welfare spending: welfare rolls and costs have exploded at near-record rates. And it did not help to stabilize the low-income family: illegitimacy has soared.[5]

Nor was the welfare system starved for funds after 1988. In fact, aggregate welfare spending has increased at a near-record rate of 10 percent per year in the last five years. In the same period, Congress deliberately expanded eligibility for programs such as Medicaid. Few funds were provided for workfare, however, because the liberal Congress is privately opposed to it.

Carbon Copy. Clinton's present welfare plan is a carbon copy of the welfare reform fraud of 1988. The rhetoric and description of Clinton's proposal is virtually indistinguishable from the earlier "historic" legislation. As with the 1988 act, Clinton's proposal does not reform welfare but merely creates the appearance of reform, blunting public disaffection with welfare while permitting the continuous rapid expansion of the current system.

---

2 Moynihan on the McNeil-Lehrer NewsHour June 13, 1988.

3 *St. Petersburg Times*, September 30, 1988.

4 *The Congressional Record*, June 13, 1988, p. 7661.

5 The conventional explanation for the failure of the 1988 Family Support Act is that it did not receive enough funding. This is untrue. The 1988 act has operated exactly as designed by Congress. The crucial fact is that the act required virtually no welfare recipients to work, and only a tiny fraction even to search for work. Most states have executed the requirements of the 1988 act faithfully; but these requirements were designed to affect less than a tenth of the AFDC caseload. Furthermore, even the minimal JOBS participation requirements in the 1988 act were opposed by Senator Moynihan.

Deception is the core of Clinton's plan. The President claims his bill ends welfare after two years. It does not. It does not even require a significant number of recipients who have been on welfare for over two years to participate in government make-work jobs in exchange for future benefits.

Specifically, the bill:

- ✗ **Does not establish time limits on welfare.** Despite talk of "two years and you are out," the bill merely places a few beneficiaries in government make-work jobs—misnamed the "WORK" program—while they remain on welfare.
- ✗ **Requires only 7 percent of the welfare population to enroll in the WORK program by 1999.** The bill is deliberately designed to affect only a small fraction of the welfare caseload.
- ✗ **Requires those in the WORK program to work for only 15 hours per week.** With the full value of their continuing welfare benefits included, these individuals will receive an effective wage rate of $16 per hour.
- ✗ **Phases out work requirements in the AFDC-UP program which can substantially reduce the caseload.**
- ✗ **Allocates $4,000 per year merely to cover the administrative overhead for each participant in the WORK program.** Adding in the cost of continuing welfare benefits and other expenditures, the total taxpayer cost of maintaining a typical household in the WORK program is likely to be around $20,000 per year.
- ✗ **Is not deficit neutral.** The bill contains many costly expansions of welfare programs. Taking advantage of a loophole in the budget rules, much of this new spending does not appear in the standard budget projections. This allows the Administration to claim its plan is deficit neutral when it is not.

While the bill's time limits and work requirements are a sham, even worse it does nothing about the two most important welfare reform issues: **exploding welfare costs** and **the crisis of illegitimacy**. Last year, federal and state governments spent over $320 billion on welfare; by 1998 welfare costs will rise to over $500 billion, costing on average nearly $5,000 for each taxpaying household. And today nearly one in three American children are born out of wedlock; President Clinton himself has warned the illegitimate birth rate will soon rise to fifty percent.

Yet the Clinton "reform" will do nothing to deal with mushrooming welfare costs or the soaring illegitimate birth rate. In fact, on both issues the Clinton plan will make the situation worse.

Why does the reality of the Clinton plan depart so much from the rhetoric surrounding it? No doubt in large part it is because many top officials in the Administration and Congress have long opposed work requirements. It is also because the professional social welfare organizations, which are so influential within the Administra-

tion and on Capitol Hill, want more spending on the services they provide rather than real reductions in the welfare caseload.

But if Congress really is to "end welfare as we know it," and thereby improve the lives of those in the system as well as reducing the burden on taxpayers, it must focus clearly on several key goals. Lawmakers must change the incentives in the current welfare system that encourage illegitimacy rather than curbing it. They must channel money now going directly to unwed mothers instead to other ways to improve the lives of affected children. Lawmakers must place a real cap in the growth of welfare spending. And they must introduce genuine work requirements, focusing on those recipients who are most employable—such as able-bodied males—not on single mothers with young children. Legislation to do these things has been introduced (S. 2134, H.R. 4566) by Senator Lauch Faircloth (R-NC) and Representative Jim Talent (R-MO), but is opposed by the White House.

The American people—the poor on welfare as well as the taxpayers who support them—have been promised an end to welfare many times before by congressional leaders and by Presidents. Each time the rhetoric was persuasive, and each time the result was more spending, more people on welfare, and higher rates of illegitimacy. The Clinton plan is merely the latest example. And like the others, it is a fraud.

PROVISIONS OF THE CLINTON BILL

To understand why the Clinton welfare plan will not deliver on its rhetoric, it is important to know a number of key facts about the legislation.

FACT #1: The Clinton bill does not establish time limits on welfare.

Although President Clinton has claimed his welfare reform bill will "end cash assistance after two years," this is untrue. Not one individual will have her cash aid terminated because she has received welfare benefits for over two years—or even for over twenty years. Instead a few individuals who have received AFDC for two years will be placed in a new welfare program misnamed WORK. These individuals will participate in government make-work jobs closely resembling the CETA "jobs" created by Jimmy Carter in the late 1970s. Individuals in the WORK program will continue to be on the welfare rolls and to receive welfare cash aid—but the cash aid will now be dubbed "wages."

Welfare recipients may remain in the WORK program indefinitely and may even be exempted from actual work assignments in the future and be recycled back into the main AFDC caseload. Welfare recipients (including those in the WORK program) may also receive Food Stamps, public housing aid, and medical aid indefinitely; the Clinton Administration opposes placing time limits or work requirements on these programs.

FACT #2: Virtually no welfare recipients will actually be required to work.

When forced to acknowledge that the Clinton plan does not actually terminate welfare after two years of enrollment, defenders of the plan adopt a fallback position: they claim that the plan does at least require those who have received wel-

fare for over two years to work in exchange for further benefits by participating in the WORK program. But this also is untrue. Under Clinton's plan virtually none of the parents who have received AFDC for over two years will be required to work, even in a government make-work job with wages paid by the welfare system.

The bottom line is clear. Among the nearly 5 million families receiving AFDC at any point in time almost half have received AFDC continuously for the last two years, and a far higher percentage have been enrolled for over two years when prior spells on the rolls are counted. Yet, under the Clinton plan, it turns out that only 7 percent of the adult AFDC caseload is required to work under the WORK program and even this requirement will not occur until 1999.

The reason only a tiny number of recipients will be required to work under the Clinton plan is because of the huge number of exemptions and limitations associated with the work obligation. The most glaring exemption is that parents born before 1972 will not be subject to any time limits or work requirements at all.[6] This alone exempts nearly 80 percent of the current AFDC caseload from the work requirement.

FACT #3: Most welfare recipients born after 1972 will not be required to work.

Many journalists and lawmakers, as well as other Americans, might assume that Clinton's rule of requiring work after two years will at least be applied rigorously to recipients born after 1972. But even this is not true. Further exemptions apply to this group as well.[7] Even five years from now, in 1999, only one-third of the AFDC parents who were born after 1972 and who have received AFDC for over two years would be required to work. The "two years and then work" rule is purely cosmetic. It is subject to so many limitations that, if enacted, it would have virtually no effect on the actual operation of the welfare system.

---

6 All citations to the Clinton bill refer to *Message from the President of the United States Transmitting A Draft of Proposed Legislation Entitled "Work and Responsibility Act of 1994,"* House Document #103-273 (U.S. Government Printing Office: Washington, D.C., June 21, 1994). This document is hereafter referred to as the "Clinton bill document." All cited page numbers will refer to the large page numbers at the top of each page in this document, which will differ from the page numbers on separate copies of the bill itself. The exemption for parents born before 1972 appears on page 2.

7 In addition to the many layers of exemptions from work, the Clinton bill contains a simple override mechanism which dictates that the number of participants in the WORK program will be determined by the amount of federal funding devoted to WORK divided by a fixed per capita participant amount. Since the WORK program is extraordinarily expensive to operate, this ensures that no more than a small fraction of AFDC recipients will ever be required to participate. See Clinton bill document pages 77 and 271.

FACT #4: Under the Clinton bill, even the small number of welfare recipients required to work must do so for only a few hours per week.

The small number of AFDC recipients who are actually required to work under the Clinton plan will have to perform very little labor. According to the bill, recipients who participate in the CETA-like WORK program will be required to work just 15 hours per week, mainly in public service positions created by local governments.[8] States may require more than 15 hours of labor, but experience from the 1988 Family Support Act, as well as earlier welfare reforms, suggests strongly that most state governments will adhere to the minimum standard. Fifteen hours of work thus will be the norm in all but a few jurisdictions.

FACT #5: WORK participants will be paid well above the minimum wage.

The Clinton Administration has claimed that participants in the WORK program will be paid the minimum wage. This is untrue. The plan actually states that all participants in the WORK program must be paid a wage plus an "earnings supplement," which together must be equal to at least the normal AFDC benefits received by the family.[9] The typical family on AFDC currently receives about $97 per week in benefits.[10] This typical recipient would thus receive a base rate of about $6.46 per hour for 15 hours of work under the WORK program, or almost 50 percent above the current minimum wage.

However, nearly all participants in the WORK program also will receive Food Stamps and Medicaid. The value of this total compensation (cash, food, and medical care) amounts to about $240 per week for the typical AFDC family.[11] With participants "working" for 15 hours per week, total compensation under the WORK program would average $16.00 per hour. (Even if the work standard were doubled to 30 hours per week, total compensation for the average participant would still equal $8.00 per hour.) In addition, WORK recipients will receive free day care. Finally, any state is free to provide any WORK participant with all or part of his or her normal AFDC benefits in addition to the wages paid by the WORK program.[12]

Yet even these above calculations still understate the actual wage rates mandated by the Clinton plan because they do not include an additional hidden wage provision in the bill. This provision stipulates that all WORK participants must be paid an hourly wage at least equal to the wage rates of normal employees within the employing organization performing similar work.[13] Under the plan, most

---

8 The fifteen hour requirement appears on page 250.

9 Clinton bill document, p. 38.

10 AFDC benefits for a single mother with two children in 1992 averaged $4,785 per year. Assuming a total increase of 5 percent for inflation over the last two years benefits would average about $97 per week in 1994. See Ways and Means Committee, *Green Book: 1993*, p. 1240.

11 Estimated value of AFDC, Food Stamps, and Medicaid for a family of three in 1994 based on data from the Ways and Means Committee, *Green Book: 1993*, pp. 1644 and 1240.

12 Clinton bill document, pp. 250-251.

WORK slots will be provided within municipal governments, many of which have unionized workforces. So in these localities, the bill requires that welfare recipients be paid union-scale wages. For example, if New York City wished to have a welfare recipient perform janitorial services in the public schools, the recipient would have to be paid about $20 per hour.[14]

FACT #5: Many WORK participants will join public sector unions.

Section 103 of the Clinton bill states that participants employed under the WORK program shall be provided with "working conditions and rights at the same level and to the same extent as the other employees of the same employer performing the same type of work" and having a similar length of employment.[15] This means that if the welfare recipient were placed in a unit of government which was unionized, the WORK participant would become part of the bargaining unit and would be represented by the union. If the municipality had a closed shop rule, the welfare recipient would become a union member and government funds would be used to pay the required union dues.

FACT #6: The bill limits useful work.

The Clinton plan makes it difficult for local governments to place WORK participants in useful work by creating strong barriers against jurisdictions wishing to fill normal job openings within the government with WORK participants. When a normal government job becomes vacant, WORK participants must be given the lowest priority in filling that job. WORK participants can fill normal job vacancies only after the government has attempted to fill the vacancy unsuccessfully through normal employment channels for at least 60 days.[16]

This provision will tend to push welfare recipients into pointless, make-work positions reminiscent of CETA program in the 1970s, which provided "jobs" such as attending dance class and performing street theater. In the real world, it is also probable that a large number of the "jobs" provided under the WORK program will consist of para-political activity such as voter registration drives as well as advocacy activities under the auspices of the Legal Services Corporation and other "public interest" legal centers.

FACT #7: The minimal work requirements are improperly targeted.

The work requirements in the Clinton bill are poorly targeted and inefficient. Proper work requirements should be targeted on those welfare recipients who have the least justification for being out of the labor force: single able bodied males, fathers in two-parent families, and single mothers with older children. But

---

13 *Ibid.*, p. 233.

14 The beginning salary for a janitor in the New York public schools is $40,000 per year or roughly $20 per hour. Senior janitors receive up to $38 per hour. Charisse Jones, "Pact Breaks Grip of New York School Custodians," *The New York Times*, May 5, 1994, pp. A1 and B8.

15 Clinton bill document, p. 12.

16 Clinton bill document, p. 224.

Clinton's plan focuses on the least employable welfare recipients: young single mothers with pre-school children. Clinton thus reverses the emphasis of current law by phasing out current work requirements on employable males while creating new (but modest) work requirements for single mothers with young children.

Current law properly focuses workfare on the most employable AFDC families. These are the 300,000-plus two-parent families in the Aid to Families with Dependent Children-Unemployed Parent (AFDC-UP) program. Under existing law one of the two parents in an AFDC-UP family will be required to work in community service (workfare) in exchange for the family's welfare benefits. This work requirement will cover up to 75 percent of AFDC-UP families in the mid and late 1990s.

Experience shows that firm work requirements on AFDC-UP families will cause an immediate drop in caseloads and large savings for the taxpayer. In 1983, Utah imposed a 40-hour-per-week work requirement on parents in their AFDC-UP program. The result was an immediate 90 percent reduction in that caseload.[17] Faced with having to perform serious work for their family's welfare benefits, most AFDC-UP fathers went out and obtained real jobs in the private sector. Utah's AFDC-UP population has remained at ten percent of the pre-workfare levels since 1983. Broadening and toughening the current nationwide work requirements on AFDC-UP families could save the taxpayers up to $15 billion in the next five years alone.[18]

But rather than toughening existing AFDC-UP work standards, the Clinton bill takes the unfathomable step of phasing them out by 1998.[19] The meager alternative work requirements in the bill would focus on exactly the wrong population: young single mothers, many with pre-school children. Because of the huge day care costs associated with trying to impose work requirements on this group, the result will be a great increase in welfare spending and barely a dent in the AFDC caseloads.

The inefficient nature of the Clinton work requirements perhaps should not come as a surprise. The Clinton Administration represents the interests of the professional welfare industry, which is naturally threatened by any reform which will significantly reduce welfare caseloads. By contrast, welfare bureaucrats are delighted by "reforms" which require them to provide an ever expanding array of

---

17 See Robert Rector, "Welfare Reform, Dependency Reduction, and Labor Market Entry," *Journal of Labor Research*, Summer 1993, pp. 284-297.

18 The Faircloth-Talent welfare reform bill (S. 2134 and H.R. 4566) establishes work requirements modeled on the Utah plan on the entire nationwide AFDC-UP caseload starting in 1995.

19 The Clinton Administration has sought to abolish the current AFDC-UP work requirements since coming into office in early 1993. The original draft of the Clinton welfare bill circulated in late June of this year, when the President announced his plan, again sought to abolish the separate work requirements on AFDC-UP families. Stung by immediate criticism showing that this would result in a net reduction in the total number of welfare recipients who would be required to work for the next five years, the Clinton Administration hurriedly revised its bill. In the present draft the existing AFDC-UP work requirements are retained, but only through 1998; they are then eliminated.

services to their welfare clientele (such as lengthy negotiations of career goals and plenty of training and day care). Growing welfare caseloads mean full employment and plenty of career potential to welfare bureaucracies; shrinking caseloads mean the opposite. Therefore, despite pious rhetoric, most welfare bureaucracies quietly but strenuously oppose any workfare measures which will quickly cut caseloads. Instead, they relentlessly promote "investments" which increase costs but are claimed to reap savings at some ever-receding point in the future.

Fact #8: The costs of operating the work program are exorbitant.

Although the Clinton plan will require only a small percentage of welfare recipients to work, and those only for a few hours per week, the per recipient cost of operating the WORK program will be extremely high. The Clinton bill allocates $4,000 per year for each participant in WORK just to cover the administrative costs of the program (roughly $3,000 in federal funds and $1,000 in required state funding).

It should be emphasized that this $4,000 per year cost is not for training or education. It simply represents the extra cost of supervising an individual in a WORK slot. Day care and wage subsidies will add even further, large costs. Although the Clinton Administration has not provided clear figures, it is likely that maintaining a single individual in the WORK program will involve some $8,000 in extra expenses above the level of conventional welfare benefits.

In the typical state, the total taxpayer cost for a family of three participating in the WORK program for 15 hours per week is likely to be around $20,000 per year —a figure covering all wage subsidies, food stamps, medicaid, administrative costs and day care. Many participating families would receive even further benefits through other welfare programs such as public housing, WIC, school lunch, and energy aid. According to the rhetoric of the Clinton Administration, such a family is said to be "off welfare."

FACT #9: The Clinton bill is not deficit neutral.

In addition to the high cost of operating the WORK program, the Clinton bill calls for a wide variety of other increases in welfare spending. It provides new funding for education, training, daycare, and administration of the JOBS[20] program (for individuals who have been on AFDC for less than two years). Other spending items include increases in welfare benefits, expansions in welfare eligibility, and daycare subsidies for single mothers who have found employment and left AFDC.

The Clinton Administration nevertheless claims its bill is deficit neutral. Officials say the new spending will not increase the deficit because it is paid for by spending cuts in other government programs. This claim is false. What the Ad-

20 JOBS is the acronym for the Job Opportunities and Basic Skills program, created by the 1988 Family Support Act. This is not a jobs program, despite the acronym, but instead mainly requires welfare recipients to look for employment through "job search" programs.

ministration does is take advantage of a loophole in federal budget law which requires that the financial impact of proposed legislation be estimated only for five years into the future. It turns out that much of the increased welfare spending in the Clinton plan is scheduled to occur in the sixth year and beyond—conveniently outside the period for which costs must be calculated. Clinton's proposed spending cuts, if enacted by Congress, may be sufficient to pay for the proposed spending increases over the next five years (from 1995 through 1999). But the plan does not even attempt to pay for the extra spending increases mandated to occur after 1999. These future welfare spending increases will be paid for either by higher deficits, higher taxes, or both.

Fact #10: The Clinton plan makes no attempt to control the growth of welfare spending.

The federal government currently runs over 70 different welfare programs providing cash, food, housing, medical care, training, and social services to low-income Americans. Federal and state welfare spending combined amounted to over $320 billion in 1993.[21]

Even without any changes in law, welfare spending will rise to over $500 billion per annum by 1998. In that year, the cost of welfare will equal nearly $5,000 for each tax-paying household. The U.S. then will spend two dollars on welfare for each dollar spent on national defense.

Clinton's response to this spending explosion is to call for even more spending. He attempts to defend his proposed spending increases by claiming that welfare increases are an investment which will yield long-run savings. This is a time-worn ploy. Proponents of nearly every welfare expansion in the last 30 years have justified new spending as an investment which will ultimately save money. Of course it never does. In launching the War on Poverty, for instance, Lyndon Johnson proclaimed that the war would be an "investment [which] will return its cost manyfold to our entire economy." Since Johnson's proclamation, annual welfare spending has increased nine-fold, after adjusting for inflation. As with past "reforms," Clinton's plan can be expected to increase welfare spending and caseloads.

Fact #11: The Clinton bill ignores the Illegitimacy Crisis.

The most serious fault in the Clinton reform plan is that it avoids the central problem of welfare almost completely: America's soaring illegitimate birth rate. In addition to all its other deficiencies, Clinton's proposal focuses almost exclusively on the superficial symptom of welfare dependence and ignores the underlying cause of this dependence—the sky-rocketing number of out-of-wedlock births. Last year, over one million children were born out of wedlock. Nearly one-third of all American children are now born to single women, up from around 8 percent when Lyndon Johnson launched the War on Poverty in 1965. The real

21 This figure covers means-tested programs for low-income individuals and communities. General spending programs for the middle class, such as Social Security and Medicare, are not included.

goal of welfare reform should not be to put thousands of single mothers in government make-work jobs, while their children are raised in government day care centers. It must instead be to reduce dramatically the number of children born out of wedlock.

Clinton's rhetoric on the question of illegitimacy has been quite good. The President correctly states that illegitimacy is a key cause of crime in the United States. He also points out correctly that welfare plays a major role in promoting out-of-wedlock births. And in his State of the Union message this year, Clinton warned that unless something dramatic is done, half of all American children will soon be born out of wedlock.

However, despite his laudable rhetoric, the President proposes no serious policies to combat the illegitimacy crisis. In fact, his reform plan would go in the opposite direction, establishing pilot programs to provide new cash welfare entitlements exclusively for unmarried mothers.[22] Even worse, by claiming to provide fundamental reform while changing virtually nothing, the Clinton plan, if enacted, will substantially relieve public pressure for change. Thus, it will effectively shut the door on desperately needed real reforms for the next five or ten years.

Fact #12: On teen abstinence, the Clinton Administration uses conservative rhetoric to camouflage liberal policies.

In an attempt to camouflage his Administration's policy vacuum on the crisis of illegitimacy, the President has included some small sex education programs in his bill. In describing this feature, like other provisions, the President uses bold, conservative rhetoric. In advertising the proposed education programs, Administration materials proclaim,

> [W]e need to send a strong signal that it is essential for young people to delay sexual activity, as well as having children, until they are ready to accept the responsibilities and consequences of these actions. It is critical that we help all youth understand the rewards of.... deferring childbearing until they are married.[23]

But once again, conservative rhetoric conceals a contradictory liberal policy. In establishing the proposed education programs, the bill itself never mentions marriage, abstinence, or moral education to delay sexual activity. This should perhaps come as no surprise, since Health and Human Services Secretary Donna Shalala has spent most of the last year seeking to abolish the federal government's only abstinence education program. In its place, the Clinton bill will promote a stock set of tired policy failures: lavish condom distribution, "self-confidence" programs, values clarification, "life-skills training," and "decision-making skills training."[24]

22 Clinton bill document, pp. 496-504.
23 "Work and Responsibility Act of 1994: a Detailed Summary," p. 32.
24 Clinton bill document, pp. 365, 351.

If the Clinton Administration proposed a broad effort to promote moral-based abstinence education, this could be expected to cause a modest reduction in illegitimacy. Such programs have a demonstrated track record.

Example: Students who participated in the Title XX-sponsored program "Sex Respect: The Option of True Sexual Freedom" had considerably lower pregnancy rates one and two years after participation than the comparison group.[25]

Example: San Marcos Junior High School, San Marcos, California, has also used an abstinence-only program. The year before it was implemented 147 girls were reported pregnant. Two years after its initial implementation only 20 girls became pregnant.[26]

However, HHS Secretary Donna Shalala is vehement in her opposition to such programs. Commenting on her elimination of Title XX funds she said: "abstinence-only messages provide no hope of protection at all against the risks of pregnancy and disease."[27]

Thus, despite its conservative rhetoric, Clinton's bill does not proposed to expand abstinence education. Instead, the proposed programs will be closely modeled on affect-based drug education programs. But, according to one of the principal originators of the techniques used in these programs, psychologist W.R. Coulson, such programs, featuring life-skills training, self-esteem building, and decision-making skills, have been shown scientifically to increase drug, alcohol, and tobacco use.[28] Similar counter-productive results can be expected from Clinton's education proposals.

TRUE REFORM

Even the simplest analysis of the White House proposal shows that Clinton's "time limits" and "work requirements" are a sham. Moreover, the President's "reforms" do not seriously address the more important issues of reducing illegitimacy and controlling welfare costs. True and comprehensive welfare reform is needed.

---

25 Project Respect, *Final Report; Office of Adolescent Pregnancy Programs.* Performance Summary Report, # 000816, Title XX, 1985-1990

26 Dinah Richard, "Has Sex Education Failed Our Teenagers; a Research Report" Focus on the Family, Pamona, California, 1990, pp. 56-60.

27 Cheryl Wetzstein, "Teen Abstinence funding deleted in Clinton Budget," *The Washington Times*, May 23, 1994, p. A-11.

28 W.R. Coulson, *Questianity: Why the War on Drugs Drags*, Research Council on Ethno-Psychology, Box 134, Comptche, California 95427. Dr. Coulson was a close associate of Dr. Carl Rogers and one of the originators of non-directive therapy and values clarification during the late 1960s and early 1970s. Coulson's techniques serve as the basis for most programs featuring decision-making and life skills training in the public schools. See also, William Kilpatrick, *Why Johnny Can't Tell Right from Wrong* (New York: Simon and Schuster, 1993).

Only one piece of legislation before Congress provides real reform. This is The Welfare Reform Act of 1994 (S. 2134) introduced by Senators Lauch Faircloth (R-NC), Charles Grassley (R-IA), and Hank Brown (R-CO) with a companion bill (H.R. 4566) introduced by Representatives Jim Talent (R-MO), Tim Hutchinson (R-AZ), and Charles Canady (R-FL).

This legislation embodies four basic reform principles:

1. **It reduces illegitimacy** in the future by eliminating those welfare benefits which subsidize and promote out-of-wedlock births.[29]
2. **It provides an improved quality of life** for those children who are born out of wedlock in the future. It does so by channeling those welfare funds which, under the current system, go directly to unwed mothers, into alternative and superior forms of care, such as adoption services and closely supervised group homes for young unmarried women and their children.
3. **It controls the size of the welfare state** by putting a cap on the future growth of aggregate federal welfare spending.
4. **It establishes serious but sensible work requirements** for welfare recipients. It does so by focusing those requirements on the most employable welfare recipients first (such as single able-bodied males and fathers in two parents families), rather than on single mothers with infant children.

The authors of this legislation realize that the welfare system is waging a war of annihilation against the American family. In that war, welfare is winning and the family is losing. Welfare pays low-income Americans to adopt self-defeating courses of action. By encouraging young women to have children out of wedlock, welfare ruins the lives of the women and their children. The disintegration of the family promoted by welfare is, in turn, a major cause of most of America's other social problems including crime, poverty, school failure, and drug and alcohol abuse.[30]

CONCLUSION

Candidate Bill Clinton vigorously promoted his pledge to "end welfare" throughout the presidential election campaign. It is unlikely that voters listening to this thought that "ending welfare" meant what President Clinton now proposes: requiring just 7 percent of the AFDC caseload to work in public sector make-work jobs by the end of this century.

---

29 One year after enactment, the bill would eliminate AFDC, Food Stamps, and Housing aid to women under age 21 who have children out of wedlock. Since the bill is intended to affect the future illegitimate birth rate, the cut-off would be prospective; it would not affect women who had children out-of wedlock before the cut-off date. All savings from the elimination of direct welfare payments to unmarried women would be directed to alternative methods of caring for illegitimate children, including adoption and closely supervised group homes for unmarried mothers and their children.

30 See Patrick F. Fagan, "Rising Illegitimacy: America's Social Catastrophe," Heritage Foundation *FYI* No. 19, June 29, 1994.

Administration officials argue that reform must be incremental and that changes take time. However, the true rationale of the Clinton plan can be better understood by examining the history and politics of the issue of work and welfare. The liberals who have dominated the U.S. Congress have adamantly opposed work requirements for welfare recipients for nearly a quarter century.[31] Many of the liberal professionals who staff key posts in the Clinton Administration share this view.[32] But since over 85 percent of the public now favor making welfare recipients work, most liberals no longer publicly oppose work requirements. Instead, they have adopted Fabian tactics, seeking quietly to minimize and delay work requirements as long as possible, while publicly claiming to support them. While public disaffection for welfare is assuaged through sham work requirements, liberals quietly move to expand welfare programs. This strategy of delay and obfuscation packaged as "bold reform" began with the Family Support Act of 1988 and will continue for the foreseeable future.

Unlike Bill Clinton, Senator Faircloth and Congressman Talent realize that the War on Poverty has failed. The Faircloth-Talent bill delivers what Clinton promised: if not an end to welfare, at least the beginning of fundamental change.

Robert Rector
Senior Policy Analyst

---

31 Senator Russell Long first proposed the idea of workfare (requiring some AFDC recipients to work for benefits) in the early 1970s, but his ideas were blocked by liberals in Congress. During the late 1970s, the Carter Administration actually declared workfare illegal and expelled the state of Utah from the AFDC program for a number of years for attempting to make some recipients work for benefits. In 1981, President Reagan finally succeeded in making workfare legal, providing states with the option to operate very limited workfare programs. However, Reagan's repeated efforts to require even a small fraction of the AFDC caseload to actually participate in job search or workfare were rebuffed by Congress on a yearly basis during the mid-1980s. During the 1988 reforms, efforts to require even a small percentage of AFDC recipients to participate in job search or to work for benefits again were opposed by liberals led by Senator Moynihan. Conservatives led by then-Representative Hank Brown (R-CO) and Senator Bill Armstrong (R-CO) succeeded in establishing, over liberal opposition, actual work requirements for some AFDC-UP recipients to take effect in 1994. Thus due to persistent liberal opposition, nearly a quarter century passed between Russell Long's initial proposals for workfare and the time when the federal government actually required the first AFDC recipient to work for benefits. See Lawrence M. Mead, *Beyond Entitlement: The Social Obligations of Citizenship* (New York: The Free Press, 1986).

32 For example, HHS Secretary Shalala is a former member of the board of the Children's Defense Fund, an organization which historically has taken the lead in opposing even token work requirements for welfare recipients.

It is the old paradigm, shall I say, the heavy hand of the Federal Government, notwithstanding some talk about State flexibility. Welfare spending is far from controlled. It is going to be a very expensive proposition.

CBO recently increased the estimate of what this is going to cost. This is the canard we are always told in Washington. We are spending $320 billion at the moment, we have to spend more in order to have longer term effects. That is straight out of the 1987–88 welfare debate. It does nothing to control it, but increases welfare spending. It is a costly proposition.

Even the modest work program doesn't go into effect until the outyears because it is so expensive. Only 7 percent of the AFDC caseload has any obligation to so-called work by the year 1999. That is because it is so costly, $4,000 per person in administrative costs alone. When they may work, they can be in a public-sector make-work job, the obligation being 15 hours a week endlessly, a make-work job for 15 hours a week.

So it is not serious with respect to its professing to put people to work and notwithstanding the President having told us that he recognizes the problem of illegitimacy, the destructive role welfare has played, illegitimacy is linked with crime, all of this the President has recognized and to good effect has used the bully pulpit, his bill totally ignores the problem of illegitimacy.

Mr. ENGLISH. Thank you very much.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Payne.

Mr. PAYNE. Thank you, Mr. Chairman. I would like to return to the issue of national savings which was a subject that was discussed earlier. I think as we pursue the policies that we are looking at on this committee, the Contract With America and other economic policies, certainly we need to ensure that we are being fiscally responsible. As I heard the two economists say, Dr. Bosworth and Dr. Boskin, that in terms of good public economic policy increasing the savings rate is a policy goal that should be at the very top of the list.

Is that correct?

Mr. BOSKIN. The national savings rates.

Mr. PAYNE. It was said by someone on this committee yesterday in questioning that, of the G–7 nations, we are dead last in terms of our national savings rates, that there is something going on in the other six industrialized countries, they are doing different things in terms of public economic policy that may encourage savings, things that we are perhaps not doing.

Are there things that we can learn from what is happening in other industrialized nations that could be effective to us?

Mr. BOSKIN. I think it is a common supposition that one of the differences is that their tax codes in some of those countries, the Western European countries, not Japan, the overall tax burden is higher than the combined Federal, State, and local burden here, but when you work through even their income taxes, they tend to tax consumption rather than income, and they tend to have far more vehicles for tax-exempt saving in Japan than in the United States.

When you get behind the simple statutory structure of their tax systems and look at what the effective rates are on capital, economists believe that that is one of the reasons. There are undoubtedly others. We had, until recently, when they started running large budget deficits, they used to have much closer to budget balance than we had for the seventies and eighties. In recent years, because of their cyclical downturns, but also because of their exploding entitlement spending, benefit payments to people that people get if they don't work is one reason they have a high unemployment rate—those two things have caused them to have much bigger public dissaving than they used to.

So it is a correct historical statement. I think if you looked at 1995, it may be a bit of an exaggeration if you started to look at some of the exploding public borrowing of those places. We have low private saving and we have been dissaving publicly. More of the difference and more of the decline in our national savings rate from the sixties and seventies is due to a decline in net private saving than to an increase in public dissaving.

Mr. PAYNE. Is there anything, Dr. Bosworth, that you would add to that?

Mr. BOSWORTH. Only that I am surprised by the last statement. What all these countries have in common is that the driving force behind it is the decline in national savings which has occurred in all the industrial countries which has been explosions in the public-sector budget deficit. We all have the same difficulty.

The differences in private savings rates are true. We are dead last among the major OECD countries in the rate of private saving in the United States. Americans have always been a low savings rate country. Perhaps it is because of cultural attitudes and American optimism about the future. I don't know.

It turns out we didn't get rich by saving a lot. We got rich by avoiding fighting any wars on our own shores. Other countries save more than we do and then every 50 years blow it up and have to start over. I think the evidence by economists is very discouraging about the argument that the differences are due to the tax system.

I recommend a recent study by Dale Jorgenson at Harvard which does 13 different industrial countries' tax systems and their taxation of capital income and can find no systematic relationship between rates of private saving and rates of capital income taxation.

I think a lot of it is cultural. I think the Japanese make a tremendous emphasis on saving. They look just like the American emphasis on consumption. We measure people by how much you consume. They tend to measure people by how much you save. And I think that a lot of these attitudinal differences lie at the core of differences. Also access to credit. In the United States, it is so easy to borrow, easier here than in any other industrial country.

Mr. BOSKIN. I second the last point, but add that Japan became a high savings rate country after World War II. Japanese history isn't of high savings rates, and I don't think Japanese culture, the typical conventional wisdom stereotype is Japan has changed very slowly culturally. If so, then it can't all be cultural, because they had a low savings rate before.

There are many things to do with demography rates and economic growth, and I believe the evidence is stronger that taxes play a role.

Mr. BOSWORTH. What I meant by cultural is after World War II and the shortage of saving, the Japanese Government put enormous public emphasis on the benefits of saving, every household should have a saving account, the postal saving system.

Mr. BOSKIN. And you could save $30,000 a year tax free.

Mr. BOSWORTH. That is true.

Chairman ARCHER. The gentleman's time has expired.

Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

Mr. Bosworth, coming from the private sector, and over the last several years, I have seen the experts testify during recessions that we can't cut government programs and spending at that point because of the deleterious effect that it would have on the economy, that it would send us into a deeper recession. Would you agree with that?

Mr. BOSWORTH. No, I don't.

Mr. ENSIGN. You wouldn't agree that cutting government spending can have somewhat of a job-cutting effect in the short term?

Mr. BOSWORTH. I think that that was a major concern 20 years ago in the United States when we were largely a closed island economy. Once you moved into a global international market, many of the short-run benefits of fiscal stabilization went away.

I now think we are far better off to focus on the long run for all fiscal policy. The issue of short-run stabilization should be handled by the Federal Reserve.

Mr. ENSIGN. Right. But in the short run, most people would say that it has a tendency to cut jobs and slow the economy even if only in the short run.

Mr. BOSWORTH. Yes, a little bit.

Mr. ENSIGN. OK. The point I am trying to make is when we talk about times like the present we say this is a good time to cut spending, but a bad time to cut taxes because we will increase jobs, we will get the economy going too much.

In the Contract With America we are talking about cutting spending, because we have committed to cutting spending first. At the same time in cutting taxes, we are worried about the Federal Reserve increasing interest rates.

Are they not going to have an offsetting effect as far as overstimulating this overheated economy and therefore take away the argument that we are going to have an increase in interest rates?

Mr. BOSWORTH. If they really did occur at the same time so that there was no net effect on the budget deficit, I don't think there would be any effect on interest. The truth is I don't believe you. I have heard this from Congress over and over again.

You keep telling me you are going to cut expenditures and, boy, we will have these tax cuts and just wait, I will come forward. I want to see the specific expenditure reductions you have in mind. You have an amazingly detailed facts program. I have not heard the same degree of detail on the expenditure side.

Mr. ENSIGN. So if we came forward with those spending cuts and we were paying for the tax cuts, as we said we will, then you think that this wouldn't have the effect that some economists have talked about, overheating the economy and raising interest rates. That argument then would go away for you?

Mr. BOSWORTH. Yes. I would only say that you have passed up an amazingly good opportunity to reduce the deficit. By holding it constant you will have no net effect, because I think that is what financial markets sort of believed up until now: The deficit was always going to be there. So if you don't change, it won't hurt anything, but you are missing an opportunity, a wonderful opportunity to reduce the budget deficit, to take those expenditure cuts which you should make and pass them forward into reductions in deficit and government borrowing, not tax reductions.

Mr. ENSIGN. Let me follow that up further with Dr. Boskin or Ms. O'Beirne. When you are looking at cutting the spending program that we are talking about, and I don't know how you feel about certain tax cuts, such as capital gains, which may stimulate the economy to the point that tax revenues will then be increased, would that not then be reducing the deficit if you are not just looking at a static model, but rather at a dynamic model?

Mr. BOSKIN. I think as a general proposition, cutting spending and taxes by the same amount when you score properly would—I think Barry is correct. I do believe some of these taxes, tax reductions that are talked about will have the advantage of increasing the potential supply in the economy and enable us to grow more rapidly without inflation, although I would agree, before Barry jumps in, the estimate of the size of those—the Chairman's indication of looking at a range and being conservative about it is up for dispute, certainly.

Mr. ENSIGN. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

I don't blame you, Dr. Bosworth, for your cynicism. It has been that way for the last 40 years, but I think we are in a new world, and I know you will judge us by what we do and not by what we say.

But my question is for Mr. Novak, and I don't know if you have read Marvin Olasky's book, but in that book he talks about the importance of a community in giving people a hand up and not a handout and I agree. I guess my question is can the Federal Government create a welfare system that encourages the Nation to be more dependent upon one's self rather than creating permanent dependency on government?

And in addition to that, Ms. O'Beirne's colleague at the Heritage Foundation, Robert Rector, has thrown out a lot of different ideas on welfare reform. One, sending back block grants to the State. Another idea, sending a tax refund back to the people in the amount of money we save in welfare and letting the States handle it and figure out where they are going to come up with the money.

I guess I would like to hear your thoughts on that as well as Ms. O'Beirne's.

Mr. NOVAK. Thank you.

I led a study group consisting of both Democrats and Republicans, Conservatives and Liberals, in 1987 on what was then called the New Consensus on Family and Welfare.

And the first step this group took was to look at what had worked well in welfare programs in the past and what had not worked well, what had and had not gone right since the sixties. On the whole, the condition of the elderly (who were the group most disproportionately poor in the sixties) improved tremendously, perhaps even too generously. Whereas the elderly had been the single largest group of the poor, they are now the smallest.

Where the welfare programs went wrong was with young, healthy people. Here for the first time in our history we created a large group of people, about 9 million adults or so, who are healthy and able bodied and have learned to be dependent on the State. This had never happened before in our history. I think this is what is frustrating people.

Some of the reasons why this happened, in addition to what government did, were what the media and the general circulation of attitudes did, what happened in the larger culture, which Congress can't do very much about, except put certain ideas on the agenda and keep talking about them. We talked just a moment ago about encouraging savings, for example.

Given our beliefs, Americans have to care about the poor people in their midst. People who are not poor outnumber the poor by 9 or 10 to 1. Seventy-one percent of those people who regularly take part in their churches are now participating in volunteerism, if I can cite a number of Mr. Olasky's by memory. And they are giving on average 3 or 4 hours a week to this work. Much more of that can be done. In all of these neighborhoods there are churches.

One more point we discovered. Sixty percent of the AFDC cases are in 10 States. That means 40 States have the other 40 percent. The situation from State to State and from county to county varies enormously.

Why are all States approaching welfare by the same set of Federal regulations? It doesn't make any sense. If you devolve authority back to the States and to counties and local governments, and then encourage the doctors and the lawyers and the realtors in each locality to work on the problem of the homeless for instance, I think the American people would respond. Ours is supposed to be an experiment in self-government. The people are responding and they need more encouragement in that direction.

I want to say one other thing. If you do three things in the United States, it is very hard to remain poor. If you get married and stay married, even if not for the first time, you have a 93-percent chance of not being poor. If you finish high school, you have about a 90-percent chance. If you work full-time year round, even at minimum wage jobs, you have about the same.

If you cross those three lines, then there are still some poor people, but they are few in number and those don't stay in poverty for long. If we could make clear what works, I think the American people would pick it up.

Mr. CHRISTENSEN. Mr. Novak, I think that is a very important figure that we haven't heard yet today or even this week on the

panels, 93 percent, you say, of those people that stay married or are married at one point in time in their life——

Mr. NOVAK. Are not poor.

Mr. CHRISTENSEN [continuing]. Are not poor. And yet our government has been perpetuating the marriage penalty and continues to perpetuate the marriage penalty in some of the administration's policies, and that is a very startling fact.

Thank you for your testimony.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. McCrery will inquire.

Mr. MCCRERY. Thank you, Mr. Chairman.

Welcome, panel. It has been a most interesting discussion.

Through my years on the Budget Committee and now Ways and Means, I have come to love economists. In fact, they are a lot like Congressmen. Each one has a very, very strong opinion, and each one is extremely convinced that he is correct.

But for us policymakers, listening to economists, it makes our job doubly difficult because both Dr. Boskin and Dr. Bosworth are extremely articulate. I have read both of your prepared testimonies and they are excellent. And they are diametrically opposed on a couple of key points, capital gains being the most obvious.

And I would love for you two guys just to go at it for a while and let us listen, but our structure doesn't allow that and neither one of you wants to do that, so I will have to proceed with my questions.

Dr. Boskin, first of all, in your testimony you say: "Finally, and most importantly, a reduction in the capital gains tax would increase the supply of entrepreneurs."

Would you expound upon that a little bit?

Mr. BOSKIN. I think there are many studies of capital gains tax rate reduction, and there are sort of standard kinds of statistical procedures that economists use to analyze it. You see what it does to the conventional estimate of the cost of capital and you have a model about what that does to investment and so on.

Among the things that I think has made our economy strong and is a tremendous advantage of America's economy relative to Japan and Western Europe and other industrialized countries but is enormously difficult to quantify, is that we are a much more entrepreneurial, flexible, dynamic economy. We have many more businesses starting, and I might add, many more businesses failing as a result of that, but then people get up and try again.

I come from an area at Stanford which is on the tip of Silicon Valley, between Silicon Valley and San Francisco, and while some of the funds that go into traditional venture capital, when you get to that stage people usually get money from a tax source first, but then by the time they get to a form of venture capital fund, some of that is coming from tax-free pension funds or tax-deferred pension funds and so on, but I think there is a general feeling that if you have a climate that rewards entrepreneurial efforts substantially that you will have more people willing to leave their decent-paying job at a stodgy, old firm—I won't name any particular ones—say a stodgy, old computer firm and try to start a new one, take their idea and run with it, see if they can build a business, build an industry and create more.

I happen to believe that is more important, but I would be the first to admit that is the thing that economists have the most difficulty quantifying. If you look at startups and look at where they got their first money, over 80 percent came from taxable sources in the first round and then they go to venture capital and some of that comes from tax-exempt sources. So it is that spirit that I am trying to incorporate, but I think it is just not easy to quantify.

Mr. McCrery. I thank you for that explanation.

I would like to go into that further, but let me get to Dr. Bosworth. Actually, I am going to quote Dr. Bosworth and get back to Dr. Boskin.

Dr. Bosworth, in his written testimony, and I think also he talked about it a little, he said that rather than reduce the capital gains rate, we ought to index all capital income. And he said if you do just one and not the other, if you just reduce—if you just index capital gains but not other capital income, or if you reduce the capital gains rate, then you skew the system and you encourage certain types of activities that is not necessarily advantageous.

Do you, Dr. Boskin, have a retort to that?

Mr. Boskin. I am partially sympathetic to the notion, as my earlier testimony indicated. I do believe, however, that we have a serious problem of trillions of dollars of locked-in capital. People have to pay a huge toll to get out of an existing appreciated asset, whether it is nominal or real gains that they have had. Twenty-eight percent of the top rate at the Federal level, plus State taxes, let's say, it is 35 or 40 percent.

You pay that today to get out of one asset to try to go into something that is likely to be more productive and help the economy, but that return is uncertain so you need more than a 35- or 40-percent expected premium to compensate. You are giving up certain extra taxes today for some possibility of higher return tomorrow. I happen to believe that both a rate reduction and indexing would be desirable. I am concerned about the tax arbitrage that Barry mentioned. It is an issue that you should be confronting in design.

I would add, however, that we have, for example, in housing, tax-free rollover. My own opinion, in an idealized world where there weren't all these other constraints, the appropriate tax treatment of capital gains would be tax-deferred reinvestment. Zero rate when you reinvest it and then taxation when it was taken out and consumed, when people stop and took it out and didn't reinvest it, indexed for inflation. That is sort of the goalpost or guideline I would aim for. I do believe—contrary to Barry, I believe the partial reforms would be a big improvement.

Mr. McCrery. Thank you, Mr. Chairman.

I want to get back later, if we have a chance, but Ms. O'Beirne I hope will be thinking about a welfare system equaling EITC, with some corrections from Mr. Collins, plus disability, plus the unemployment compensation. And I would like to ask you about that later.

Ms. O'Beirne. Good, terrific.

Chairman Archer. Let me quickly ask Dr. Boskin and Dr. Bosworth, is there any known study done on this country estimat-

ing what percent of capital transactions are reinvested in other capital assets and not converted to consumption?

Mr. BOSWORTH. There is no standard number floating around in the literature that I am aware of, but I think the answer is very high.

Chairman ARCHER. It would be well up into the nineties.

Mr. BOSWORTH. Ninety-five plus, easy.

Chairman ARCHER. Thank you.

Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman.

Ms. O'Beirne, I—first of all, I want to thank all the witnesses for their testimony, but I had just a couple of points I wanted to make.

I think in response to another question and the figures you came to on the cost of welfare programs, that included all means tested programs that you testified to, our research has indicated there are 340 means tested programs, all with their own rules, regulations, and reporting requirements and the bureaucrats, to make sure that the States comply with those reporting requirements, so clearly there is a great deal of room for reform there.

In answer to a question about paternity establishment in the information necessary, I think what I understood you to be getting at was simply to make a very small commercial loan, more information than a name is necessary, like address, phone number, that kind of threshold. And I think what you are getting at is that the parent or the mother would have to not just give a name but cooperate fully and try to give whatever other additional information, any relatives of the father, to try to get this paternity establishment rate up.

Is that what I understand?

Ms. O'BEIRNE. Exactly. Exactly so, Mr. Camp, because to do otherwise would be merely be the status quo which has had a very frustratingly low paternity establishment connected with it.

Mr. CAMP. Some of these high benefit States or high benefit areas, I know it has been a criticism that people would migrate from area to area. And my question to you, is that necessarily all bad and wouldn't that then force States to try to hold down their welfare costs so they wouldn't become the welfare magnet for the Nation? I would like to hear your thoughts on that.

Ms. O'BEIRNE. Good. Certainly.

I would be the first to say that very intelligent, rational people get caught in the system in responding like rational people. And the example of welfare migration that I know Wisconsin has faced is an example of that. I don't think that is a bad thing at all.

The beauty, I think, is the point that Mr. English was getting at. There is so much we simply don't know. We know what has been a colossal failure. We need to know a lot more about what might work. And given the commitment on the part of Governors to do some experimenting for us, maybe on a countywide basis, not even statewide, and as a Conservative, what is so appealing about the different 50 sovereign States is the system works that way.

If I am living in a State whose tax policies, regulation policies I find frustrating and an impediment to living, I can go elsewhere. We don't have that luxury when national policies are adopted out of Washington and we are all made to live under the same one.

And I don't disagree with you at all and would welcome the opportunity to have maybe very, very different welfare systems among the States.

Mr. CAMP. You mentioned in your written testimony that you would like to see that single mothers with "older children be required to work before mothers with preschool children."

Is there an age—this has been the subject of a great deal of debate, and I wonder if you had in mind a particular age limit or threshold?

Ms. O'BEIRNE. I would for the reasons that are perfectly apparent in the administration's proposal which is how extremely costly the younger mothers with younger children are to focus on. Day care costs alone come to $5,000 or $6,000 a year. Given that, these are the mothers who are least job ready, too, as you know, given the need to prioritize, clearly money is better spent on an older, more mature population with older children, so I would concentrate there, after I concentrated on single males in order to make sure that they are working in exchange for welfare.

I think preschool is the good cutoff point, Mr. Camp, because then you get around the child care question. If mothers with only school-age children were first prioritized, I think the States would find it a much more efficient use of those moneys because they do not, with the child in school all day, have those child care expenses, and if need be, the obligation could fit the school day, a 30-hour-a-week obligation in order to coincide with the school schedule.

Mr. CAMP. You would also require that at least half of all AFDC parents work in exchange for welfare benefits. How did you reach that point or could you enlighten us on that, please?

Ms. O'BEIRNE. I think that is the goal that Governors should be asked to try to get to. I think within that maximum flexibility, exactly how, during which period of time, education and training first, job search, that is totally up to the Governors. But I think as long as it is Federal dollars, those sorts of goals ought to be laid out.

Because we are dealing, Mr. Camp, with an able-bodied population capable of working. And I am delighted that Dr. Novak cited what we all know to be true. It is not a thorny proposition. You graduate from high school, you work full time, year round and don't have children until you are married, and this system all but guarantees you will not be in poverty. So imagine the monstrosity that Washington has created, that being the simple truth, in order to have created so many millions of dependent families.

Mr. CAMP. Thank you very much.

Chairman ARCHER. Does Mr. Kleczka wish to inquire?

Mr. KLECZKA. Mr. Chairman, I do, for just a short period of time.

I would like to direct my question to Dr. Boskin.

We did have on panel number one a CPA. We did discuss for a short time this thing called neutral cost recovery. And I note in your testimony that you indicate that good cost recovery policy must consider not only interest deductibility but also depreciation writeoffs.

I don't see that in the proposal before the committee on neutral cost recovery. I see the depreciation schedule, index for inflation,

plus an added 3.5-percent factor to offset any interest loss because the corporation is giving up the savings or the—the savings.

Are you concerned that we could be establishing another tax shelter by going to this thing called neutral cost recovery? On a piece of equipment with a life of 10 years, using this calculation, I find that the corporation will write off in excess of the original investment. In fact, if you would include the interest expense, that could almost approach another 100 percent of the actual cost.

Mr. BOSKIN. Well, let me just repeat the combination of interest deductions plus depreciation should be equivalent in present value terms of expensing. That is neutral. The specific proposal I think has to be looked at in that context.

I also think that we too often think about depreciation in the traditional wear-and-tear notion. We are not mostly in a wear-and-tear economy anymore. Depreciation of a very large fraction of assets is primarily, as I mentioned in my testimony, due to technological obsolescence, and I think our Tax Code does not take sufficient account of that.

We have whole industries whose product cycles are more rapid than 1 year. We certainly have whole industries whose product cycles and the rate of depreciation—economic depreciation decline in economic value, because one generation of machines or products, whatever, software, computer centers are replaced by the next, is more rapid than the most rapid depreciation.

So I think that depreciation is something that is proper to look into. I think that as a general proposition, depreciation is too slow, but as we have discussed in these other situations, you have got to be careful that a combination of interest, plus depreciation, or capital gains, or whatever, doesn't wind up creating a tax shelter—abusive tax shelter possibilities. The laws have helped reduce that, although I don't——

Mr. KLECZKA. As drafted, do you think the neutral cost recovery system, the proposal before the committee, would have the effect of doing that?

Mr. BOSKIN. I think at times, it would. At other times, it wouldn't. I think you can't make a generalization.

Mr. KLECZKA. Thank you very much.

Chairman ARCHER. Mrs. Johnson will inquire.

Mrs. JOHNSON OF CONNECTICUT. Thank you.

Dr. Bosworth says in his testimony, Dr. Boskin: "There is no shortage of incentives for investment. Business equipment spending adjusted for inflation has increased by 40 percent in the last 2 years."

First, do you agree with that statement, and second, in light of that statement, do you think that reducing the deficit is a more important priority than stimulating investment?

Mr. BOSKIN. Of course, if the deficit is reduced in a manner that does not decrease private saving as, unfortunately, the 1993 tax increases did, it would make more funds available for private investment so they are not—it is not an either/or proposition in that sense.

But it is my own belief that one shouldn't take the shortrun cyclical and technological boomlet in investment, a spectrum-led recovery when people are buying computer equipment and pagers

and so on as a permanent feature. If you are writing tax laws, and I agree with Barry that in general, we shouldn't primarily be using the Tax Code for quarter-to-quarter or year-to-year cyclical reasons, but to have a stable basis to have the strongest base and foundation for economic growth for the private sector as possible.

I do believe that there are still problems in the business incentives: Capital gains, depreciation and elsewhere. But you have got to be careful how the thing is drafted or you can get back into the shelter business.

So I think deficit reduction is important, but I think the tax structure is important as well, and I don't think you can say that the amount of the deficit or the amount of the deficit reduction is a sufficient measure of how much you are going to help private—national saving, and eventually in the long run, investment, because I think the—how we raise the revenue affects whether there will be more businesses started, more investment done and more consumption and so on. So I think the structure of the tax system is important as is the level of the deficit, so I think you have to move on both fronts and be careful on both fronts.

Mrs. JOHNSON OF CONNECTICUT. Thank you.

Dr. Bosworth, your comments about our proposed changes in support of the elderly were interesting to me, partly because I do agree with you, that half of our program outlays are already going to the elderly community. But you may not be aware that in the last two Republican budgets, we proposed means testing Medicare premiums.

Do you think it makes better economic sense to means—and fairness sense, is it better policy to eliminate the disincentives to work for retirees, particularly given the weakness of our system in helping people to prepare for retirement, and also restore fairness to the taxation of Social Security benefits, that is, eliminating the double taxation of the portion that was already tax dollars and instead to means test Medicare premiums to cover some of the costs that, frankly, no one paid into that system?

Wouldn't that end up to be a fairer and healthier tax structure, governing both senior activities and senior income tax responsibilities?

Mr. BOSWORTH. Well, two things: One is the proportion of the benefit that the worker had contributed himself and previously paid tax on was not taxed under the proposal. That is where the 85 percent comes from that was going to be included. Only about 15 percent of the Social Security benefits today represents the contribution of the workers. And so it really didn't make a big difference on it. When you get——

Mrs. JOHNSON OF CONNECTICUT. Excuse me. To that point, from the workers' point of view, it is 50 percent.

Mr. BOSWORTH. No, the worker did not—it will in time. You are going to have—your benefit is composed of your contribution, which was taxed, your employer's contribution, which was not, and then the accumulation of an interest, so to speak. In the case of Social Security, the interest rate is actually the rate of growth of productivity plus population. That is not taxed either. So when you look at the outcome of a person's dollar benefits, how much of those dollars adjusted for inflation ever got taxed; 15 percent.

Mrs. JOHNSON OF CONNECTICUT. I don't think that you can necessarily say that the tax liability for that section should go entirely to the individual.

Mr. BOSWORTH. Well, let's put it another way. I have absolutely no objection to treating the Social Security system exactly the way you treat private pension. In fact, I would most prefer that reform; that what you do for Social Security benefit recipients under the taxation of their income is do precisely what is done for private pension, because that is the right way to do it.

With respect to your question about means testing elderly programs——

Mrs. JOHNSON OF CONNECTICUT. Medicare premiums in specific, because those heavily taxed, subsidized——

Mr. BOSWORTH. I understand. I understand. I have one concern with means testing against retirement income. And that is if I know that the better off I am when I retire, the more you are going to reduce my benefit, why the hell should I save for my retirement. You are going to pay. Or what I will do is just before I get to this age, why don't I shove a little of this income off to my children or some others to avoid taxation. I think this country already has too few incentives for people to save for their own retirement and I don't like these proposals that tend to weaken those measures.

Mrs. JOHNSON OF CONNECTICUT. I certainly agree with that. But the small Medicare tax we pay is not an incentive to save, it is an incentive to cover your health care costs. And in the end, 75 cents of every dollar of part B premiums is paid by the taxpayer.

And as to a disincentive because of means testing premiums, there is no more disincentive than an income tax which says the more retirement income you have, the higher tax you pay. I do think it is important to put on the record that we are in a sense redesigning the burden to support work to restore a certain equity to the treatment of Social Security benefits from the payor's point of view, but we are not blind to the responsibility that one must take to one's own costs, particularly in the health care area.

I do want to say in conclusion, because my time has expired, that it ought to be clear on the record that there is no welfare reform proposal that doesn't provide the same money to the States that they are currently getting, so they will have lots of money to provide developmental day care services for 17-year-old mothers who need their faith in themselves restored, who need to manage money better and who need parenting education. So there are resources to do a far greater job than we are doing now because we don't have any money right now to do any of that stuff for teen parents.

So I think the optimism has to come from withdrawing the mandate to provide income benefits for kids and we are losing sight of that in our discussion here in the committee, that there are resources, there will be new programs, and they provide an enormous opportunity in our society for those young kids, teen mothers, not just for government.

Chairman ARCHER. Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. I will be very, very brief. I don't have any questions. I just want to follow up on what Mrs. Johnson was saying. The gentleman from Washington, Mr. McDermott, a few minutes ago, was talking about how are we

going to take kids away from their parents, and that we are going to build orphanages.

We don't do those things. The Federal Government does not do that. I do not know of one single orphanage that the Federal Government has ever built, nor will it ever build one. I do not know of one instance in which the Federal Government has taken a child away from a parent, nor do I think it has the power to do so even if it should want to.

And we certainly on this side of the aisle do not advocate anything such as that. Nancy, I think, brought it out very, very well when she said that we are going to be able to provide services for these young mothers that have never been provided before. The bill in the Contract With America simply takes away cash benefits from these young mothers; 13-, 14-year-old kids should not be receiving cash in lump sums to go out and spend as they see fit. In some instances, it is a sizable part of the inducement for them to end their—really end their economic life and go and commit themselves to a life of poverty just for those few dollars that they are going to get for having that illegitimate kid at a very early age.

This is an area, though, in which I think that we can certainly work together. There is going to be a great deal of latitude given to the States as to how they can handle that money and how they can get these programs going and get in there and service the kids.

A lot of attention has been brought to the almost obscure provision in there that would allow the States to use some of that money for orphanages. That is such a minute part of the bill when you think of how we are trying to build people. I think Ms. Kellogg was very eloquent in her testimony this morning as to what is happening to those kids, how their self-esteem and self-incentive, their empowerment, their drive, anything they had within their own souls to make them succeed is being blotted out by the cruelness of the present system.

Ms. O'Beirne, I would like to compliment you on your testimony in that regard. I think that you have made a lot of sense and a real contribution to the committee.

I would like to just briefly touch on the question of depreciation because that has been a part of the other discussion. I think we need to go back and not return to the old days of tax shelters where people were investing for tax deductions alone, but the depreciation schedules have to be a lot more realistic than they are today.

When you go in and make improvements for a leasehold and then find that you have got to spread that out over the life of the building, even though the lease may be only 5 or 10 years and a specialty type of renovation is made for a particular tenant, businesswise that just doesn't make any sense. And I think we need to go over the code as far as the depreciation schedules are concerned, take into account obsolescence, the rate of technology that is going forward, and the useful life of the improvement that is being made. And I think that this committee would do very well to go about the business of doing that.

If any of the witnesses have anything to add with regard to that, I would welcome their comments.

Mr. BOSKIN. I would agree with your general sentiment. I would just briefly repeat what I said before about being careful about shelters, and I would also add that if you as a committee get around to fundamental overhaul of the tax system as opposed to specific items in the Contract or other things to do, one of the things that you ought to be looking at is whether it is so complicated to have depreciation schedules for all the types of assets and they are going to change over time so rapidly and the Treasury is never going to be able to keep up with it, they are always going to be off, that you might be able to move to a simpler system that did away with all that sort of thing. That is in the future.

Mr. SHAW. Perhaps with some of this type of technology, maybe even with mobile phones or something like that, let people just write them off like you would a small tool and not bother to capitalize them and have to set up these depreciation schedules. Maybe that would be something that we should be looking at it. And even with the area of computers, don't worry about it, just go ahead and get rid of them and write them off and be done with it and try to simplify the way we do business today rather than just overly complicate it.

The revenue stream for the Federal Government over a 5-year period is not going to be really affected by it. I think probably part of the problem is that we do everything within a 5-year window rather than expand that window and try and make more sense out of it and be more user friendly to businesses.

Thank you, Mr. Chairman.

Chairman ARCHER. I am sure every member of the committee joins me in complimenting each of you for the contribution that you have made today to the deliberations of this committee. I think this panel has been outstanding. We want to continue to draw on your expertise as we move along.

Thank you very much.

Mr. MCCRERY. Mr. Chairman, could we have another round, if they are willing to stay for just 1 minute?

Chairman ARCHER. Well, we have significant time constraints with another panel coming up. I wonder whether we will be able to complete the business of the committee today in an expeditious manner. If there are no other members who want to pursue additional questioning, I am sure we can accommodate one member.

Two. All right.

Is that it?

We will take one from each side for second questions.

Mr. MCCRERY. I think mine will be short. I don't know about Dr. McDermott's.

Chairman ARCHER. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

Ms. O'Beirne, I gave you a formula for welfare before I ended my earlier round, which is my ideal formula for welfare in this country: Welfare equals EITC, plus disability, plus UC. That would be it. Simple. If you don't work, if you are able bodied and you don't work, you don't get welfare. And that would be, I think, the ideal system.

However, since that would make—cause you to talk for longer than we want, perhaps maybe we can get together some other time

and talk about that. But I am concerned about your statement that under your ideal welfare system, if people collect welfare, perhaps they should do community service jobs. In effect, they would have a public job.

Do you—and maybe there is—and I hope there is more to that concept than you have given us today. Would you put any limit on that community service in terms of years performed? And if not, isn't there a danger that some people would just depend on that public job forever and that would relieve them of any duty to go out in the private sector and get a real job?

And I am reminded of the CETA program and all kinds of public programs that were—that didn't do very much good. Could you comment on that?

Ms. O'BEIRNE. Let me hasten to say, Mr. McCrery, that would not be my ideal welfare system but it strikes me that the Personal Responsibility Act, which is, of course, the subject of the hearing, is on the right track with respect to work obligations, not public-sector jobs, but community work which as you know, CETA was different.

I would be happy to talk to you at some time about the difference between those two, and about the focus on illegitimacy and spending in the States.

My ideal system would be look much closer to your own. The key part of my ideal system is that it would be funded at the State level. Governors would raise moneys locally to fund whatever welfare system a given State might want to design.

And if it looked—I suspect given the need for local support for welfare spending, it would look a lot closer to your system certainly than the status quo. So I think longer term, Washington, D.C., simply has to get out of this business of even raising these moneys in the name of helping low-income Americans.

Mr. MCCRERY. Well, to try to make it more clear; on the subject of public jobs, I am still not clear as to your position on that, and you know, there is a lot of talk about workfare and how do we move people from welfare to work and all that and that is a complex problem, but if our solution is to simply move them from doing nothing into a—into a make-work public job, then what have we accomplished? I have serious doubts that we have accomplished much of anything.

Ms. O'BEIRNE. I would agree. The end goal to which we must be striving cannot be a public-sector job. I would be happy to share with you some——

Mr. MCCRERY. Can it be an intermediate goal, though, for the next 50 years? That is what we often have happen with these Federal programs, we create them and then they just last forever.

Ms. O'BEIRNE. Self-sufficient in the private sector. For the purposes of the Personal Responsibility Act, though, I will share with you some material we have about the relative success of things that look a lot closer to what Governor Tommy Thompson does in Wisconsin than, for instance, the administration proposal which really are public-sector jobs where you have to pay union scale wages, and you can't take an available job.

For instance, absent fathers who have been identified and don't pay child support paint benches in Wisconsin, Governor Thomp-

son's "pay or paint" proposal. That kind of community work for failure to meet a child support obligation has had a terrific effect, as you know, if you are familiar with the data from Wisconsin, in helping fathers meet their obligations. But I would be happy to share some of the data we have from counties about—not the public-sector model in the administration bill but community-oriented work in exchange for benefits.

Mr. MCCRERY. Thank you for drawing that distinction.

Thank you, Mr. Chairman.

Mr. BUNNING [presiding]. Mr. McDermott.

Mr. MCDERMOTT. Yes. Thank you, Mr. Chairman.

I am much more reassured after listening to both Mr. Shaw and Mrs. Johnson tell me that there will be no cut in the welfare money nor in the money for public assistance that is going out in the budget which is going to be proposed, but I would like to ask a hypothetical question, Ms. O'Beirne.

If a Governor received less money than he gets now for public assistance in his or her State, and it is in the form of a block grant to cover three or four or five different programs, one of which is AFDC, and if he had a requirement in the Federal law that he couldn't give money to mothers where paternity had not been established, what would be the incentive for a Governor to aggressively pursue establishing paternity if he could avoid the cost of paying the benefits if he wasn't able to?

Ms. O'BEIRNE. Well, if I understand your hypothetical, the prohibition would be on the use of Federal moneys in that situation——

Mr. MCDERMOTT. Yes.

Ms. O'BEIRNE [continuing]. Is presumably how the obligation would go.

Mr. MCDERMOTT. You are assuming there would be no commingling, as there presently is, between State and Federal money.

Ms. O'BEIRNE. Yes, I am assuming that. I am assuming that in order to provide Governors maximum flexibility, there will no longer be a State maintenance of effort. States will be free to use their current welfare spending, some $90 billion, I guess, which is currently spent pursuant to matching Federal programs. If that restriction were lifted, the Governors would also have another $90 billion broadly available to meet the needs of low-income citizens in their State no longer dictated by program requirements out of Washington.

That gives, it seems to me, the Governor an awful lot of flexibility with prioritizing where he thinks the need is greatest, where he thinks the funds in order to help very young mothers with children might be best spent. That is a whole——

Mr. MCDERMOTT. So if you didn't want to punish the illegitimate children, he would be able to use State money—as long as we didn't prohibit State money to be used he could use his State money to deal with it.

Ms. O'BEIRNE. I would so design such a proposition because I don't believe Washington should be in the business of prohibiting uses of State moneys. And then the Governor would be—which is how the system should work—fully accountable for raising those moneys and fully accountable for the use of such moneys and perfectly free——

Mr. McDERMOTT. But essentially what you are doing then is washing the Federal Government's hands of any responsibility for a child born out of wedlock.

Ms. O'BEIRNE. No, that is not certainly how I would characterize what I am saying. What I am saying is the Federal Government, it seems to me, would be saying we have had certain policies in place over the past 30 years that we now recognize have been a disaster in the lives of women and children.

We have learned something. We have learned it is not a smart idea to give direct benefits to the 16 year old on the condition that she has a child without being married. We have stopped doing that with Federal money. We have learned.

Governors, if you want to continue that policy with State moneys, notwithstanding the experience we have had, you are free to, but we are now saying no longer Federal money, as I said, having learned some things at the Federal level.

Mr. McDERMOTT. So you are basically saying that if the Governors fail to do anything about these kids, you don't care. I mean, you are saying that I, as a Congressman, should vote and my colleagues should vote for a proposal that would say that if the Governor doesn't take care of those kids, it is not my problem. That is basically what you are giving us, is giving us a kind of carte blanche to walk away from those kids.

Ms. O'BEIRNE. No, I am not, because——

Mr. McDERMOTT. Well, then we are going to have to require the State to do something about that.

Ms. O'BEIRNE. Dr. McDermott, we have very different views. I believe that there are people at the State level every bit as compassionate and intelligent and committed as people in this room, to helping low-income Americans.

Mr. McDERMOTT. I would suggest to you that the reason we have this program is because that was just not happening.

Ms. O'BEIRNE. Well, if that was the case in 1965——

Mr. McDERMOTT. The reason we got to this program was because the States were not dealing with it. It didn't come up because they came up here and begged us. We looked out there and saw the problem of the unevenness of what went on in Wisconsin versus what went on in some other State and we said, this isn't right. We have to do something so everybody gets taken care of.

So we can't—I mean, you are saying we have to trust the States and I——

Ms. O'BEIRNE. I do.

Mr. McDERMOTT [continuing]. Think that is the basis of your proposal.

Ms. O'BEIRNE. I think that is what the system is all about, and I do trust the States to have the same wisdom and compassion we have.

Mr. McDERMOTT. I disagree.

Mr. BUNNING. Thank you very much, panel. We appreciate your testimony.

[The following was subsequently received:]

JON CHRISTENSEN
2D DISTRICT, NEBRASKA

Congress of the United States
House of Representatives
Washington, DC 20515-2702

January 11, 1995

Chairman Bill Archer
House of Representatives
Committee on Ways and Means
1102 Longworth H.O.B.
Washington, D.C. 20515

Dear Mr. Chairman:

I submit the following articles to be included in the record for the January 11, 1995, Ways and Means Committee overview hearing on the Contract with America.

Sincerely,

Jon

Jon Christensen

National Center for Policy Analysis

BRIEF ANALYSIS
No. 137
For immediate release:
Wednesday, October 26, 1994

The Case for a Capital Gains Tax Cut

The 1986 Tax Reform Act increased the maximum tax rate on capital gains income from 20 percent to 28 percent. This 40 percent tax hike has reduced government revenues, discouraged entrepreneurship and caused many investors to hold on to assets they would prefer to sell.

As a result, support for change is growing. On September 27, 1994, every Republican candidate for the House of Representatives signed a "contract" that proposes indexing capital gains for inflation and effectively cutting the capital gains tax rate in half for all taxpayers. Similar reforms are supported by many Democrats and such business organizations as the U.S. Chamber of Commerce. Let's see why.

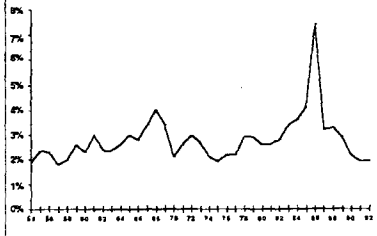
The Case for Indexing. Because tax brackets and the personal exemption are indexed to inflation, people who receive wage income cannot be pushed into a higher tax bracket by the effects of inflation alone. No similar protection exists for those who receive investment income.

Because investors must pay taxes on gains that merely reflect the effects of inflation, the effective tax rate on their real gains can be extraordinarily high. For example, someone who invested in common stock in 1970, did as well as the Dow Jones Industrial Average and sold the stock in 1980 would have had a capital gain of 18.4 percent. During this same period the price level more than doubled, so the nominal gain actually represented a real loss of 44 percent. Nevertheless, the investor would have been assessed a capital gains tax. The purpose of indexing is to ensure that only real gains are taxed.

The Case for Lower Tax Rates. The vast majority of assets have value only because they are expected to produce future income. For example, bonds will produce interest income and stocks will produce dividends and retained earnings. Since this income will be taxed as it is realized, there is no need to tax the owners of these assets at the time the assets are bought and sold. It impedes the efficient transfer of assets from those who value them less to those who value them more, and it makes investments in all income-producing assets less attractive.

FIGURE I

Capital Gains Realizations as a Percent of GDP



Source: Congressional Budget Office and Internal Revenue Service.

Economic Effect: "Unlocking" Investments. The current taxation of inflationary gains, together with high statutory capital gains tax rates, creates a powerful "lock-in" effect. Since selling is taxed and possessing is not, high capital gains taxes encourage investors to hold rather than sell — thereby avoiding the tax indefinitely. Assets that are held until death avoid capital gains taxes altogether.

When investors lock in their assets this way, government loses revenue it would have gotten if tax rates were lower, and the capital market loses efficiency because the flow of assets to those who value them the most is impeded.

Economic Effect: More Revenue for Government. Capital gains are realized at the time assets are sold. It is clear from the history of asset sales that investors are highly sensitive to the tax on capital gains. As Figure I illustrates, investors rushed to sell assets in advance of increases in the capital gains tax in 1969 and 1987. This led to a bulge in sales in 1968 and again in 1986. After the tax increase, however, asset sales fell. Conversely, cuts in the capital gains tax in 1978 and 1981 led to increased sales, as the lock-in effect abated.

This history has been repeatedly ignored in Washington, DC. In 1986, the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) misled many members of Congress by predicting that the increase in the maximum capital gains tax rate from 20 percent to 28 percent would not deter asset sales and would increase government revenues. In fact:

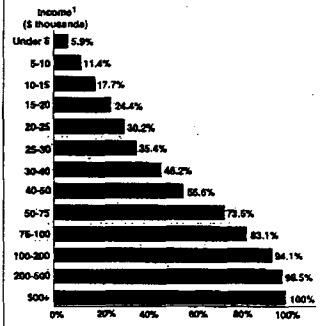
- Capital gains realizations in 1992 (the latest year for which statistics are available) were $116.5 billion, far lower than the $165.5 billion in 1985.
- At 40 percent higher tax rates, capital gains tax revenue of $26.8 billion in 1992 was about 13 percent higher than the $23.7 billion collected in 1985, but after adjusting for inflation, the collections represented a 13 percent decrease.

Economic Effect: More Investment. Capital gains taxes affect investment decisions. In particular, they reduce the amount of capital available for investments with higher risk potential, such as new start-ups and companies in emerging sectors. As a result, the capital gains tax tends to be a direct tax on the entrepreneurship that all economists recognize as essential to growth.

Economic Effect: Benefits for All Income Groups. Despite the strong evidence that lower capital gains tax rates buoy the economy, many in Congress continue to resist cutting the rate for fear they will be accused of cutting taxes only for the wealthy. Yet, as Figure II illustrates, the bulk of taxpayers realizing capital gains are those with middle incomes.

FIGURE II

Cumulative Percentage of Taxpayers Reporting Capital Gains in 1992



[1] Adjusted Gross Income.
Source: Internal Revenue Service.

- Well over half of all taxpayers with capital gains in 1992 had adjusted gross incomes of less than $50,000.
- More than 73 percent had incomes of less than $75,000.

Economic Effect: Economic Growth. All Americans would benefit from the stronger economic growth that would result from lower taxes on capital gains. Earlier this year a study by the Institute for Policy Innovation predicted that:

- A 50 percent capital gains exclusion (effectively cutting the tax rate in half) plus prospective inflation indexing would lower the cost of capital by 5 percent, thereby inducing investors to increase the capital stock by $2.2 trillion by the year 2000.
- This larger stock of capital would create 721,000 new jobs and increase total GDP cumulatively by almost $1 trillion by the year 2000.

Financing the Tax Cut. Expansion of economic activity would increase the overall tax base of the economy by more than enough to compensate for any loss in federal revenue from the tax changes described above. Indeed, the indexing feature alone is probably enough to ensure that the proposal increases revenue. Since only new investments would be indexed, most taxpayers would want to realize their existing gains and invest in new inflation-indexed assets.

This Brief Analysis was prepared by NCPA Senior Fellow Bruce Bartlett, an economist at the Alexis de Tocqueville Institution.

National Center for Policy Analysis

BRIEF ANALYSIS
No. 138
For immediate release:
Wednesday, November 2, 1994

The Republicans' Pro-Growth Contract

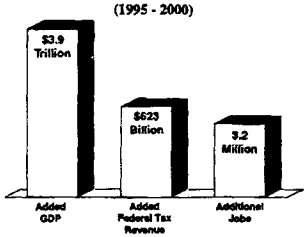
The partisan battle over the Republicans' "Contract With America" has obscured the fact that at least six of the contracts proposals would, if enacted, stimulate economic growth. [See Figure I.]

- Cumulatively, the six pro-growth measures would increase Gross Domestic Product (GDP) by $3.9 trillion by the end of the decade.
- They would create an additional 3.2 million jobs over the next five years.
- They would raise $623 billion in additional federal revenue during the same period.

The additional revenue would be more than enough to pay for the contract's other proposals — including a $500 per child tax credit and removal of the marriage penalty — and would go a long way toward achieving a balanced budget with no increase in spending.

FIGURE I

Economic Effects of the Republican Pro-Growth Proposals[1] (1995 - 2000)



[1] Excludes balanced budget amendment and other spending cuts.
Source: TaxAction Analysis.

Although the six proposals come from Republicans, most have also attracted support from many Democrats. Let's see why.

Expanded Individual Retirement Accounts (IRAs). The Tax Reform Act of 1986 limited tax-free IRA contributions to people with no employer-provided pension and those with incomes less than $25,000 for individuals and $40,000 for couples. As a result, we have a lower national savings rate. When Secretary of the Treasury Lloyd Bentsen was a senator, he cosponsored a bill to restore the right of every American to contribute up to $2,000 a year to an IRA. Senator John Breaux (D-LA) is another prominent Democrat who favors the idea.

These proposals would create a "backended" IRA option, under which IRA deposits would be made with aftertax dollars, but withdrawals at retirement would be tax free. This is important because middle-income Americans can expect to face higher marginal tax rates during retirement than during their working years.

Previous NCPA studies have shown that IRAs do not reduce government revenue. Instead, they result in additional investment, which results in additional output, which results in additional taxable income. Not only would the IRA proposal not cost the government any revenue, but it would increase federal tax revenue by an estimated $50 billion between 1995 and 2000 — even without any new savings — because it would induce people to pay taxes on their current IRA deposits in order to switch to a backended account.

Reducing the Capital Gains Tax. Because the tax brackets are indexed, wage earners cannot be pushed into a higher tax bracket by the effects of inflation alone. However, savers have no comparable protection. People who sell assets are forced to pay taxes on inflation-created profits, even if there has been no real profit.

To correct this defect in the tax law, the contract proposes excluding 50 percent of capital gains from taxation and indexing capital gains for inflation. Previous NCPA studies have shown that almost any capital gains tax rate reduction would produce more revenue when the effects of increased investment are taken into account.

Neutral Cost Recovery. The tax code also fails to index the depreciation of productive assets in order to allow for their replacement. If inflation averages, say, 5 percent per year, a company must spend 50 percent more to replace a machine after eight years. This means the company must earn additional income and pay additional taxes equal to about one-fourth of the replacement cost.

The contract proposes that businesses be allowed to increase their depreciation expenses each year for investments in plant and equipment to compensate for the effects of inflation and the time value of money. It also increases the amount of assets that could be expensed from $17,500 to $25,000, thus helping small businesses.

Reducing the Social Security Benefits Tax. Before 1993, Social Security recipients above a certain income level were taxed on half of their benefits. In 1993, the taxable amount was raised to 85 percent for single people with $34,000 or more and married couples with $44,000 or more in income. As a result, elderly taxpayers in the 28 percent bracket now face a marginal tax rate of 51.8 percent (28% x 1.85). The contract would phase out the 1993 changes, dropping it back to 50 percent by 1999.

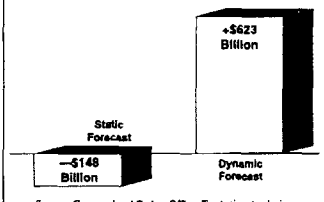
The Social Security benefits tax is mainly a tax on investment income. No tax is paid unless a taxpayer's income reaches a certain level. Beyond that point, the tax rises as income rises. Since 85 cents of benefits is taxed for each additional $1 of income, elderly taxpayers pay taxes on $1.85 for each additional dollar of income.

Increasing the Social Security Earnings Limit. Under this proposal, people between the ages of 65 and 70 who receive Social Security benefits could earn up to $30,000 without penalty in 1995. Currently, if they earn more than $11,160 in a year, they lose one dollar in benefits for every three dollars in earnings. This 33 percent tax rate makes the total marginal tax rate more than 100 percent for some older workers.

Raising the amount that retirees can earn without loss of benefits would expand the supply of elderly workers, help employers meet their demands for skilled labor over the next decade and increase federal revenue. If the earnings limit were completely abolished, the federal government would still make a small profit as additional work-related taxes more than offset increased benefit payments.

FIGURE II

Projected Impact of Proposals on Government Revenue (1995 - 2000)



Source: Congressional Budget Office, TaxAction Analysis.

Raising the earnings limit would increase federal outlays for Social Security benefits by $6.8 billion between 1995 and 2000, but higher economic growth created by the move would generate an extra $15 billion in federal revenue.

Increasing the Estate Tax Credit. The first $600,000 of an estate has been excluded from tax since 1987. As incomes and asset values have risen, it has become more likely that the tax would reach the estates of middle-income taxpayers. The contract would increase the exclusion to $750,000 in 1995 and index it for inflation thereafter.

Net Economic Effects. If increased investment is ignored, the Congressional Budget Office predicts that making all the tax cuts the contract calls for would reduce federal revenue by $150 billion over five years. [See Figure II.] However, NCPA Senior Fellows Gary Robbins and Aldona Robbins have calculated the dynamic — as opposed to static — effects in a study for TaxAction Analysis and have concluded that the measures would add 2 percentage points to our annual growth rate, resulting in a higher GDP, more jobs and more tax revenue.

Mr. McDERMOTT. The next panel, Paul Beckner, David Keating, J.D. Foster, Iris Lav.

Chairman ARCHER [presiding]. Mr. Beckner, if you will proceed.

STATEMENT OF PAUL BECKNER, PRESIDENT, CITIZENS FOR A SOUND ECONOMY FOUNDATION

Mr. BECKNER. Thank you.

Good afternoon, Mr. Chairman.

My name is Paul Beckner and I am president of Citizens for a Sound Economy Foundation, a nonpartisan research and education organization formed in 1984 to study and develop market-based solutions to public policy problems. Our 250,000 members have worked long and hard to reverse the trend of ever-higher tax burdens and government spending.

I want to thank you for the opportunity to address this committee on the very important issues of welfare reform and tax reform outlined in the Contract With America.

I would like to start with the subject of welfare reform, and what I want to talk to you about today is a national survey that CSE Foundation conducted in December, of 1,000 middle-income American voters earning between $20,000 and $60,000 per year.

If you will bear with me for a few minutes, I want to go into a fair amount of detail on the results, because I believe that what the American people are saying about welfare reform provides a sound blueprint for welfare reform.

Middle-class Americans believe our welfare system is a failure because it does little to promote self-sufficiency and any reform of the system should include a requirement that welfare recipients work for their benefits. Notably, two out of three surveyed who themselves have been on welfare or who know someone who has been on welfare, want a tough love approach to welfare.

These Americans don't think reform means having to spend more money nor do they think it means raising taxes to pay for reform. The middle class want those who benefit from the taxpayers' generosity to contribute more to their own well-being.

Our survey found that an overwhelming majority of middle-class voters, 93 percent, believe able-bodied welfare recipients should be required to work at least part time in a community job while they receive benefits. A slight majority, 53 percent, think able-bodied individuals on welfare should be given 1 year or less to find a job. Just 12 percent believe welfare recipients should be given 2 or more years to find work. And 80 percent of middle-class voters were supportive of giving a tax credit to businesses hiring welfare recipients.

Seventy-nine percent of the middle-class voters polled support requiring mothers to identify a child's father in order to receive welfare assistance, and 61 percent support a requirement that teenage mothers live at home with their families in order to receive benefits.

On the other hand, 57 percent of those surveyed would oppose denying benefits for women under 18 who have children. While only 15 percent of middle-class voters favor current regulations that allow women on welfare to increase their family's benefits

when she has additional children, 77 percent oppose moving children from welfare families to group homes or orphanages.

By a 59-to-39 percent margin, middle-class voters oppose increasing taxes on such items as cigarettes, alcohol, or gasoline to fund welfare reform. An even larger majority, 82 percent, favor handing over the responsibility for running welfare programs to State and local governments.

The middle class is telling policymakers in Washington that the days of welfare assistance without limits are over. They want policies that require people to work in order to receive assistance, to have teen mothers remain with their parents, and the father of a child be identified so he can be held accountable. What middle-class voters want are incentives to have people be responsible for their own actions and to get off welfare as quickly as possible.

Let me turn very briefly to the subject of tax reform. Tax reform is another top concern to CSE Foundation's 250,000 members. Today, the typical American family pays more in total taxes than it spends on food, clothing and shelter combined. If the elections on November 8 mean anything, it meant that the time is ripe to completely revamp the Federal income tax system.

Not only is there a genuine recognition that the tax burden on all income groups is at a record high, but just complying with our complex tax system requires nearly 6 billion man-hours and costs more than $192 billion per year. If this time was spent on productive work, it would represent the entire annual outputs of the U.S. auto, truck, and aircraft industries.

The major tax relief items outlined in the Contract With America recommends a welcome and needed step in reversing the growing tax burden on the middle class and small business. I urge you to quickly implement the major Contract items that include a $500-per-child tax credit, repealing the 1993 tax hikes on Social Security recipients, expanding IRAs, and reducing the punitive tax burden currently levied on capital gains.

These items alone would go a long way toward allowing individuals to keep a greater share of their hard-earned money. However, while these tax relief items would provide needed relief, a more comprehensive tax reform agenda should also be considered for the longer term.

Efforts to achieve true tax reform goals will undoubtedly strike up a chorus of naysayers who believe it can't be done and will draw attacks from those who benefit from the status quo. However, the Contract, and proposals like the flat tax plan introduced by Congressman Dick Armey, can accomplish these goals and deserve serious attention in the 104th Congress.

I appreciate this opportunity to testify this afternoon on tax reform and welfare reform, and I look forward to working with you in the months and years ahead to enact policies that will enhance economic growth and improve the standard of living for all Americans, and I will be happy to answer any questions you have.

Thank you.

[The prepared statement follows:]

Statement of

Paul Beckner
President

Citizens for a Sound Economy Foundation

before the

Committee on Ways and Means
United States House of Representatives

on

Tax and Welfare Reforms and the Contract With America

January 11, 1995

Good morning Mr. Chairman. My name is Paul Beckner, and I am President of Citizens for a Sound Economy Foundation, a nonpartisan research and education organization formed in 1984 to study and develop market-based solutions to public policy problems. Our 250,000 members have worked long and hard to help reverse the trend of ever-higher tax burdens and government spending. I want to thank you for the opportunity to address this committee on the very important issues of welfare reform and tax reform outlined in the Contract With America.

Welfare Reform

Though one recent Wall Street Journal/NBC News poll showed that the electorate's top congressional priority is welfare reform (beating out health reform, a balanced budget amendment, and even a middle-class tax cut), President Clinton has failed to make good on his popular promise to "end welfare as we know it." And, there is little, if any, consensus among lawmakers on the numerous and diverse proposals currently aimed at reforming our welfare system.

However, the broad middle-class, those who pay the bulk of the tab for social programs like welfare, do know quite clearly just how they would want to see welfare reformed. Lawmakers can and should take the advice of the middle-class when making the tough decisions needed to accomplish genuine welfare reform.

Middle-class Americans - those earning between $20,000 and $60,000 a year, believe our welfare system is a failure because it does little to promote self-sufficiency, and any reform of the system should include a requirement that welfare recipients work for their benefits. These and other attitudes of the middle-class on this issue were documented by a national survey of middle-class voters commissioned last month by Citizens for a Sound Economy Foundation.

Interestingly, these middle-class voters -- two out of three who themselves had been on welfare or knew someone who has been on welfare -- want a 'tough love' approach to welfare. These Americans don't think reform means having to spend more money. Nor do they think it means raising taxes to pay for reform. The middle-class want those who benefit from the taxpayers' generosity to contribute more to their own well-being.

I'd like to summarize some of our survey's findings. Seventy-eight percent of those asked agreed that "the current welfare system is a failure because it encourages long-term dependency on the government and does little to promote self-sufficiency." Only 17 percent of those asked believed the welfare system "is a success because it provides a safety net for less fortunate Americans until they can get back on their feet."

An overwhelming majority of middle-class voters - 93 percent - believe able-bodied welfare recipients should be required to work at least part-time in a community job while they receive benefits. A slight majority - 53 percent - think able-bodied individuals on welfare should be given one year or less to find a job; just 12 percent believe welfare recipients should be given two or more years to find work. And 80 percent of middle-class voters were supportive of giving a tax credit to businesses hiring welfare recipients.

Seventy-nine percent of the middle-class voters polled support requiring mothers to identify a child's father in order to receive welfare assistance, and 61 percent support a requirement that teenaged mothers live at home with their families in order to receive benefits. On the other hand, 57 percent of those surveyed would oppose denying benefits for women under 18 who have children. While only 15 percent of middle-class voters favor current regulations that allow a woman on welfare to increase her family's benefits when she has additional children, 77 percent oppose moving children from welfare families to group homes or orphanages.

By a 59 to 39 percent margin, middle-class voters oppose increasing taxes on such items as cigarettes, alcohol or gasoline to fund welfare reform. An even larger majority - 82 percent - favor handing over the responsibility for running welfare programs to state and local governments.

The middle-class is telling policymakers in Washington that the days of welfare assistance without limits are over. They want policies that require people to work in order to receive assistance, to have teen mothers remain with their parents, and the father of a child be identified so he can be held accountable. What middle-class voters want are incentives to have people be responsible for their own actions and to get off welfare as quickly as they can.

Based on our survey results, here's how the middle-class's welfare reform plan would look:

1. **The problem** is not so much that payments and benefits going to welfare recipients are too high, rather, the incentives are such that people are on welfare too long, and it has become a way of life.

2. **The role of government** cannot be one of guaranteeing the financial well-being of every able-bodied citizen -- otherwise we will never be able to reform the welfare system. The middle-class's reform plan can best be described, as I said before, as a "tough love" approach where recipients become more responsible for their own actions.

3. **No new spending** should be required for welfare reform. The money now being spent on welfare should be spent differently to reduce the size and scope of federal programs.

4. **No new taxes** are necessary for reform either. More than one-third surveyed stated that welfare reform means that fewer tax dollars should be spent on welfare, and nearly twice as many said increasing taxes on such items as alcohol, cigarettes, and gasoline to finance any reforms was unacceptable.

5. **Keeping families together** is an important goal. The middle-class overwhelmingly opposes the concept of moving children from welfare families to orphanages or group homes, and supports requiring teenaged mothers to live at home with their families in order to receive benefits.

6. **Compassion with incentives** means women on welfare who have additional children should not have their benefits cut off. However, their benefits should not rise with each additional child as they do currently. The middle-class does not favor disallowing benefits for women under 21 who have children, but a mother should be required to establish the identity of the father of her child before receiving any welfare benefits.

7. **Time limits on benefits** will restrict how long able-bodied individuals should receive benefits before they are required to find a job. While eight of 10 middle-class voters surveyed prefer not more than two years as a limit, a majority would be even tougher by putting a one-year limit on benefits.

8. Work tied to benefits would require able-bodied people receiving welfare payments to work full- or part-time in a community service or other available job while they receive benefits. Businesses should be given a tax incentive for hiring welfare recipients.

9. State and local governments are best suited and better able manage welfare programs. It is a good idea to consolidate the many different federal poverty programs and allow those resources to be used in state and local welfare systems.

Hopefully, the reform parameters outlined by the middle-class will provide lawmakers with a realistic and solid guide for transforming our welfare system. The Contract With America's Personal Responsiblity Act is consistent with the broad views of the middle-class by calling for welfare savings, spending caps, consolidation of several programs into block grants, and limiting eligibility.

Tax Reform

Tax reform is another top concern of CSEF's 250,000 members. Today, the typical American family pays more in total taxes than it spends on food, clothing and shelter combined. If the elections on November 8 meant anything it meant that the time is ripe to completely revamp the federal income tax system. Not only is there a genuine recognition that the tax burden on all income groups is at a record high, but just complying with our ultra-complex tax system requires nearly 6 billion man hours each year and costs more than $192 billion. If this time was spent on productive work, it would represent the entire annual outputs of the U.S. auto, truck, and aircraft industries.

After seven decades of abuse by lawmakers, lobbyists, special interests, and self-righteous income redistributors, our tax code is a dangerous mess. People have been taxed retroactively without recourse. Marginal income tax rates that were 15% and 28% just a few years ago now are as high as 45 percent. These high tax rates combine with double and even triple taxation of income to stifle work effort, discourage savings, retard innovation, and foster unproductive investments in tax shelters. All told, the current income tax system needlessly hinders our nation's productivity and reduces every American's standard of living.

The major tax relief items outlined in the Contract With America represent a welcomed and needed step in reversing the growing tax burden on the middle-class and small business. While middle-class taxpayers were promised relief a few years ago, they have instead absorbed new tax increases levied on gasoline, small business owners, and Social Security recipients. Therefore, the tax relief items in the Contract With America would help reverse the increased tax burdens recently levied on the beleaguered middle-class taxpayer.

I urge you to quickly implement the major Contract items that include a $500 per child tax credit, repealing the 1993 tax hikes on Social Security recipients, expanding IRAs, and reducing the punitive tax burden currently levied on capital gains. These items alone would go a long way toward allowing individuals to keep a greater share of their hard earned money and would encourage greater work effort, saving, and investment that would help boost economic growth and our standard of living.

However, while these tax relief items would provide needed relief, a more comprehensive tax reform agenda should also be considered for the longer term. Short of repealing the 16th Amendment passed in 1913 that allowed Congress to "tax income from whatever source derived," how can real tax reform be achieved? What are the most important goals?

First and foremost, any real tax reform must not involve the addition of new forms of taxation on top of the existing tax structure. Much talk, on both sides of the political aisle, has been spent on completely replacing the income tax with some form of a National Sales Tax, Value Added Tax, or other "consumption"-type tax. Realistically, a replacement for the income tax is a farce unless the 16th Amendment is gone. Otherwise, any so-called replacement tax becomes a new "add-on" tax that would only increase the level of complexity within the tax system and undoubtedly would lead to an even higher tax burden.

In addition to simplifying the tax code, tax reform should seek to reduce the record-high tax burden across the board--not simply shifting the tax liability among income groups. Tax reform should involve real tax relief. It's now time to end the "rich" vs. "poor" tax

warfare that has prevailed to the disadvantage of all taxpayers.

The destructively high marginal income tax rates that discourage working, saving, and investing need to be dramatically reduced. These high marginal tax rates need to be cut in order to foster long-term economic growth and to improve investment, productivity, and the overall standard of living. Reducing high marginal tax rates worked when President Kennedy did it in the 1960s and for President Reagan in the 1980s, resulting in two periods of our most vigorous economic growth.

Relief must be provided from the double and even triple taxation of savings and investment that continues to hinder our rate of savings. The indexation of capital gains and expanding the use of IRA accounts outlined in the Contract is a good start. These new savings are critically needed for new investment that all economists agree is necessary to create more jobs and increases wages.

Moreover, any tax reform needs to honestly address and reduce the record-high burden of payroll taxes. Commonly referred to as Social Security taxes, most American families now pay more for these Social Security payroll taxes than they do in income taxes. Meaningful "middle-class" tax relief cannot ignore the burden of Social Security taxes. Too often in recent years, the mushrooming spending growth on Social Security programs has been largely addressed by simple increasing payroll tax rates and levying additional taxes on beneficiaries rather than controlling spending.

These Social Security taxes are an especially bad deal for current taxpayers because their projected rate of return is far less than they could get under a private savings arrangement. Worse yet, these tax liabilities will increase as spending levels on associated entitlement programs continue to mushroom. Therefore, any comprehensive tax reform must be tied to reducing the growth rate of entitlement spending. Tax reform should allow individuals the flexibility to save for their own retirement, health care, and other needs to avoid forced dependency on financially floundering government entitlement programs.

Efforts to achieve these true tax reform goals will undoubtedly strike up the chorus of naysayers who believe it can't be done and will draw attacks from those who benefit from the status quo. However, bold proposals like the flat tax plan introduced by Rep. Dick Armey (R-TX) can accomplish these goals and deserves serious attention in a re-energized 104th Congress.

I greatly appreciate this opportunity to present CSEF's ideas on tax and welfare reforms before this committee. I look forward to working with you in the months and years ahead to enact policies that will enhance economic growth and improve the standard of living for all Americans. I will be happy to answer any questions you may have.

Mr. BUNNING. Thank you.
Mr. Keating.

STATEMENT OF DAVID KEATING, EXECUTIVE VICE PRESIDENT, NATIONAL TAXPAYERS UNION

Mr. KEATING. Thank you, Mr. Chairman and members of the committee for the invitation to appear today.

I appear on behalf of the 250,000 members of the National Taxpayers Union, and we fully support the tax reduction concepts contained in the Contract With America. It is equally important that the spending cuts pledged by that Contract be enacted, because if they aren't, the tax relief will be temporary at best.

Using the spending cuts to finance the $500-per-child tax credit demonstrates one of the fundamental principles of the Contract, and that is to increase the choices of the American people. Fewer choices would be made by elected officials and bureaucrats, because the money would go back into the hands of the American family. Not only would this lead to less government waste and inefficiency, it would strengthen the American family, which is so essential to improving our children's futures.

We are especially enthusiastic about the American dream savings accounts, which would allow families to contribute up to $4,000 annually into a special savings account. Now, most people have talked about the tax reduction aspects of these accounts and how that could increase savings. Equally important is that these savings accounts will lead to a new blizzard of advertising each year that will help change the culture in America to one of savings and investment.

When the fully tax-deductible IRA disappeared, so did the annual advertising blitz urging people to save for their retirement. With American dream savings accounts, I think we would again see national advertising by banks, thrifts, mutual funds, and others teaching people the virtues and rewards of saving for the future.

We are also particularly enthusiastic about the proposed indexation of the capital gains tax. As you may know, our organization worked very hard in 1981 for indexing the tax rate structure of the personal income tax, and we think it is long overdue to index the capital gains tax for inflation. It is not uncommon for taxpayers to pay over a 100 percent tax rate on real gains after the costs of inflation are considered.

I would also like to make two other suggestions about capital gains. It would be far preferable to have a capital gains rollover provision. If you take the money from the sale of one asset and invest it in another asset, you really haven't made any income at all, you just switched your investment strategy. We allow a rollover right now for owner-occupied housing, which is probably the least important in terms of the economic effect of a rollover provision.

You may also want to look at ways to reduce the lock-in effect on capital gains for elderly taxpayers. It really makes little, if any, tax sense for an elderly person to sell an asset, because at death the basis is stepped up. Perhaps you could offer a tax credit against estate taxes for any capital gains taxes paid within 10 years of death. That might reduce some of the lock-in effect on the investment strategies of the elderly.

My written statement goes into additional details of our views on other portions of the tax reductions contained in the Contract With America.

I do want to say one other thing and that is although we support these proposals, we are even more interested in a fundamental reform of the tax system. While some of the measures in the Contract With America will certainly make an important step to improving the fairness or efficiency of the Tax Code, we can get far greater benefit from an improved tax system by replacing it with, say, a flat rate income tax or replacing the income tax with a consumption tax.

Thank you very much for the opportunity to express our views this afternoon.

[The prepared statement follows:]

NATIONAL TAXPAYERS UNION

Statement of

David Keating
Executive Vice President
National Taxpayers Union

on

Tax Provisions in the Contract With America

before the

Committee on Ways and Means
U.S. House of Representatives

January 11, 1995

Mr. Chairman and Members of the Committee, thank you for the invitation to express our views on the tax provisions in the Contract With America. I appear on behalf of the 250,000 members of the National Taxpayers Union.

For 25 years, the National Taxpayers Union (NTU) has fought for lower taxing and spending, and welcomes the efforts in the 104th Congress to reduce both.

The legislation contained in the Contract With America outlines many tax reduction proposals that would help reduce the tax disincentives to savings, investment, job creation, wage increases and economic growth. Equally important, passage of this legislation would help improve the fairness of the tax laws.

These changes must also be viewed in the context of the pledge made in the Contract With America to reduce the deficit. Near the conclusion of the Contact, House Republican candidates made the following pledge:

> Further . . . we will work to enact additional budget savings, beyond the budget cuts specifically included in the legislation described above, to ensure that the Federal budget deficit will be less than it would have been without the enactment of these bills.

It is vitally important that the spending cuts pledged by the Contract be enacted. The true burden of government is not solely what the federal government collects in taxes, but what it spends. If the rate of spending increase is not reduced, then the tax relief promised in the Contract will prove to be temporary.

The American Dream Restoration Act

The Contract summary of the American Dream Restoration Act says it proposes a "$500 per child tax credit, [to] begin repeal of the marriage tax penalty, and creat[e] American Dream Savings Accounts to provide middle class tax relief."

Using spending cuts to finance the tax credit for children demonstrates one of the fundamental principles of the Contract -- to increase choices. This portion of the Contract proposes to reduce the spending choices made by elected officials and bureaucrats, while increasing the choices made by the average American family. Not only will this lead to less government waste and inefficiency, it will strengthen the American family, which is so essential to improving our children's futures. While not every family will make the best decision, overall the decisions about how to spend family resources are best made by each family; not by Washington.

We note that the tax credit is available only to families with annual incomes of $200,000 or less. One great weakness of the current tax law is that it contains many provisions to phase out the value of tax breaks, which causes hidden marginal tax rate increases over certain income ranges. We hope that the final language of this provision will minimize additional complexity or seek to minimize marginal tax rate increases at the income cut-off for this tax credit. The Committee may also wish to convert the current personal exemption for dependents to a tax credit, which may help reduce tax form complexity.

We are especially enthusiastic about the proposed American Dream Savings Account, which would allow families to contribute up to $4,000 annually into a special savings account. The deposit would not be tax deductible, but the withdrawal would be tax free, if certain conditions are met. This provision will be beneficial in a variety of ways.

First, it will add to the nation's pool of savings. Savings and investment rates in the United States are far below its key competitors. Our savings rate over the past twenty years is a mere 5.3%, barely one-quarter of Japan's 19.4%, and only one-half of Germany's 10.8%. American Dream Savings Accounts will help bolster our low savings rate.

While the tax reduction is the most obvious incentive for boosting the savings rate, few people have commented on the ability of such accounts to change cultural attitudes about savings. When the fully tax-deductible Individual Retirement Account disappeared, so did huge annual advertising campaigns that taught Americans the advantages of steady savings for retirement. The tax advantages of the American Dream Savings Accounts would likely lead to another annual blizzard of advertising on the benefits of savings. The power of this advertising should not be underestimated. In 1981, virtually every tax analyst drastically underestimated the number of taxpayers who would open an IRA.

Second, American Dream Savings Accounts will provide security for America's families. A recent paper by Neil Howe for the National Taxpayers Union Foundation showed conclusively that demographics over the coming decades will put a squeeze on the American economy and its ability to fund our current commitments to retirees under Social Security. To maintain our current system of Social Security, Medicaid and Medicare would require total tax rates on workers to climb from their current 41 percent to between 57 and 69 percent by 2040. Given this bleak scenario, it is wise to encourage American families to increase their savings because the benefits promised by current laws are not sustainable.

The Job Creation and Wage Enhancement Act.

There are many attractive features for small businesses in the Job Creation and Wage Enhancement Act. By expanding from $17,500 to $25,000 the amount that small businesses can deduct for investment in equipment and inventory, we will foster greater long-term growth in one of our most important economic sectors. This tax change is especially critical when we recognize that while two-thirds of all jobs created in the 1980's were in small business, nearly half of all small businesses fail within the first five years.

Proposing to cut the capital gains tax to 15% and adding indexation is one of the most pro-growth features of the entire Contract tax cut agenda. Capital gains taxes are detrimental to capital investment and economic growth. The high cost of capital has slowed economic growth and lessened our ability to compete internationally.

John Kennedy once said, "The tax on capital gains directly affects . . . the ease or difficulty experienced by new ventures in obtaining capital, and thereby the strength and potential for growth of the economy." Kennedy's insight about the inverse relationship between capital gains taxes and economic growth has been documented in numerous studies in recent years.

The National Center for Policy Analysis notes, "Higher capital gains taxes stifle investment and economic growth, reducing employment opportunities for all Americans -- particularly for the poor. Historically, entrepreneurial activity (which stimulates job creation) is lowest during periods of high capital gains tax rates and greatest during periods of low capital gains tax rates. For instance, there were 20 times more public stock offerings in 1983, when the capital gains tax rate was 20 percent than in 1978, the last year it was 49 percent. Lower capital gains taxes contributed to the creation of 20 million jobs during the 1980s."

And contrary to the myths being propagated in criticisms of capital gains tax reductions, the lower and middle income groups benefit as much as upper income groups. Beyond the job creation that benefits Americans of every income group, 68 percent of the tax returns showing capital gains in 1987 were from Americans earning $50,000 or less.

Indexation of the capital gains tax would greatly improve the fairness of the capital gains tax. It is not at all uncommon for taxpayers to pay effective capital gains tax rates of over 100%, after the costs of inflation and taxes are considered. Capital gains taxes are levied on the difference between the purchase and sales price of an asset. In many cases taxpayers have had to pay taxes on real losses due to fictitious gains caused by inflation.

The capital gains reduction may provide more economic growth for the dollar of tax cut than any other proposal in the Contract. The capital gains relief provisions could be improved by allowing a tax-free rollover of the proceeds from the sale of an asset. Such a provision is already available for owner-occupied housing. A rollover provision would end the problem of lock-in, where investors do not change their portfolio because of taxes.

Complete elimination of capital gains taxes, as has been suggested by Representatives David Dreier and Billy Tauzin, should also be seriously considered. Federal Reserve Chairman Alan Greenspan was one of the first to argue for a zero federal capital gains tax: "It is easier to make the case to eliminate it entirely than it is to merely reduce the rate . . . It is a direct tax on the nation's standard of living."

I suggest the Committee also consider methods to reduce the lock-in effect of capital gains taxes on investment decisions made by elderly taxpayers. The basis for bequeathed

assets is stepped-up to the fair market at the date of death. An elderly taxpayer is thus unlikely to sell an appreciated asset, especially if the taxpayer's assets will be subject to estate taxes. One way to significantly reduce this lock-in effect would be to allow a tax credit against estate taxes for any capital gains taxes owed within ten years of death and paid in full.

Expanding the estate tax exemption from $600,000 to $750,000 will make a long overdue adjustment for inflation and help ensure that small businesses and family farms will stay in the family, instead of being sold to pay a tax bill.

Another significant change that will help taxpayers will be the changes proposed in the home office deduction. The Contract proposal would clarify the current deduction and allow taxpayers to qualify if their office is used exclusively for a business purpose, used on a regular basis, used to perform tasks that could not easily be performed elsewhere, and is essential to the taxpayer's business. The Contract's provisions would broaden the rules under which taxpayers could claim this deduction and end current, somewhat arbitrary exclusions of certain businesses from this provision.

Senior Citizens Equity Act

The Contract proposes repealing the 1993 change in the tax treatment of Social Security benefits, which increased the portion of Social Security benefits subject to taxation from 50% to 85%. While there is an argument to be made that Social Security benefits should be targeted to the elderly poor, the 85% rate is arbitrary and unfair. Another problem with the 1993 law's tax treatment of Social Security benefits is that it actually results in very high marginal tax rates on people who have saved for their retirement. We believe it would have been more fair to put these benefits on a similar footing as benefits paid by private pensions. Subject Social Security benefits to tax, but only to the extent that the benefits received exceed the taxes paid into the Social Security system. Going back to the pre-1993 law still results in an unfair and illogical tax treatment of Social Security.

Taxing only the excess of benefits received over taxes paid is much more fair and would dramatically increase public understanding of the system. Many elderly believe the myth, created by years of government propaganda, that they only receive benefits that represent a return of their Social Security taxes. Taxing only the benefits that exceed taxes paid would help correct this myth. Each Social Security recipient should receive an annual statement from the Social Security Administration showing lifetime benefits paid to date compared to lifetime taxes paid. Only the excess would be subject to tax.

Such a statement would probably increase the willingness of today's better-off retired elderly to accept restraints in Social Security benefit payments. They would clearly see that Social Security benefits far exceed the taxes they paid into the system. As a result, the tax treatment of the benefits would be perceived as being more fair.

The Contract also proposes to increase the Social Security earnings limit. While this limit functions in ways that are quite similar to taxes, it actually results in an increase in Social Security benefits and an increase in federal spending. We urge that any such increases in entitlement spending on Social Security be accompanied by reductions elsewhere in the program. Otherwise, such a change would move up the date for the coming bankruptcy of the Social Security system.

Conclusion

The National Taxpayers Union looks forward to working with this Committee and the entire 104th Congress to ensure that we enact real and meaningful tax and spending cuts. Just as importantly, should the Congress pass and the states ratify the Balanced Budget Amendment to the United States Constitution, the federal government will have to cut approximately $1.4 trillion in spending over the next seven years. Thus, we concur with the judgment of Senators Domenici, Packwood and others that the spending cuts we enact this spring should not merely be limited to those required to pay for these tax cuts. Congress should make substantial further spending cuts as a "down payment" on a balanced budget.

While we are supportive of the aforementioned efforts to lower the tax burden, I would also like to reiterate the support of the National Taxpayers Union for even more fundamental reform of the tax system. While some of the above measures will stimulate growth and provide needed tax relief to American families, the benefits from these provisions would pale in comparison to the economic benefits flowing from adoption of a flat rate income tax, such as the one proposed by Rep. Dick Armey. A flat rate income tax will free American individuals and businesses from the billions of hours they annually spend preparing taxes and remove huge disincentives to growth. It is one of the best ways we can prepare our nation to compete in the 21st century.

Mr. BUNNING. Thank you, Mr. Keating.
Chairman ARCHER. Dr. Foster.

STATEMENT OF J.D. FOSTER, PH.D., EXECUTIVE DIRECTOR AND CHIEF ECONOMIST, TAX FOUNDATION

Mr. FOSTER. Thank you, Mr. Chairman, members of the committee.

I appreciate the opportunity to address the committee, and I commend you for your ability to sit through these long hearings.

The Tax Foundation is a nonprofit, nonpartisan organization that has monitored fiscal policy at all levels of government since 1937.

The Tax Foundation is not a lobbying organization. We don't take positions on specific legislation. Our goal is to explain as precisely and clearly as we can the current state of fiscal policy and the consequences of particular legislation so that you, the policymakers, may make informed decisions.

The Tax Foundation's founding fathers set out certain principles of taxation to guide our analysis. Among these principles is that a good tax system should be simple. It should be easy to understand for the average taxpayer. It should not include retroactive tax provisions. It should be used solely to raise revenue, not micromanage the economy. It should not be continually rewritten and it should be implemented recognizing the competitive nature of the world economy.

In the recent elections, the American people, as interpreted by the press and this Congress, expressed a clear preference for lower taxes and less government.

One does not have to look far to find an explanation. Every year the Tax Foundation produces an analysis we call Tax Freedom Day. Imagine every dollar you earn going to pay Federal, State, and local taxes beginning January 1. Tax Freedom Day is the day when the average taxpayer's tax liability is paid off for the year, when the taxpayer is finally free to keep the money he or she earns. In 1994, Tax Freedom Day fell on May 5 which tied 1981 as the latest Tax Freedom Day in U.S. history.

Facing historically high tax burdens it is easy to see why taxpayers demanded relief. Yet it would be an extraordinary shame if the current effort to reduce taxes ignored some of our long-term economic problems as described in detail recently by the President's Entitlement Commission. Among these I would emphasize that we have an abysmally low savings rate, as Drs. Boskin and Bosworth mentioned in the earlier panel.

We have a very low private investment rate and the Federal deficit remains a problem even though we have made some progress recently. Since not all tax cuts will address those problems equally, I would like to offer a simple five-point checklist for choosing among the tax cuts under consideration.

First the tax cut package should not increase the budget deficit. That is clearly number one. Second, tax cuts for individuals should not be paid for by tax increases on businesses. Third, tax cuts for low- and middle-income taxpayers, however defined, should not be paid for by raising taxes on other citizens.

Fourth, whatever tax cuts are enacted, they should not make the tax system more complicated than it already is. And fifth, whatever

tax cuts are enacted, even though passed relatively quickly, should not be chosen to meet short-term political goals, but should instead be designed to address the needs of a long-term policy consistent with sustained economic growth.

The current spate of proposed cuts should be developed as a near-term downpayment on a long-term program of fundamental tax reform.

What does a long-term program look like? The majority leader has a flat tax proposal. The minority leader is purported to have a plan. The chairman of this committee has expressed interest in major reform. Senators Domenici and Nunn have spent a couple of years now developing a very detailed tax reform plan.

But as the committee weighs its options, it will save itself and the taxpayers a lot of hardship if it keeps the future direction of tax reform in mind. And whatever reform you prefer at this point, it seems likely that capital gains relief, at least in the form of indexing, will be appropriate, and neutral cost recovery will be consistent with that reform, and that the improved IRA, called the American dream savings account, will also be consistent with future tax reform.

On the other hand, however well intentioned, a child tax credit and an adoption tax credit, if enacted, in the cuts of today seem less likely to survive the tax reform of tomorrow because they complicate the Tax Code without offering any offsetting benefits in terms of marginal tax rate reductions.

The Congress has embarked on a program of change in the role of government. Less is now perceived to be better than more. Yet, as in most things, some means of achieving the desired results are better than others. The five-point checklist may be a useful guide to making these decisions: Deficit neutrality, individual tax cuts without business tax increases or raising taxes on other individuals, avoiding complicating tax changes, and reducing the micromanagement of the economy through the Tax Code.

Finally, if the past election really was a call for less government and more freedom, then perhaps Tax Freedom Day itself provides a good measure of what is and should be accomplished. Tax Freedom Day in 1994 was May 5. Perhaps the Congress should decide how many additional days of tax freedom the American people really want. Was the recent election a call for 1 more day of tax freedom, for 1 week? That is what you have to decide and then having decided how much additional tax freedom the American taxpayer really wants, that then should be the guide to how far taxes and spending ought to be cut.

Thank you.

[The prepared statement follows:]

Statement of

J.D. Foster, Ph.D.
Executive Director and Chief Economist

Tax Foundation

on

The Contract With America and Tax Reform

January 11, 1994

Mr. Chairman and Members of the Committee, my name is J.D. Foster and I am the Executive Director and Chief Economist of the Tax Foundation. It is an honor for me to appear before your committee today on behalf of the Tax Foundation to discuss the "Contract with America" and the direction of tax policy.

The Tax Foundation is a non-profit, non-partisan research and public education organization that has been monitoring fiscal policy at all levels of government since 1937. We have approximately 600 members, consisting of large and small corporate and non-corporate businesses, charitable foundations, and individuals. Our business membership covers practically every region of the country and every industry category.

I would like to emphasize to the Committee that the Tax Foundation is not a "grass-roots" organization, a trade association, or a lobbying organization. We do not take positions on specific legislation or legislative proposals. Our goal is to explain as precisely and clearly as we can the current state of fiscal policy and the consequences of particular legislation in the light of the tax principles delineated above, so that you, the policy makers, may make informed decisions.

When it was established in the late 1930s, the Tax Foundation's founding fathers set out certain principles of taxation which the Tax Foundation would promote and which would guide our analysis of tax proposals. According to these principles, a good tax system should:

- Be as simple as possible -- complexity makes accurate tax compliance needlessly expensive and diminishes the public's willingness to comply with the law;
- Not be retroactive -- taxpayers must have confidence in the law as it exists entering into a transaction;
- Raise revenue, not micromanage the economy with subsidies and penalties;
- Not be continually rewritten -- frequent change lessens citizen understanding of the tax code and complicates long-term economic planning; and,
- Be implemented recognizing the competitive nature of the world economy.

In the recent election the American people, as interpreted by the press and this Congress, expressed a clear preference for lower taxes and less government. One does not have to look far to find an explanation. Every year the Tax Foundation produces an analysis we call Tax Freedom Day. Imagine every dollar you earn going to pay federal, state, and local taxes beginning January 1. Tax Freedom Day is the day when the average taxpayer's tax bill is paid off for the year, when the taxpayer is free to keep the money he or she earns.

In 1994, Tax Freedom Day fell on May 5, tying 1981 with the latest Tax Freedom Day in U.S. history. In 1989, Tax Freedom Day fell on May 4. In 1964, after President Kennedy's tax cuts, Tax Freedom Day fell on April 13, nearly three weeks earlier.

TAX CUTS AND THE BIGGER PICTURE

There are many economic problems facing the country that demand our attention. Many of these problems were discussed in great detail and clarity by the President's Entitlement Commission. Among these problems, I would emphasize that:

- Our rate of national saving is very low and constitutes a serious threat to long-term prosperity;
- Our rate of private investment is probably insufficient to create sustained growth in high-wage jobs; and
- The federal deficit, while less of a problem today than just a few years ago, is projected to grow rapidly in the coming years unless corrective action is taken.

Another problem related to all of the above is the anemic growth in productivity. Whether your main concern is wage growth, job growth, international competitiveness, or the economic futures we leave to our children, it all boils down to increasing productivity.

Productivity, measured as output per hour of all persons in the nonfarm business sector, grew at about 2.4% between 1959 and 1969, slowed to 1.3% from 1969 to 1979, and slowed further to 1.2% between 1979 and 1993 (and even this may be artificially high due to the surge in productivity experienced during the recent recession). This general pattern has been repeated in most of the major industrialized nations.

Tax policy is one of many influences on our economy. Even a perfect tax policy on economic efficiency grounds will not guarantee prosperity if we make enough other mistakes. Nevertheless, tax policy can contribute to higher productivity growth in many ways, most of which can be summed up by simply getting out of the way. Tax policy can best contribute to higher productivity by getting the tax disincentives out of saving, investing, business formation, and risk taking.

A TAX CUT CHECKLIST

In many ways, the current prospect of cutting taxes is extraordinary. And it would be an extraordinary shame if the exercise were completed in such a way that it ignored some of our long-term economic problems. Thus, I would like to offer a simple 5-point checklist for choosing among the tax cuts under consideration.

1) The tax cut package should not increase the budget deficit.

2) Tax cuts for individuals should not be paid for by raising taxes on businesses.

3) Tax cuts for low- and middle-income taxpayers, however defined, should not be paid for by raising taxes on the rest of our citizens.

4) Whatever tax cuts are enacted, they should not make the tax system more complicated than it already is.

[Complicating changes in tax law impose their own costs on the taxpayer in time and energy spent trying to comply with the changes. It would be a great shame if the taxpayer's tax burden were reduced while his compliance burden were increased.]

5) Whatever tax cuts are enacted, even though passed relatively quickly, should not be chosen to meet short-term political goals but should instead be designed to address the needs of a long-term policy consistent with sustained economic growth. The current spate of proposed cuts should be developed as a near-term down-payment on a long-term program of fundamental tax reform.

TAXES, CHOICES, AND PROSPERITY

Everyday, each of us faces choices: should we go out to dinner or eat in tonight; should we buy a fancy new car or go with something more moderately priced; should we do our own taxes or pay somebody to do them for us; should we take a vacation or save the money for a rainy day; should we work this weekend or play golf; should we work at all or should we stay home and raise a family?

Each of these choices is made based on a variety of factors, one of which is almost always the relative costs of the alternatives. If I dine at home, then I have to buy the groceries, cook the food, and clean up. If I go out, then somebody else will do the work, but it might cost twice as much. If I buy the moderately priced car, then I may have enough left over for a nice vacation this year. Each set of opportunities carries a price, and so we speak of the price of one choice relative to the price of the choices foregone.

Virtually every tax affects some group of relative prices. Some of these effects are relatively easy to predict. For example, a new 5 cent per gallon tax on gasoline is probably going to raise the price of gasoline by about 5 cents relative to the price of most everything else. Other effects are much harder to predict. For example, it is very difficult to know who actually pays the corporate income tax in the sense of suffering a reduction in after-tax income.

The individual income tax is often not too difficult to diagnose. We know, for example, that as the marginal tax rate on earning income rises, individuals will choose to work less where possible because the relative price of labor to leisure has gone up. We also know that income tax is imposed on income from saving, thereby creating a disincentive to save.

The Power of Little Changes

It is sometimes hard to understand intuitively how small changes can affect economic incentives. After all, if you need to buy gas to drive to work, you are probably going to buy the gas whether it costs $1 or $2, so you will almost certainly buy it at $1.05.

Over time, however, changing relative prices can have profound effects on behavior. For example, at $2 a gallon for gasoline you may be inclined to buy a more fuel-efficient car next time, or you may move closer to work, join a car pool, or take mass transit.

Most of the time most people willing to buy a product at one price will still buy it if it costs just a bit more. That does not mean, however, that small changes in price do not affect individual choices. Why else is the Sunday paper filled with advertisements and coupons offering a few cents off on this product or that? Why else do retailers advertise their sales? When you drove to work this morning, whether you were listening to Christian radio or Howard Stern, there's a good chance you heard the local automobile dealerships advertising the "biggest sale of the year" two weeks into 1995.

Advertising a sale works because there are always consumers who are wavering between choices and who will respond to a new price differential. To be sure, most consumers will not be swayed by a small change in price. But those consumers who are wavering between their choices, those consumers who are on the margin, will respond and may respond strongly.

What holds true for buying cars also holds true for the choice to save and invest income rather than to consume it, and for working more or working less. Marginal tax rates, that is, those rates that apply to the next dollar of income or the next dollar of expenditure, can have powerful effects on the choices individuals make.

The Tax Foundation performed an analysis of marginal tax rates in June, 1994, some of which is presented in the table below, which demonstrates the extraordinary bias in the tax code against saving. The table presents the total effective marginal tax rates on different types of income after accounting for the tax increases of 1993.

1994 Effective Marginal Income Tax Rates by Type of Income

Type of Income	Total	Federal	State
Wages	27.5%	22.8%	4.7%
Interest	34.5%	29.7%	4.8%
Business	38.2%	32.9%	5.3%
Dividends	42.1%	36.8%	5.3%

These figures indicate, for example, that an individual considering whether to invest an extra dollar in corporate equity must pay 42 cents in total tax for every $1.00 earned. When potential investors consider whether to spend a dollar on consumption or to invest it, it should come as no surprise that individuals so frequently choose consumption.

While all modern taxes distort individuals' decisions, not all tax cuts reduce these distortions equally. Some tax cuts can have a profound effect on how much individuals save, how much they invest, and how much they are willing to work. Others will have very little effect at all. It's all a question of rates: statutory tax rates, average tax rates, and marginal tax rates.

Consider a typical American family. The Census Bureau reports that the median income of a two-earner family in 1994 was $53,354. According to a Tax Foundation analysis done in November of last year, this family faced an average federal income tax rate of 10.4 percent and a marginal federal income tax rate of 28 percent.

Now consider two alternative tax plans, the first of which would increase the personal exemption for all taxpayers by $2,000; the second would allow taxpayers to contribute $2,000 to an Individual Retirement Account (IRA) and reduce their taxable income by $2,000.

The first plan would reduce the family's average tax rate on all income to 9.4 percent; it would not affect the family's marginal tax rate on either wage income or savings. Consequently, this plan would not reduce the tax disincentive to work since another dollar of labor income still faces a marginal tax rate of 28 percent. Nor would this plan reduce the tax disincentive to save since the tax reduction occurs whether the taxpayer saves or not.

Now consider the second plan whereby taxpayers are allowed to contribute $2,000 in pre-tax income to an IRA. Like the first plan, this plan does not reduce the marginal tax rate on labor. However, this plan does reduce the tax disincentive to save because the tax reduction is linked directly with the amount of saving that occurs through the IRA.

IRAs increase private saving because they reduce the tax burden on saved income, thus lowering the price of saving relative to consumption. That IRAs tend to increase private saving is certain; the amount of the increase, however, is certainly open to debate.

There was a time not long ago when tax policy discussions took place almost entirely in terms of economic incentives, marginal tax rates, and long-term goals. These concepts, which reached a height of popularity in the debate leading up to the 1986 Tax Reform Act, have since been overtaken by revenue estimates and tax fairness.

Whatever one's opinions about the 1986 Tax Reform Act, the motivations of the Congress and the President were right on target. Whatever tax cuts are passed in the coming few months would most benefit the nation if they adhere to those same motivations, if not

necessarily the same types of results, such as reducing the disincentives to working, saving, and investing.

NEAR-TERM OBJECTIVES AND LONG-TERM REFORMS

One statement on which virtually everyone agrees is that the current federal income tax system is too complicated, too expensive to operate and comply with, and far too much of a burden on the economy. The question is, what should be done about it?

The Majority Leader, Congressman Dick Armey (R-TX), has a tax reform plan built around the concept of a flat tax which seemed to be picking up steam before the November election, and which must now be assumed to have been given a big boost by that election.

Senators Domenici (R-NM) and Nunn (D-GA) have their own detailed tax reform plan that is expected to be introduced in the next few weeks. These plans are sufficiently similar -- they both emphasize simplification and the elimination of the multiple taxation of saving -- and have drawn enough support from diverse quarters, that it may be safe to assume that they represent the starting point for the coming tax reform debate.

As the Committee considers various options for cutting taxes in the near term, it will save itself and the taxpayers unnecessary hardship if it keeps in mind the direction tax reform is likely to follow. If you believe that the Armey/Domenici-Nunn approach is the path we are likely to follow, or if you believe that lower marginal tax rates and a simpler income tax is where we should be heading, then some elements of the Contract with America are very likely to be consistent with future tax reform efforts. Capital gains relief, neutral cost recovery, and the improved IRA called the American Dream Savings Account are all likely to be consistent with future tax reform.

On the other hand, however well intentioned, it is less likely that the child tax credit and the adoption tax credit, if enacted in the tax cuts of today, will survive the tax reform of tomorrow because they complicate the tax code without offering any offsetting benefits in terms of marginal tax rate reduction.

TAX RELIEF AND DEFICIT REDUCTION

The federal budget deficit remains a very serious problem despite a series of large tax increases. Some have argued that we should take advantage of the current willingness of the Congress and the American people to cut federal spending and use those cuts to reduce the deficit. Others have argued that there should be a division of the spending cuts between tax relief and deficit reduction. Anyone concerned about the federal deficit should take heart in the current exercise, and not merely because of the general agreement that the bill should be paid for in full.

Most recent tax bills have raised taxes based on highly suspect revenue estimating procedures. (I do not mean at all to impugn the professionalism of the revenue estimators at either the Joint Tax Committee or the Treasury Department; but the fact is even the best navigator will get lost if the compass is faulty.) If the tax bill that emerges from this exercise includes tax increases on some to pay for the tax reductions on others, then it, too, will fail to achieve the expected revenues and we face the possibility of increasing the budget deficit.

Spending cuts, in contrast, are far easier for the Congress to guarantee because it is not a question of one group or another responding in predictable ways to tax increases; the Congress merely has to forego spending the money as enforced by lower spending limits. With tax increases, therefore, the economy must behave as predicted to achieve the expected revenues; with spending cuts, the Congress must merely act on its own decisions.

Just as tax increases generally raise less, (and sometimes much less), revenue than forecast by the estimators, tax cuts rarely cost the Treasury as much in tax revenues as the estimators expect. Of course, in each case the amount of error will depend on the nature of the tax reduction. Estimates of the revenues lost from increasing the personal exemption or establishing child tax credits are likely to be reasonably accurate because little economic activity will be affected.

In contrast, the Social Security earnings limit increase, the American Dream Savings Account, capital gains relief, the increase in the amount of capital purchases that a small business may expense, even the proposed estate tax relief, all may cost less than estimated because they will each stimulate economic activity, thereby increasing federal revenues from a variety of sources.

REVENUE ESTIMATES AND COLLECTIONS

The revenue estimating process is one of the most poorly understood and poorly reported aspects of the tax debate. Without going into an extended discussion of static versus dynamic revenue estimates, two examples should demonstrate why a tax bill using spending cuts to pay for tax cuts that improve economic incentives will actually reduce the budget deficit through the non-inflationary stimulative effects of the tax cuts.

The Capital Gains Exclusion

The capital gains exclusion in the Contract with America is similar to previous proposals that the Congress has considered. Four dominant revenue effects will follow from such a proposal: an exclusion effect, a realizations effect, a price effect, and a growth effect. Of these four, the current estimating procedures account for the exclusion and realization effects with great precision and detail, and ignore the price and growth effects altogether.

A capital gain arises when an asset is sold that has appreciated since its time of purchase, that is, when the capital gain is realized. Of the four effects, the exclusion effect is the easiest to understand and to measure. Quite simply, given a level of net capital gains realizations, a 50 percent exclusion would reduce by half the amount of realizations subject to tax.

In a given year, taxpayers own a certain body of assets which have appreciated in price. From this pool of appreciated assets they will sell a certain dollar amount on which will arise a certain dollar amount of taxable capital gains. For each taxpayer, the decision to sell an asset may be the product of many factors, one of which is the tax on capital gain that may be owed. Clearly, the higher the rate of tax the less disposed the taxpayer will be to sell a tax-bearing asset. The effect of a capital gain exclusion is to reduce the effective rate of tax, and thereby reduce the disincentive to sell the asset. Consequently, all else held equal, a capital gains exclusion will increase the rate of capital gains realizations.

Few issues in tax policy have been so thoroughly researched empirically as the change in capital gains realizations following a change in the effective tax rate. And, despite the differences in their estimates, the Treasury Department and the Joint Tax Committee actually use very similar estimates of taxpayer response so that the difference in their estimates is statistically meaningless, even though the difference in dollar terms may be quite large.

One effect that neither Treasury nor the Joint Tax Committee account for is the price effect of capital gains relief. An asset's price is determined by the discounted value of all after-tax proceeds from that asset. Clearly, for any asset inclined to increase in price, a lower capital gains tax will produce a higher asset price. Therefore, any reduction in the effective capital gains tax rate will surely produce a general increase in asset prices, thereby increasing the current pool of unrealized capital gains, thereby further increasing the dollar volume of capital gains realized in a given year and increasing the aggregate amount of capital gains tax paid.

Finally, capital gains relief is proposed because it is expected to reduce the tax disincentives to save and invest, ultimately producing stronger economic growth. While the

degree to which a given capital gains proposal will have this beneficial effect is debatable, the existence of the effect itself is not. Nevertheless, the official estimates make no effort to include even the slightest growth effect in their calculations. Moreover, this effect would manifest itself not only in terms of higher subsequent capital gains tax receipts, but also as higher receipts from virtually every tax and fee imposed by the federal government.

Even if the combination of the exclusion and realization effects reduces federal receipts as the official estimates predict, when we add in the combination of the price and growth effects, then a 50 percent exclusion of taxable gains will almost certainly produce higher federal receipts in both the short run and the long.

The Social Security Earnings Limit

The Social Security earnings limit applies to taxpayers under 70 years of age and reduces their Social Security benefits by one dollar for every three dollars they earn over a specific threshold. The earnings limit, therefore, is the economic equivalent of a 33 percent income tax surcharge on those affected. Any raising of the earnings limit threshold or the benefit loss ratio reduces the effective tax disincentive facing the elderly who wish to continue to earn labor income. Such a change would also, in the first instance, increase the federal outlays for Social Security benefits, thereby increasing the budget deficit.

Raising the earnings limit would have other, revenue increasing effects, as well, which are not included in the official estimates. For example, if an elderly individual chooses to work more following the increase in the earnings limit, he or she will be subject to payroll tax on the earnings. Thus, while the amount of benefits paid increases, so, too, does total payroll tax receipts.

Also, the General Fund of the Treasury would receive an increase in individual income tax receipts as the elderly would likely have larger amounts of income subject to income tax. In fact, the elderly are likely to pay more of a wide variety of federal levies if they choose to work longer following the raising of the earnings limit. In combination, each of these effects may not cause the increase of the Social Security earnings limit to reduce the budget deficit on net, but they certainly would reduce the amount of the deficit increase relative to the official estimates.

The congressional leadership has indicated that it will accept the methodologies of the past for purposes of scoring the Contract with America's proposals and that the bill or bills will not be permitted to increase the federal budget deficit on that basis. Since the Contract will be revenue neutral on a static basis, and since many of the tax cuts will cost the Treasury less than the official static estimates indicate, it therefore follows that the federal deficit will be lower than it otherwise would have been following the enactment of this bill.

CONCLUSION

The Congress has embarked on a program of change in the role of government. Less is now perceived to be better than more. And yet, as in most things, some means of achieving the desired results are better than others. The 5-point checklist presented earlier, and again below, may be taken as a guide to these policy decisions:

- Deficit neutrality;
- Individual tax cuts without business tax increases;
- Eschewing the tax shuffle of cutting some individuals' taxes while raising other individuals' taxes;
- Avoiding complicating tax changes; and,
- Reducing the micromanagment of the economy through the tax code.

If the Congress follows this checklist, then whatever bill is sent to the President is very likely to achieve results every American can support.

Finally, if we really believe that the American people spoke in the past election in favor of less government and more freedom, then perhaps Tax Freedom Day provides a good measure of what is or should be accomplished. Tax Freedom Day in 1994 was May 5, tying 1981 with the latest day ever. Perhaps it would be useful if the Congress were to decide how many additional days of tax freedom the American people really want. Was the recent election a call for one more day of tax freedom? Two? A week?

And then, having decided how much additional tax freedom the American taxpayer wants, that then should be the guide to how far taxes and spending need to be cut.

Mr. BUNNING. Ms. Lav.

STATEMENT OF IRIS LAV, ASSOCIATE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

Ms. LAV. Mr. Chairman, thank you for inviting me to testify this afternoon on the Contract. I am Iris Lav, the associate director of the Center on Budget and Policy Priorities, which is a nonpartisan organization that studies government spending and policies that affect low- and moderate-income Americans.

My analysis today highlights four key problems in the Contract. Three problems relate to the tax proposals. The tax proposals threaten to increase the long-term deficit. The distribution of the tax benefits are strongly skewed to upper-income families. Significant new opportunities for tax shelters would be opened. In addition, the proposals to block grant means tested entitlements create difficult new problems for States.

Starting with the tax cuts, we are particularly troubled by the long-term impact of the proposals on the Nation's deficit. By long term, I mean beyond the 5-year budget window that is traditional and even beyond 2002 when a proposed constitutional amendment for a balanced budget would take effect.

The Center's executive director recently served with Chairman Archer and others on the Bipartisan Entitlement Commission. The Commission did not reach consensus on solutions, but its diagnosis of the looming fiscal crisis is stunning and cannot be ignored. Even in the absence of tax cuts, the deficit would reach nearly 6 percent of GDP by 2010 and nearly 19 percent of GDP by 2030. The tax cut provisions would exacerbate this problem. The Contract tax cuts reach a cost of nearly $120 billion a year by 2005 and keep growing after that.

This is the same time when the continued growth in health care costs and the aging of the population together will begin to substantially increase the Federal budget deficit. Once put in place, these large and growing revenue losses will become a formidable obstacle to achieving the long-term deficit control that will be critical to the economic health of this country.

Four of the Contract's proposed tax cuts are particularly troubling. They account for most of the growth in cost. These four, the new IRAs, capital gains, depreciation, and Social Security benefits taxation grow in cost from $53 billion in their first 5 years to $317 billion dollars in the second 5 years, a six-fold increase.

Yesterday, Treasury testified on the distribution of the benefits of the tax cut. I would like to add two additional perspectives. First, the four provisions I highlighted as increasing rapidly in cost primarily benefit higher income taxpayers. However, the middle-class child credit doesn't grow much. The cost is steady. The child care credit therefore is half the total cost of the tax cuts in the first 5 years, but less than one-third in the second 5 years.

Second, the depreciation provisions will increase the aftertax profits of the very largest corporations in this country. Less than one-half of 1 percent of corporations with net assets exceeding $100 million are likely to take three-quarters of the increased deduction. This dimension of the potential for new tax shelters: For example, the depreciation and capital gains proposals adjust depreciation al-

lowances and the cost basis of assets respectively for inflation, but investors will be able to continue to deduct the full cost of interest on borrowing to purchase the assets. This will result in negative tax rates on the profits from some investments because the deductions will exceed the income subject to taxation. The excess deductions will be available to shelter other types of profits. Eventually there will be almost no tax on capital.

In considering these tax proposals, I would urge you to focus not just on the cost in the first 5 years, but on their total cost when their full effect would be felt in the second 5 years and beyond. I would urge you to be fiscally conservative with respect to these tax proposals and not to open up large revenue losses and tax-sheltering opportunities. The Nation will not be able to afford a large and growing revenue drain as it copes with the demographic and budget imperatives of the next 30 years.

A quick comment on the Personal Responsibility Act. We see a number of problems as programs such as food stamps and AFDC lose entitlement status and are converted to block grants. Block grants do not respond when the country falls into recession. That is important because after unemployment compensation, the current food stamp program is the second most important automatic stabilizer that the government has. In the last recession, the food stamp rolls rose by 5 million people. AFDC caseloads also increased. Under block grants, no additional Federal funds would be forthcoming to meet needs.

In addition, it is probably impossible to design a formula that fairly allocates funds among States and that responds to changing economic circumstances in each State. We believe welfare systems can be reformed, States can be given greater flexibility, and if you desire, spending could be cut without eliminating the entitlement status of these programs. The problems block grants entail could be avoided.

Thank you.

[The prepared statement and attachment follow:]

TESTIMONY OF IRIS LAV
Associate Director, Center on Budget and Policy Priorities
before the
House Ways and Means Committee
January 11, 1995

Mr. Chairman and members of the Committee, thank you for inviting me to testify this afternoon on the Contract with America. I am Iris Lav, Associate Director of the Center on Budget and Policy Priorities. The Center is a non-partisan, not-for-profit organization that studies government spending and the programs and public policy issues that have an impact on moderate- and low-income Americans. Our work is supported by foundations, individual contributors, and publications sales.

I will focus my remarks today primarily on the revenue proposals in the Contract with America, although I also want to raise a few issues before I close about the Contract proposals to transform major low-income entitlement programs into block grants.

Our analysis of the Contract highlights four key problems:

- the tax proposals threaten to increase the long-term deficit,
- the distribution of the tax cut benefits is strongly skewed to upper-income families,
- significant new opportunities for tax shelters are created, and
- the proposals to block grant means-tested entitlements create difficult, new problems for states.

Turning to the tax cuts, we are particularly troubled by the long-term impact of those proposals on the nation's deficit. And by long-term I mean beyond the traditional five year budget window, and even beyond the seven year period to 2002, when the Contract's proposed constitutional amendment requiring a balanced budget would take effect.

The executive director of my organization, Robert Greenstein, recently served with Chairman Archer and others on the Bi-partisan Commission on Entitlement and Tax Reform. And while the Commission was not able to come to consensus on solutions, its diagnosis of the looming fiscal crisis is stunning and cannot be ignored. In the absence of any tax cuts, the deficit would reach nearly 6 percent of GDP by 2010, nearly 12 percent of GDP by 2020, and nearly 19 percent of GDP by 2030.

As the tax cut provisions are designed, the revenue loss grows rapidly in the out-years. Four provisions in the Contract — the new IRAs, the reduction in capital gains taxation, the greatly increased depreciation allowance, and the reduction of social security benefits taxation — are particularly troubling. These four provisions were designed to have small revenue losses — or even to raise revenues — within the first five years after enactment. But the revenue losses associated with these provisions increase dramatically outside the five-year budget period.

These tax cuts would continue to drain increasing amounts of revenues in the years after the turn of the century. This is the same time when continued growth in health care costs and the aging of the population are projected to substantially increase the federal budget deficit. Those deficit increases already are noticeable in the new CBO baseline released last week. But that is just the beginning of the problem.

The Contract tax cuts reach a cost of nearly $120 billion a year by 2005 — and keep on growing after that. Once put in place, these large and growing revenue losses will become a formidable obstacle to achieving the long-term deficit control that inevitably will be critical to the economic health of this country.

I should note that the Contract authors did not pioneer the design of tax cuts whose true fiscal impacts do not emerge until after the first five years passes. Such designs have a bipartisan history ever since the 1990 budget reforms required the cost of tax cuts to be offset within the first five years. Indeed, the tax cut recently proposed by President Clinton also has backloaded revenue losses, albeit on a much smaller scale. (See graph attached.)

As I mentioned, four of the Contract's proposed tax cuts account for most of the growth in cost. These four — IRAs, capital gains, depreciation, and social security benefits taxation — grow in cost from $53 billion in their first five years to $317 billion in the second five years according to Treasury's preliminary estimates. That is a six-fold increase in cost.

I will not take the time here to describe the design features that cause these tax cuts to grow dramatically over time. I have attached to my testimony a summary report that briefly describes these issues, and we have a more detailed report available for anyone who would like it.

I would, however, like to make a couple of points about the distribution of the benefits of these tax cuts, and about the strong potential they open up for creating new types of tax shelters.

I know you heard yesterday the data from the Treasury Department on the distribution of the benefits of the tax cut package. About half of the benefits would go to the ten percent of families with incomes exceeding $100,000 and nearly 30 percent of the benefits under the Contract's tax plan go to the two percent of families with incomes over $200,000. I'd like to add two additional perspectives to that.

First, the same four provisions that increase rapidly in cost also are the four major provisions in the Contract that benefit higher-income taxpayers. However, the tax credit for children — the major provision in the Contract that would benefit middle-class households — would remain relatively constant in cost over time. As the cost of the other tax cuts grow, the tax credit for children declines from over half of the total cost of the tax cuts in the first five years to less than one-third of the total cost of the tax package in the second five years.

Second, while the Treasury income distribution attributes the cost of corporate tax cuts to the owners of capital (who ultimately benefit from such cuts), it also is useful to look at which corporations are likely to benefit from the extremely costly depreciation provision in the form of increased after-tax profits. The benefits are likely to be distributed similarly to depreciation deductions under current law. And under the current law, the vast majority of depreciation deductions are taken by very large corporations. Approximately three-quarters of depreciation deductions are taken by the less than one-half of one percent of corporations with net assets exceeding $100 million. This is not a proposal that primarily benefits small- and medium-size businesses.

I cannot leave the subject of the Contract tax cuts without a mention of the potential for new tax shelters. Among other problems, the depreciation and capital gains proposals adjust depreciation and the cost basis of assets, respectively, for inflation. At the same time, investors will be able to continue to deduct the full cost of interest on borrowing to purchase assets. This will result in a negative rate of tax on the profits from some investments, because deductions will exceed the income subject

to taxation. The excess deductions will be available to shelter other types of profits. (See example in box in attached report: *Tax Proposals in the Contract with America: Assessing the Long-Term Impact.*)

To summarize, in considering these tax proposals, I would urge you to focus not just on the costs in the first five years, but on their total cost when their full effect would be felt in the second five years and beyond. I would urge you to be fiscally conservative with respect to these tax proposals, and not to open up large revenue losses and tax sheltering opportunities. The nation will ill be able to afford a large and growing revenue drain as it copes with the demographic and budget imperatives of the next 30 years.

Finally, I would like to turn briefly to the proposals in the Contract's Personal Responsibility Act to block grant means-tested entitlement programs. I should note that Bob Greenstein will be testifying specifically on these proposals Friday before the Human Resources Subcommittee. I would just like to highlight a few problems we see if programs such as food stamps and AFDC lose their entitlement status and are converted to block grants.

First, a block grant would not respond to the increases in need that states face during recessions. Under the current financial structure for AFDC and food stamps, increased federal matching funds for AFDC — and an increase in 100 percent federally funded food stamp benefits — automatically flow into a state when recession hits and more families apply for aid. After unemployment compensation, the food stamp program is the second most important automatic stabilizer in the federal government's recession-fighting arsenal.

The recent recession provides an example. Between June 1990 and June 1992, as the national unemployment rate jumped from 5.1 percent to 7.7 percent, the number of people receiving food stamps rose by more than five million. But under a block grant, this provision of additional federal resources during recessions would end. A fixed amount would be provided to a state at the start of a year. If unemployment subsequently rose, the state would have to bear 100 percent of any additional cash and food assistance costs itself.

We believe this would pose serious problems for states. State revenues shrink during economic downturns, and many state programs are cut. Under a welfare block grant structure, states would be forced to choose between raising taxes (or cutting other programs more deeply in recessions) to address the mounting needs for low-income assistance or instituting across-the-board benefit cuts, making some categories of needy families and children ineligible for the rest of the year, or placing poor families that recently lost their jobs on waiting lists for aid.

If states responded by instituting waiting lists, two-parent families could be significantly affected. The subpopulation whose participation in AFDC rises most sharply in recessions is two-parent families.

It is probable that the loss of the automatic increase in federal funding during a recession would make recessions somewhat deeper and more protracted, weakening the national and state economies. The food stamp and AFDC programs function as what economists call "automatic stabilizers" — federal programs that moderate economic downturns by infusing more purchasing power into state and local economies when recession sets in. Under a block grant structure, the automatic stabilizer role played by these programs would be lost.

These problems are aggravated by another shortcoming of a block grant structure — it would badly misallocate funds among states. Any formula that could be used to allocate block grant funds among states would be based on data for a year in

the past; the formula would not be able to reflect economic and demographic changes since that time. States whose economies had grown robustly since the year in which the data were collected would receive more funds than warranted, while states where economic conditions had deteriorated would receive too little.

Of particular concern is the fact that during a recession, the hardest-hit states would likely be subject to a "triple whammy." First, there would be insufficient federal funds nationally, since the federal funding level would not automatically rise with a recession. Second, the allocation formula would not recognize the depth of the downturn in states that had been hit hard. Finally, the states hit hardest by the recession would generally face large declines in state revenues and be among the states least able to provide state funds to respond to the additional need the downturn had created.

It should be noted that once these programs lose their entitlement status and are converted to block grants, there will be no turning back, despite whatever problems may ensue. Given the federal government's fiscal problems, it would be extremely unlikely to regain entitlement status for such programs for years to come.

There are strong calls from many quarters for flexibility in designing and operating low-income assistance programs; they merit careful attention. However, it is not necessary to go to block grants to give states flexibility. Nor is it necessary to go to block grants to reduce spending on such programs, if that is what Congress wants to do. Welfare systems can be reformed and states can be given flexibility without eliminating the entitlement status of these programs, thereby avoiding the problems block grants entail.

January 11, 1995

Attachment

TAX PROPOSALS IN THE *CONTRACT WITH AMERICA*: ASSESSING THE LONG-TERM IMPACT

By Iris Lav, Cindy Mann, and Pauline Abernathy

Overview

A number of federal tax and budget changes are proposed in the *Contract with America*, that Speaker Newt Gingrich has vowed to try to move through Congress early in 1995. Among other proposals, the Contract calls for changes that would reduce revenues by $205 billion over the next five years.[1]

The revenue losses from the Contract tax proposals would mushroom after the initial five-year period, totaling $725 billion over the next ten years. The growth in cost is largely attributable to proposals for a new type of Individual Retirement Account, reductions in the rate of taxation of capital gains income for individuals and corporations, a reduction in taxes for businesses that invest in buildings, machinery, and equipment, and a reduction in the extent to which Social Security income is taxable for higher-income taxpayers. All four of these provisions were designed to have minimal costs or even to raise revenues within the first five years, with revenue losses dramatically increasing outside the five-year budget period.

In addition, these four proposals all heavily benefit upper-income households and large corporations. The Contract includes a new tax credit for children that benefits middle class families, as well. But the tax credit for children accounts for less than one-third of total cost of the tax package in the second five years after enactment, when the costs of tax benefits for wealthy individuals and corporations explode.

A Treasury Department analysis of the distribution of the benefits of the total package shows that more than half of the benefits from the Contract's tax cuts go to the top ten percent of U.S. families, those with incomes over $100,000 a year. Nearly 30 percent of the benefits under the Contract's tax plan go to the two percent of families with incomes over $200,000.

There are a number of key issues with respect to the long-term impact of the tax proposals in the Contract with America and the interaction of these tax proposals with the Contract's call for a constitutional amendment requiring a federal balanced budget.

The revenue loss under the plan would rise dramatically after five years. The plan was presented as losing slightly over $190 billion in revenue over the next five years, itself a substantial amount. But a Treasury Department analysis finds that the Contract tax provisions would lose $205 billion in the first five years rising to $520 billion in the second five-year period after enactment — bringing the total revenue loss to $725 billion over the next ten years.

Most of the growth in revenue loss over time is attributable to four provisions. The IRA, capital gains, business depreciation, and social security provisions are designed so they lose smaller amounts or even *raise* revenue over the next five years — and then lose much larger amounts of revenue after the five-year budget period ends.

---

[1] Revenue numbers are from the Treasury Department preliminary analysis of the Contract as introduced as legislation, January 10, 1995.

IRAs

The Contract would create a new, more generous type of Individual Retirement Account tax break — called an "American Dream Savings Account" — that would be available to taxpayers at all income levels. Upper-income taxpayers covered by private pension plans who lost eligibility for traditional IRA tax breaks in the Tax Reform Act of 1986 would be able to take advantage of this new tax benefit.

- According to Contract sponsors, the IRA proposal raises $5 billion over the next five years. Short-term revenue gains would come from incentives for holders of current-law IRAs to pay taxes on those holdings now, rather than at retirement, and roll over the funds to the new, more generous and more flexible IRAs.

- After the rollover window expires, however, the revenue losses mount. In the second five years, this proposal would lose nearly $18 billion, according to the Treasury Department. Past analyses of similar proposals indicate that losses would continue to mount even after the second five-year period and could eventually be as high as $10 billion per year.

Capital Gains

The Contract would reduce the taxation of capital gains income — profits from the sales of assets such as stocks, bonds, and buildings — in two ways. Taxpayers could exclude from taxation the portion of profits that is attributable to inflation. In addition, half of the inflation-adjusted profits would be excluded from taxation.

- The Contract puts the cost of the capital gains proposal at $56 billion over its first five years. In the years immediately after implementation, revenues are assumed to be boosted by an increase in asset sales as investors rush to take advantage of the new provisions.

- Over time, however, asset sales level off and the cost of inflation indexing increases. The Joint Committee on Taxation has estimated that the cost of such a provision in the second five-year period after enactment would exceed $160 billion; the Treasury Department places the cost in the second five years at $122 billion.

Depreciation

The Contract also proposes some complex changes in depreciation allowances. Depreciation is the way that businesses account for the use of capital investments such as buildings, machinery, and equipment in the production of business income. Since these items typically are used for a number of years, businesses deduct a portion of their cost from taxable income each year over a specified period of years. Under current law, total depreciation deductions over the life of the asset are limited to the original value of the asset. Under the Contract proposal — the "Neutral Cost Recovery System" — businesses could deduct amounts over the useful life of an investment that exceed the original value of the asset.

For example, a business purchasing a piece of equipment for $100,000 could deduct $135,000 over the 10-year life of the equipment, rather than the $100,000 permitted under current law.[2] These changes are extremely costly.

---

[2] The higher depreciation over the life of an asset is the result of indexing the value of the depreciation deduction for inflation and, for assets with a depreciable life of less than 10 years, allowing an

(continued...)

- The Contract lists the depreciation proposal as *raising* $20 billion over the first five years and Tresury estimates it raises $18 billion in that period. The proposal is turned into a revenue gainer for this initial five-year period by decreasing, in the first few years, depreciation allowances for equipment that turns over frequently, such as computers and vehicles.

- Depreciation for longer-lived assets is made much more generous, however, and the long-term costs of this proposal are large. The Treasury estimates the depreciation provision as proposed last September would lose more than $180 billion in the second five years. The provision was modified when the Contract was introduced as legislation in January, but the revenue loss from the revised depreciation provision is still $139 billion in the second five years.

Social Security

Another provision in the Contract would repeal the 1993 change in taxation of Social Security benefits of higher-income beneficiaries. In 1993, Congress increased the percentage of Social Security benefits subject to taxation from 50 percent to 85 percent for single taxpayers with annual incomes above $34,000 and for married couples with annual incomes above $44,000.

- The provision lowering the proportion of Social Security benefits subject to taxation for higher-income beneficiaries would be phased in so that its full revenue-losing effects are delayed. The Treasury analysis shows its losses would rise from $15 billion in the first five years to $33.5 billion in the second five years.

Just these four proposals in the Contract, which have a net cost of approximately $53 billion in their first five years, would have a combined cost in the second five-year period of about $317 billion — more than six times the initial cost. These four provisions are the major reason the cost of the Contract tax provisions grow so fast, from $205 billion in the first five years to $520 billion in the second five years.

The four provisions with escalating revenue losses primarily benefit upper-income taxpayers and large corporations. The changes in IRAs, capital gains taxation, and the taxation of Social Security income would primarily benefit those at higher income levels. The vast majority of the revenue loss from the change in depreciation would result from a tax reduction for the nation's largest corporations.

- Past analyses indicate about 95 percent of the benefits from the IRA proposal would accrue to the top fifth of the population.

- According to analysis by the Joint Tax Committee, almost half of the benefits from the capital gains provisions would go to the wealthiest one percent of the population.

- The reduction in the proportion of Social Security benefits that are subject to taxation would give a tax break to the top 13 percent of beneficiaries.

- Under the current law, the vast majority of depreciation deductions are taken by very large corporations. Approximately three-quarters of depreciation deductions are taken by the less than one-half of one percent

---

[2] (...continued)
additional adjustment in excess of inflation. These calculations were made assuming a modest three percent rate of inflation. If inflation were higher, the depreciation over the life of the asset would be greater.

CAPITAL GAINS PROVISION IN *CONTRACT* COULD CREATE TAX SHELTERS

Under the capital gains proposal in the Contract with America, the taxation of capital gains income — profits from the sales of assets such as stocks, bonds, and buildings — is reduced in two ways. Taxpayers exclude from taxation the portion of profits that is attributable to inflation. In addition, half of the inflation-adjusted profits are excluded from taxation.

At the same time, large investors who borrow to make investments would still enjoy a tax deduction for the full amount of their interest on their borrowing. The borrowing costs (interest deduction) would not be adjusted for inflation.

As a result, many investors would be able to deduct from their taxes amounts that *exceeded* their profits. The excess deductions could become a tax shelter for other types of income.

Example:

An investor borrows $100,000 to be repaid over ten years at an 8 percent rate of interest. The borrower uses the funds to buy $100,000 worth of stock. Interest payments over the lifetime of the loan are $45,000 and are deducted from taxable income as incurred.[1]

Over the 10 years, the stock grows in value to $179,100. Under current law, $79,100 would be taxable as a capital gain. Under the Contract, only $22,350 of that $79,100 capital gain will be subject to taxation (assuming a modest three percent inflation rate).

Since the $45,000 of interest the investor deducted over the life of the loan far exceeds the $22,350 capital gain subject to tax, the investor has been able to use the remaining $22,650 to offset — or shelter — other income. The investor essentially has a negative rate of tax on the investment made with borrowed funds. Because of the unbalanced treatment of borrowing and investments, the investor not only would never pay any tax on the profit but could use the excess interest deductions to reduce taxes owed on other income.

---

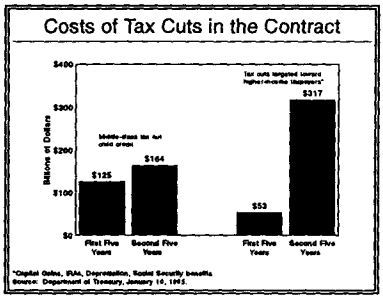
[1] Unlike consumer interest, which is not deductible, interest used to make investments may be deducted from taxable income so long as it does not exceed the amount of investment income reported in the year. If the investment in the example were the only investment the taxpayer had, then the interest on the loan would not be deductible each year because there would be no reported investment income until the stock was sold. By contrast, if the taxpayer had investment income each year from a large portfolio of investments, he or she likely would have sufficient investment income to deduct the yearly investment interest.

of corporations with net assets exceeding $100 million. The benefits of the increased depreciation deductions under the Contract proposal are likely to be similarly distributed.

The Contract's proposed tax cuts break the *quid pro quo* of the Tax Reform Act of 1986. The Tax Reform Act of 1986 sharply lowered income tax rates on wealthy individuals and corporations in return for scaling back the tax breaks provided for such things as capital gains, IRAs, and depreciation. Under the Contract, the tax rates faced by those in the top brackets would remain far below the rates such taxpayers encountered prior to the 1986 Act. But capital gains, IRAs, and depreciation tax breaks would not only be restored but would be made more generous than they were before 1986. The result would be windfalls for wealthy investors and large corporations.

The middle-class tax cut in the Contract dwindles in importance as upper-income tax cuts phase in. The cost of the major provision in the Contract that would benefit middle-class households, a tax credit for children, would remain relatively constant over time. It would cost approximately $124 billion over the first five years and modestly more than that in subsequent five-year periods. As the cost of the other tax cuts grow over time, the tax credit for children declines from over half of the total cost of the tax cuts in the first five years to less than one-third of the total cost of the tax cut package in the second five years.

The revenue proposals would jeopardize further progress on deficit reduction. The deficit has been halved as a share of the Gross Domestic Product since 1992, but the proposals in the Contract would put further progress in question. Over the next five years, large potential budget savings would have to be devoted to paying for tax cuts rather than continuing to make progress on deficit reduction. After five years, when the revenue losses would escalate, much larger cuts would be needed to keep the tax cuts from increasing the deficit.



When coupled with a requirement for a federal balanced budget, the tax cuts in the Contract virtually insure that programs on which the middle class relies — as well as programs that assist the poor — will have to be cut deeply. The fiscal strategy of the new Congressional majority calls for the establishment of a constitutional requirement for a balanced federal budget each year, starting in fiscal year 2002. The strategy also includes efforts to protect defense and Social Security from budget reductions and make it difficult to raise taxes in the future. To reach a balanced budget in 2002 under these conditions while offsetting the tax cuts proposed in the Contract would require all federal expenditures other than Social Security and defense (and the required interest on the national debt) to be cut nearly 30 percent compared to spending projected under current law for fiscal year 2002. In the years after 2002, the required reductions would grow still deeper. This suggests that major benefit programs such as Medicare, Medicaid, and student loans could be subject to substantial reductions and that federal support to states and localities for services such as education and transportation would be sharply scaled back.

The cost of the cut in the taxation of Social Security payments could be borne by elderly and disabled Medicare beneficiaries. The Medicare hospital insurance trust fund is out of long-term balance. The Medicare actuaries project that without changes to reduce Medicare costs or increase the revenues flowing into the trust fund, the Medicare hospital insurance trust fund will be insolvent by 2001. Yet the Contract would lower the taxes that are now deposited in the Medicare trust fund. The Contract proposes to cut the taxes of higher-income Social Security beneficiaries through lowering the proportion of their Social Security benefits that are subject to taxation; the revenues lost as a result of this proposal are now deposited into the Medicare trust fund. By withdrawing these revenues from the trust fund, the Contract would push Medicare further out of balance and require larger Medicare reductions or tax increases to avert insolvency.

High-income households would be the only clear winners under the Contract tax cuts. Several of the major revenue proposals — including the changes in IRAs, capital gains taxation, and the taxation of Social Security income — would primarily benefit those at higher income levels. Overall, the Treasury Department analysis found

that about one-half of the tax cuts proposed in the Contract with America would go to the ten percent of families with incomes over $100,000. Nearly 30 percent of the benefits under the plan go to the two percent of families with incomes over $200,000.

Middle-income families would benefit significantly from the $500 per child tax credit, but whether middle-income families are better off in the long-run would depend on how the costs of the various tax cuts are financed. This is especially true in years after the five-year budget period ends, when the costs of the tax cuts primarily benefitting upper-income households and corporations begin to mushroom. If financing the tax cuts required sharp cuts in programs from which middle-income families derive substantial benefits or shifted costs to states and localities that had to raise taxes to accommodate those costs, significant numbers of middle-income families might find their disposable incomes reduced as a result of the offsetting actions.

Low-income households are the clear losers. They would gain little from the tax proposals. And the Contract's authors shied away from endorsing specific budget cuts before the election in most areas except one — programs targeted on the poor. Virtually all of the budget savings proposed in the Contract consist of reductions in basic food, cash, housing, medical, child care and other benefits for poor families and individuals. Low-income households would likely also be affected by other cuts that would ultimately have to be made.

Mr. BUNNING. Thank you very much.

Mr. Gibbons.

Mr. GIBBONS. I am worried about the timing of all the things that we are considering here. We have some very complex tax legislation before us and the only reason it is before us is because it is in the so-called Contract With America.

It seems to me that really the complexity of it and the size of it, $725 billion revenue loss over 10 years and growing very rapidly after that, should require Congress not to give it just the kind of cursory examination that we are doing here, but deliberate a long time about it.

What worries me further is that, as I look at the economy, we have got an economy that is heating up at a very rapid rate. The Federal Reserve is concerned about it and they have increased interest rates rather substantially in the last year, and I am worried that perhaps they are, if they watch us, they may increase interest rates even at an accelerated pace because we are at full de facto employment. We are at full capacity in our industrial production, and we have a huge budget deficit as well—and that is the perfect formula for another bout of inflation, and to talk about substantial tax cuts before we face the reality of inflation seems to me to be almost foolhardy.

I am not taking any position against any of the tax cuts per se, but worrying about inflation—am I on the right track? Should we really be talking about these drastic tax changes in the first 100 days or should we keep our eye on inflation?

Ms. LAV. I think that inflation is an important thing to keep an eye on, I think, because the economy is quite healthy now. The deficit has been cut in half as a percent of GDP in the last 3 years, and I think this is the time when we have to worry.

The new CBO forecast shows in 2002 and 2003 and 2004 an upturn in the cost of particularly health care programs that are focused on the elderly, Medicare, and Medicaid, which has a substantial nursing home care for the elderly, the problem of cost increase, and the aging population together with health care costs are our major problems.

So we should take advantage of the healthy economy now and continue to pull down the deficit and worry about those long-term problems rather than enact tax cuts that will make the long-term problem worse.

Mr. BECKNER. I would respond by saying that for sustained long-term economic growth, I think the tax cuts would be very important. The American taxpayer is overburdened. The tax burden is at a historical high, as Dr. Foster pointed out, and the economy is doing well today, but what about 1 year from now? What about 2 years from now.

Mr. GIBBONS. We are going to be in a rapid inflation is the way I read it.

Mr. BECKNER. My understanding of inflation is it has a lot more to do with what the Federal Reserve is doing with the money supply than it does with tax and spending policy. I feel that over the long term reducing the rate of taxation and rate of government expenditures will have a long-term positive effect on economic growth and will not have an impact on inflation one way or the other.

Mr. GIBBONS. Do you think Dr. Greenspan would agree with that?

Mr. BECKNER. I don't know.

Mr. GIBBONS. I can tell you I don't think he would. He has been there at that table a number of times and I believe he has cautioned against actions such as we are about to take.

Mr. KEATING. Certainly you can make his job more difficult by increasing the deficit. It certainly increases the temptation to monetize it. I would agree that inflation is very important. It is very important for many reasons, one of which is you can't have a free market economy if people can't know or have good reason to believe what the value of the money will be 5 or 10 years down the road. You can't make sound investment decisions.

Inflation also plays havoc with the Tax Code. We heard earlier how savings and investment, depreciation schedules, capital gains and the like all have very large distortions caused by inflation. Inflation is also a form of hidden tax on people who are retired who are on fixed incomes.

Many corporate pension plans pay out a fixed amount, and are not indexed for inflation. Inflation is a tax on people who are least able to pay. So I think it is very important to keep your eye on inflation. That is one reason why passage in this Congress of a balanced budget amendment to the Constitution and ratification by the States would really hold Congress' feet to the fire, and help keep the budget under control. Spending should not exceed revenues. This amendment would be an important complement to any policy changes made by this Congress.

Mr. FOSTER. Yes, sir, as usual, you have put your finger on the serious problem. If we go through the tax cutting exercise and violate point one on our checklist, that it should be done in a neutral manner accepting the scoring methodologies that we are currently employing, then as long as it is done in a deficit-neutral manner then we will be all right. The consequence of cutting taxes and spending simultaneously by like amounts is to free resources up to the private sector that are currently being used by the public sector.

Furthermore, again, not all tax cuts are created equal. If we enact tax cuts which expand the ability of the economy to produce, which increases the amount of private saving available for investment, increases the amount of investment and capital available to the labor force, increases the labor participation rates so that more people are inclined to enter the labor force, you then have a series of tax cuts which can expand the ability of the economy to grow without having an inflationary consequence. In fact, you will have a deflationary consequence because, by having tax cuts and spending cuts simultaneously in like amounts, you have increased the resource base, and the tax cut means that the economy employs those most efficiently. I would argue that that is a deflationary program.

Ms. LAV. I think that we have to be careful of the context here. We are not just talking about tax cuts. We are talking about a balanced budget amendment. If you enact these tax cuts and a balanced budget amendment by the year 2002, you have to cut nearly 30 percent of all spending other than defense and Social Security, assuming that those are off the table. That means that lots of costs

are going to be pushed onto State and local governments. They represent about a third of what is left when you take Social Security and defense off the table. They cannot accommodate those costs unless they raise their own taxes, so that probably will push your tax. Since those State and local taxes fall more on moderate- and low-income people, that will push the Tax Freedom Day forward and not backward.

Also it is impossible to cut that much out of the Federal budget without imposing significant—Medicare is such a large part of it, there is likely to be significant cost shifting and that will cut into people's incomes. So I think you have to look at total effects and not just say that yes, you might be able to pay for the tax cuts, but then how are you going to pay for a balanced budget, and how are you going to put a downpayment on these demographic problems that are coming.

Mr. GIBBONS. Thank you.

Mr. BUNNING. Mr. Hancock.

Mr. HANCOCK. No questions.

Mr. BUNNING. Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman. Let me ask all the panelists whether or not your group is not-for-profit and what is the major funding source of your organization?

Mr. KEATING. Our group is a nonprofit, incorporated under 501(c)(4) of the Internal Revenue Code. Our funding sources are from our 250,000 members. Our average donation is $20.

Mr. KLECZKA. Do you also have corporate sponsors?

Mr. KEATING. We have corporate sponsors, but unfortunately very few.

Mr. BECKNER. Our foundation is supported by our individual members, by foundation support, and by the business community.

Ms. LAV. The Center on Budget and Policy Priorities is a 501(c)(3) nonprofit organization supported over 90 percent by foundation grants with small amounts from our publication sales and individual contributors.

Mr. FOSTER. The Tax Foundation is 501(c)(3). We are a nonprofit organization and one stridently nonpartisan, as I think the ranking member could attest. Our support comes from foundations, corporations, and individuals.

Mr. KLECZKA. I just wanted to be nosey, but it also gives me a background as to your views. Ms. Lav, in your testimony you indicate that if we go through with some of the changes that have been suggested, that we could possibly be setting up a tax shelter.

I wish you could brief the committee in more detail on that. I do think when we talk about the neutral cost recovery system, there is definitely the potential there for tax shelters. I would be interested to hear your views on capital gains also.

Ms. LAV. The problem with indexing capital gains, and I should say even without indexing, just the exclusion would bring us to the lowest rate of capital gains taxation since 1954, and indexing would be on top of that.

One of the problems with indexes for inflation is that the rest of the tax system isn't indexed. The brackets are, but wealthy investors typically borrow to make investments. Lots of people make in-

vestments with borrowed funds; not the small investors, but people who make a business of investing.

When you have investment interest, interest for investment purposes, that is fully deductible as an expense from your taxes. It is not a part of the interest that exceeds the rate of inflation; it is the whole thing. So if an investor borrows $100,000 to be repaid over 10 years at an 8 percent rate of interest and uses the $100,000 to buy an asset, the interest payments over the lifetime are $45,000, and assuming there is enough other investment income, they can be deducted from taxable income as they are incurred. After 10 years, the asset grows in value to $179,000. The $179,000 would be taxable under current law as a capital gain, but under the Contract, only $22,000 would be taxable, approximately.

So $45,000 of investment interest would already have been deducted. There is only $22,000 of capital gains subject to tax, so there is another $22,000 to shelter other income of deductions. Essentially you are throwing off more deductions by borrowing to invest than is the amount of your profit that is going to be subject to tax. In this way, eventually probably, coupled with other tax-sheltering opportunities, for example, matching losses that are created by the fact that you are indexing with other gains plus the fact that you have additional interest deductions, you essentially would get around to pretty much eliminating tax.

Mr. KLECZKA. Mr. Keating was shaking his head.

Mr. KEATING. I wanted to make one thing clear. The rules for deducting investment interest include a provision that you cannot deduct investment interest unless you have some investment income, so it is not completely deductible under current law.

There may well be some sheltering opportunities. The way to shut them down is not by refusing to index capital gains, but to reduce the deductibility of investment interest so you are not deducting more investment interest than you are getting in investment income total.

Ms. LAV. That is one of the sheltering. Actually you can carry forward the investment interest with a large investment.

Mr. KLECZKA. Thank you, Mr. Chairman.

Mr. BUNNING. Mr. Ramstad will inquire.

Mr. RAMSTAD. I appreciate the ideological diversity and the different perspectives that this panel brings today. It is refreshing to have such pluralism represented on a panel.

The leadoff witness explained to us a fact that I think everyone understands. The average family spends more on taxes per year than for food, clothing, and shelter combined; 30 years ago, put another way, the average middle-income family spent 3 percent of its income in taxes. Today, three decades later, that average family is spending 24 percent of its income in taxes.

Given those facts, which are just that, factual and not disputable, Ms. Lav, do you think that is what the American people want? You were very critical of our Contract's policy to reduce this burden of taxation and correspondingly, government spending.

Do you really think the American people want to continue spending more on taxes than they do on food, shelter, and clothing combined?

Ms. LAV. I think it is perfectly appropriate for Congress to look very carefully at all the spending the Federal Government does, and it is perfectly appropriate to try and reduce the burden and probably should reduce the burden by looking at whatever spending you think is not appropriate.

What I am saying is not appropriate is to sort of just cut the taxes and take the risk of increasing the long-term deficit when we know we have these problems coming that can not be avoided. What also is not appropriate is to shift the burden of who collects the taxes to State and local government because that won't do low- and moderate-income families much good.

I think that if there are ways to make government more efficient, if there is a decision that government should not perform some functions, that is an appropriate way to reduce taxes. But I think that you shouldn't put the cart before the horse, basically.

Mr. RAMSTAD. So as long as we make real spending cuts and not just play the shell game that has been played for too long, if we make real spending cuts and make them first to lay the foundation for the tax cuts, then you find that acceptable?

Ms. LAV. I would not agree with the particular tax cuts, particularly the capital gains and depreciation tax cuts in the Contract because I think those would ultimately increase the burden on low- and moderate-income households.

Mr. RAMSTAD. The other question concerns personal savings. I think everyone understands that we in America have the lowest personal rate of saving of any of the G–7 nations. A Harvard economist concluded recently that were we to put all our savings into plant and equipment, we could not sustain economic growth. That fact should be alarming to anyone who understands economics.

Yesterday the distinguished minority leader said he does not believe that tax policy can necessarily induce desired economic behavior. He really dismissed the idea of tax policy that would encourage personal savings. I would like to ask any of the witnesses, Mr. Beckner or Dr. Foster, Mr. Keating, since I asked Ms. Lav the last question, you three are fair game for this one, do you agree with the minority leader's assessment and, if not, what tax policies do you believe would promote personal savings?

Mr. KEATING. It is not so much that it encourages it. It probably never will as long as we have a tax system. The question is: How much are the disincentives on people that save for the future? If you look at the Tax Code, it is almost a miracle that anyone ever does save for the future. After taxes and inflation, it is very difficult, especially for the average person, to generate a positive rate of return over any period of time.

Now, entitlement programs provide more and more safety nets. Between the safety net on the one side and the tax penalties on the other side, it is a miracle that anyone saves, and the answer is, very few do.

As the Entitlement Commission showed, and as a recent report by our affiliated foundation showed, the benefits that are promised under current law—without adding any more entitlements—would require tax rates of anywhere from 57 to 69 percent by the year 2040.

The tax rates required to pay for these promised benefits are so large that even though the government projects incomes to increase over the next 45 years, our calculations show that after taxes people will likely only make $125 more on average than they do today. So we have to get those programs under control or we will be overwhelmed with either deficits, taxes, or both.

Mr. RAMSTAD. Thank you, Mr. Chairman and Mr. Keating.

Mr. BUNNING. Mr. Zimmer.

Mr. ZIMMER. Thank you. Ms. Lav, I would like to pursue your analysis of the, what you call the tax shelters that would be available under capital gains. As Mr. Keating pointed out, your gripe may be with the tax deduction that is available for interest payments.

Do you believe that the cost of interest is a legitimate business expense or not?

Ms. LAV. You know, I don't have a strong belief one way or another. There may be circumstances when it is. If one wanted to say that you couldn't deduct interest, that should be pretty much across the board so there wouldn't be distortions.

I think that the tax system shouldn't create distortions among different types of investments. I think they should be viewed on their own merit. I think either it is or it isn't deductible, but you wouldn't want to make it not deductible for capital gains, but definitely deductible for other kinds of business activities because that would cause a variety of distortions.

Mr. ZIMMER. Then since you are not prepared to attack the deductibility of interest, let's take the other half of your model, which is a proposal to allow the investor to disregard the portion of the capital gain that is attributable solely to inflation. Do you believe that it is fair to tax somebody on a nominal gain that doesn't reflect a real increase in value, but only reflects the decrease in the value of the dollar?

Ms. LAV. I think the way our whole tax system is set up, you could go to a tax system where every single thing was indexed and maybe you could find a way to tax people only on their real increase in wages and not the part of their wage increase that represented inflation.

We index the brackets, but that doesn't come to that—do the same thing. We don't have that system, and I think when you start taking pieces out of it and indexing it, you have a major problem. So yes, under the current system, it makes sense to tax people on their nominal gain. They are paying the taxes out of their nominal income.

Mr. ZIMMER. But if I paid $10,000 for an investment and I sold it for $20,000 and in the interim the cost of living has gone up 100 percent, where is my income? Where is my real income? Where have I increased the value of what I originally invested, and why should the Federal Government assume that I have made a killing of some sort? And why should your organization assume I am in some kind of tax shelter?

Ms. LAV. The shelter I referred to was the imbalance. You are sort of picking a piece out of the tax system and saying we tax all other kinds of nominal income, we are taxing nominal wage income, we are taxing nominal interest on saving——

Mr. ZIMMER. Every dollar that I get today is being taxed today at current rates, and on the current value of the dollar.

Ms. LAV. You make your profit today too.

Mr. ZIMMER. But I haven't made a profit. Explain to me why I have made a profit if the value of my investment——

Ms. LAV. Because today, the amount of money if you have invested $10,000 and you get $20,000, you have $20,000 in your hands today. That is value and you are going to get to keep a portion of it and a portion of it will be taxed away. It is not just the interest imbalance. There are other tax shelters that will be set up by that.

If somebody has a closely held business and makes profits, they are going to want to retain those profits and perhaps try and sell the business as a capital gain. There used to be collapsible corporations that people used when there was tax sheltering. So you set up all kinds of problems and they will give the lawyers and accountants a field day.

Mr. FOSTER. I am certainly no fan of tax shelters. That would fall under the heading of micromanaging the economy, which we don't favor, but if you take every opportunity in the Tax Code to wipe out a tax shelter, we might wind up living in huts.

The fact is the capital gains tax has an unfortunate effect on the economy. Capital gains indexing—this may be a very unique experience for me. I have never heard anyone attempt to make a solid argument against capital gains indexing.

The taxational, inflationary gains are grossly unfair.

The tax system is, in fact, tremendously indexed already. It is not just the brackets, it is personal exemptions and standard deductions. Our depreciation system, while complicated, is intended to come up with a simplified way of indexing depreciation for inflation. That is why we have a 200 or 150 percent declining balance system, as a shorthand, easy to work proxy for indexing for inflation.

Indexing matters because we have activities that occur in certain years that become taxable events in subsequent years. For most of what we do, wages and so forth, it is automatically indexed. You pay tax on wages the year that they are earned. So the entire system is tremendously indexed automatically, and where it is not, we have made provision to index it. Capital gains, other than the estate exemption, is one of the few areas where you don't either explicitly or implicitly already have indexing. Capital gains indexing would certainly remedy this.

It is possible that 10 years from now when we have passed these tax cuts, whichever ones we do pass, that they will all have been repealed again through two or three tax reforms in the intervening years. One thing we can be sure of is if you pass capital gains indexing now, there is a very high probability it will be law 10 years from now.

Mr. BUNNING. The gentleman's time has expired.

Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. I thank all of you for being here today. Your testimony is very helpful. I was intrigued, Dr. Foster, with reading over your statement. I am sorry I wasn't here to hear it. I read it and with regard to long-term tax reform

and the system, I think, all of the criteria which you set forth, I would agree with probably most members of this committee.

You talked about the need for long-term tax reform to simplify the system to take some of the complexity out of it and to make economic decisionmaking real rather than tax decisionmaking. But you say that it is your feeling that a capital gains differential or indexing, would be consistent in your view with any long-term reform of the code.

Why do you say that? What is your basis for that statement?

Mr. FOSTER. I will break the two pieces out. Because in general we have been moving to an increasingly indexed tax system, and I think capital gains indexing is appropriate for many reasons.

Looking at the exclusion itself, if you examine the kinds of tax reform plans that are on the table, the major plans more fully thought through, and up until I think yesterday we had two that fit that description, the majority leader's flat tax plan and the Nunn-Domenici plan, both plans emphasize reducing or eliminating the multiple taxation of saving. That means, in both those plans, you are not taxing capital gains at all. So a 50-percent exclusion is halfway there to where we would be if we pass these tax reforms.

I am not arguing in favor of either or any reform plan, but that is just what they say. So anything that moves us in the direction of reducing the taxation on saving would then be consistent with those kinds of tax reform efforts, and I assume that those are the starting points, wherever we end up with the evolution of the tax reform debate.

Mr. PORTMAN. Would you include the IRA provisions in that?

Mr. FOSTER. Yes. The only caveat that I would add, and this is from personal experience shared by almost everyone who used the IRAs in the early eighties, if we have this sort of an expanded IRA system now and then 3 or 4 years from now we go through a tax reform that has a more vastly expanded IRA, you have to be careful that people who put their money into the IRA next year or this year because of what we do this year are not locked into that arrangement, that they can roll their investment into the new IRA.

For example, if you put money in an IRA in the early eighties, you are locked in. There isn't much you can do with that money. I hope if we do expand the IRA in the next year or two that we allow people who saved in the early eighties to roll that money into these new accounts and not keep these funds sequestered. That is a very inefficient way of investing. But no question, an expanded IRA, since it reduces the taxation of saving, moves us down the road consistent with that kind of tax reform.

Mr. PORTMAN. Let me ask a general question. How would you put deficit reduction along the spectrum in terms of increasing savings and investment in this country? Our savings rate is at the bottom of the G–7. I think that is generally a consensus among economists. Deficit reduction has been discussed today by Dr. Bosworth and others as a solution to that problem, and then we have the IRA solution, capital gains solution, and other incentives for saving.

Where would you put deficit reduction on that spectrum?

Mr. KEATING. I suppose if Ross Perot were here, he would say the deficits are the giant sucking sound against the savings rate.

The Federal Government's deficits and debts suck those savings to pay for these deficits, which will be spent largely on consumption items.

So you have to get toward a Federal balanced budget if you want to raise the national savings rate unless we see a huge, stunning turnaround in American cultural attitudes about saving. This is unlikely given the Tax Code, the safety net programs, and the entitlement programs that are making promises that can't be sustained into the next century.

Ms. LAV. I think we may sort of agree on this. I think that the savings rate has been remarkably the studies show unresponsive to tax incentives and that if we want to improve the savings rates, we have to improve the government dissavings by, in the long term, not necessarily every year and not necessarily today, but certainly address these issues as the population ages and as we have these deficits exploding in future years.

Mr. KEATING. I strongly disagree with the term tax incentives for savings. We don't have tax incentives for savings. It is a question of how much disincentive we have. And to the extent we reduce the disincentives, I think you can and will see, and did see with the IRAs, an increase in the savings rates.

I would not discount the effect of national advertising, because when people finally can save and make it worth saving, mutual funds, banks, and others will tell people about it because they want to manage the money. Advertising, I think, is greatly underappreciated as a potential effect on the national savings rate.

Ms. LAV. The question is whether it shifts savings from other forms and puts them into a tax advantaged or whether you increase the rate.

Mr. BUNNING. The gentleman's time has expired.

Mr. Cardin will inquire.

Mr. CARDIN. Thank you, Mr. Chairman, and thank you all for your testimony here today. I remember before 1986 when tax shelters were plentiful in this country, many of my friends and colleagues were investing in office buildings and condominiums with the guarantee that they couldn't lose any money because of the Tax Code and because of the writeoffs in the Tax Code.

Treasury testified yesterday before our committee that unless we make certain modifications in the proposal that has been made to us with the Contract With America that we will again see tax shelters, that because of the neutral cost recoveries and the other provisions in the bill, there will be circumstances where an investor because of the writeoffs and because of their tax brackets would be guaranteed to recover more money than they are laying out with no risk and still retain the asset.

My question to the panel is whether that concerns you, whether we should all be working together to make sure that we don't see tax shelters return to our Tax Code, where people's decisions are not based upon what is right economically, but are misled by the Tax Code itself in investing in a particular asset that we may not need.

As you know, we overbuilt offices and probably had more condominiums and rental pools at that time than were economically justified. I am interested as to whether this concerns you and

whether Democrats and Republicans shouldn't be working together to make sure that we don't, through our desire to encourage investment, we don't start a new round of tax shelters.

Mr. BECKNER. I would say two things to that. One is, the tax reductions in the Contract With America serve to lower the tax burden. That to me is the most important policy goal here. The tax burden is too high. It hurts the quality of life of citizens. It lowers the economic growth rate.

That having been said, and both Mr. Keating and I talked about this, over the long term what we need to do is have a comprehensive tax reform where we dramatically simplify the Tax Code, where we have flat rate taxes——

Mr. CARDIN. Address though, the shelters. Remember, we knew we had shelters in the tax law and it took us many years and a long effort before we were able to repeal them. So if we create a new tax shelter, it is not going to be overnight before that comes out of the Tax Code.

Mr. KEATING. I would agree. If there are any problems with the Contract With America, I am sure the chief authors will be happy to take a look at them. I would say if there are sheltering problems, we certainly want to get those addressed.

I would like to point out one other problem with shelters which is not often talked about, and that is the way the IRS closed them down. A lot of people put their money into these shelters and they went with major investment firms. The fact is, a lot of these things collapsed, people found themselves losing money from them and then found the IRS would audit the shelters. There was no one left to defend them from the tax claims, the tax benefits were disallowed, and then the IRS picked off investors one at a time. Even if there were shelters in a new tax law, I bet you there are many investors that won't touch anything that is called tax shelter with a 10-foot pole because of what happened in the eighties and the way the IRS came after people.

Mr. CARDIN. What you are referring to happened after the 1986 tax law changes.

Mr. KEATING. The whole thing was a mess in terms of Tax Code enforcement.

Ms. LAV. Two quick points. Who paid for the tax shelters? A lot of the overbuilding led to the S&L crisis and the middle-income taxpayer certainly suffered from that.

Second, whenever there are differential rates and differential provisions in the Tax Code like indexing, like a lower rate on capital gains, you are going to have people manipulating to get their income to look like that kind of income. That happened prior to 1986.

If you want to—in 1986 the attempt was to say we are going to tax all income the same, capital gains at the same rate as everything else, and that is one of the ways we had losses. The shelters were shut down and now we are opening a gaping hole, the Contract opens a gaping hole to create these shelters and be creative again.

Mr. CARDIN. Thank you.

Mr. BUNNING. Mr. Christensen.

Mr. CHRISTENSEN. I thank the panel for their testimony. We heard from Mr. Bosworth about the need for an independent economic forecasting model, and one that was not giving us "funny numbers" with Treasury or CBO or the GAO or outside firms.

I am wondering what would be your recommendation and how would you go about setting up that kind of firm, because I thought we had that now, but I don't know that we do. No one seems to understand static versus dynamic scoring and everybody has a different plate.

How do you go about getting the right numbers? I am more interested in hearing the dynamic scoring which I believe is more accurate, but yet it seems like all the bureaucrats come in with static scoring, and I don't agree with it.

Mr. FOSTER. This is a truly serious problem. It is one of those things where, if we could make the change and make it correctly, it would have an extraordinarily long-term beneficial impact on policymaking. I probably would not agree with Dr. Bosworth just because I think if you were to create an independent panel of economists to come up with revenue estimates, you would never get any revenue estimates.

We have an opportunity now with Ken Kies of the Joint Tax Committee and with the Congressional Budget Office, to put in place a program, which is going to take awhile to do, to put in place a program of developing dynamic revenue estimates which eventually, whether they like it or not, Treasury is probably going to have to start doing as well, and keeping it in-house.

The CBO/Joint Tax Committee have resisted doing dynamic revenue estimates for a variety of reasons, as has Treasury. Most of those reasons I find having not much support, in fact. It can be done.

One thing we tend to ignore in this country is that the United Kingdom has been doing dynamic revenue estimates for quite some time, and yet the Treasury and Joint Tax have told us over the years that it can't be done. It tells us I guess that the British are smarter than we are because they have been doing this since the early eighties.

It can be done through CBO and Joint Tax, which is where I think it should be done because you really do want to have the staffpeople who are answerable to the Congress and these organizations are. They are going to have to embark on a program of learning how to do dynamic revenue estimates, not just for tax, but for spending proposals as well, and they probably ought to get to it pretty quickly.

Mr. CHRISTENSEN. Mr. Keating, yesterday we had the opportunity to hear from the Administrator of the Social Security Administration and your organization represents a lot of seniors also. She came to the conclusion that a moderate increase in the earnings cap for seniors was $200 a year. Over the next, I believe, 5 years she was going to be able to raise it $1,000. In the Contract With America we talk about raising that to $30,000.

Could you give me your opinion on the earnings cap and how that is being detrimental to seniors or whether you see it a different way?

Mr. KEATING. There are a lot of problems with the way it works. It essentially says if you have retired and are on Social Security and you make any extra money, you pay what is similar to the higher marginal tax rate.

What actually happens, as I understand it, is the benefits that are paid are actually higher if you were to get rid of the earnings test. The way it would actually be scored in the Federal budget is Federal spending would go up if you eliminate or make the earnings test more liberal.

So we advocate that if you are going to do it, and there are many logical policy reasons for doing so, that you also restrain the growth in Social Security benefits elsewhere so that overall you don't move up the date of bankruptcy for the Social Security system. If you do something with the earnings test, I believe it should be paid for with other changes in the same entitlement program which, as I understand, is what the House budget rules are now, and those are good ones.

Mr. CHRISTENSEN. Thank you.

Mr. BUNNING. Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman. Dr. Foster, getting back to this dynamic scoring thing that I have been talking about for a long time, you say the United Kingdom has been using a dynamic scoring in their budget projections, and, if so, could you get us some information—I would like to know a little bit more about it.

Mr. FOSTER. They have been doing it. A few years ago, in 1989, I had occasion to go over and visit with some of the fellows from the Ireland Revenue Service who actually were in the business of doing these sorts of estimates. It should be kept in mind that it is somewhat easier for them to do these because, in the parliamentary system, the Prime Minister comes up with a well-defined set of proposals, a single set and fairly narrow, and they run the estimates on this set of proposals, so it is not like the Joint Tax Committee eventually will be asked to do which is to provide estimates on an ongoing basis over the course of the year.

Mr. HANCOCK. I would just like to have some more information on it. I pointed out to the minority leader yesterday that business has been using it in this country, our own system requires dynamic scoring. In other words, when you invest money based on what is going to happen sometimes in 2 or 5 years or 10 years from now, you certainly do not use a static model. If you did use a so-called static model, then you would never make that investment in the first place because you would assume that everything is going to stay the same rather than having expanding markets.

I don't know whether you have ever done this, and I planned several times to call your organization and ask. You show on page 1 your Tax Freedom Day. That has always been an interesting date to me. Back in 1977, we held a big celebration on the square in Springfield, Mo., and got all the national news media calling it Tax Freedom Day, had a bunch of people from Branson come up and perform country music. On this Tax Freedom Day, you are showing Federal, State, and local taxes. Now, you are not including the increase in the debt of the Federal, State, and local governments. I am assuming that——

Mr. FOSTER. That is correct.

Mr. HANCOCK. Isn't the increase in the debt also the money being spent by the taxpayers, even though it isn't directly taxed from their income? I ran these figures not long ago using statistical abstracts with my calculator.

I would appreciate it if your organization would run some figures on this. I calculated that the cost of government in the United States right now is in excess of 70 percent of personal income. That is when you take the total amount of taxation that—you know, the money that the government actually taxes, add to that the increase in the debt of government at all levels, school boards, city councils, all the way, which is an increase in debt, that the total cost of government annually is in excess of 70 percent of personal income.

And I think that that is something that we need to talk about a little bit because there is no way that you can continue that type of spending if that is in fact what it is. I would appreciate it if your organization and maybe Dave Keating would look at it and the Citizens for a Sound Economy, because if that figure is correct, we are on a collision road to bankruptcy, and I think you will find that is not too far off. I would like somebody like you to verify that.

Mr. FOSTER. I would be glad to do so. Almost every year that we publish Tax Freedom Day, we receive a letter from Milton Friedman encouraging us to do just what you suggested.

Mr. HANCOCK. Maybe Mr. Friedman couldn't get it done, but maybe as a Member of the U.S. Congress we can.

Thank you.

Mr. BUNNING. Mr. Collins will inquire.

Mr. COLLINS. Just one question, Mr. Chairman. There has been a lot said about tax deductions for business or for individuals. Is it not true for anyone to take advantage or to enjoy a tax deduction, first, they must have an income. Second, they must spend portions of that income either in investment or in expenditure for capital outlay in the area of the tax-deductible item or the provisions allowing the deduction, which then further enhances the cash flow of the private sector. That, in turn, moves those funds through another set of hands, which then moves them to another set of hands. Each time those funds are transferred, the Federal, State, and local governments each get a portion of those funds. Is that not true?

Mr. FOSTER. I think that applies to just about every situation other than theft.

Mr. COLLINS. I think the Federal Government is stealing from its taxpayers and from its people.

Thank you.

Ms. LAV. I think that this is true, but we talked about taxing income. What this is moving, the Contract moves toward is having taxes only on wage income, because most forms of income from capital investment and profits would eventually be negligible once all of the Contract provisions are phased in. So I think that one has to think very carefully about whether one wants to just finance government by taxing primarily wage income.

Mr. COLLINS. Is it not further true though that businesses collect taxes from consumers through the goods and services it provides for sales; it is not really a tax on business. Isn't it true that busi-

nesses have no tax; they only collect through the products and services they render?

Ms. LAV. The taxes on business generally are considered to be distributed on the owners of capital, so the owners of capital would have no tax, that is true.

Mr. COLLINS. For a sale or service. I suppose from your perspective the dollars here in this town belong to the government and not to taxpayers?

Ms. LAV. No. I am saying that a certain amount of taxes have to be collected to finance the government, whatever size it is decided by the government and whether those should be collected just from wage and salary income or whether people who have capital income, either through businesses or investment, should make a contribution to that. That is the choice this is making.

Mr. COLLINS. Everybody works off a bottom line and when you get to the bottom line of taxation, there is only one place to get it. That is from working men and women in this country.

Thank you.

Mr. KEATING. I agree. I strongly disagree with what Ms. Lav just said. The owners of capital are not the only ones that bear the cost of corporate income taxation. Indeed most economists do not agree how it is divided, but they would agree it is divided among capital owners, workers, and consumers.

How it is divided, I am not sure. I just wanted to disassociate our organizations from those comments.

Mr. COLLINS. But the truth of the matter is that if you don't have working men and women in this country working, making an income to spend that income, there is no cash flow.

Mr. BUNNING. Thank you, Mr. Collins.

I want to thank the panel for their patience and their contribution to the record and we really appreciate your staying so long and being so patient. Thank you very much.

[Whereupon, at 4:02 p.m., the hearing was adjourned.]

CONTRACT WITH AMERICA—OVERVIEW

THURSDAY, JANUARY 12, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 10:07 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

Chairman ARCHER. Could our guests take their seats as soon as possible. We will commence the committee hearing.

Today we begin the final overview hearing on the Contract With America. We have before us distinguished guests who will share their thoughts with us about the Contract. Several of these witnesses are Governors and mayors who are already moving forward in their own States cutting taxes and reducing spending, moving in the direction that we would like to take the country, which is smaller government, more efficient, leaner government.

I believe we can learn from their examples and I look forward to their testimony. As we did yesterday, and we will continue to do, we have a panel of American citizens from beyond the Washington beltway.

Yesterday we heard from four people who traveled to Washington to let us hear their thoughts about passing our Contract. I found and I believe all of our members found their testimony to be very helpful. Again today we are privileged to hear from what we might call mainstream, ordinary Americans including an immigrant to the United States who now lives in Illinois, a secretary from California, the director of the California Department of Social Services and a farmer from Michigan. They will be here later and I am grateful to them for joining us.

We will also listen to four highly respected experts representing the National Federation of Independent Business, the U.S. Chamber of Commerce, the National Association of Manufacturers, and the American Federation of Labor and Congress of Industrial Organizations.

Before turning to our witnesses, I would like to recognize my friend, the minority leader of the committee, for any statement that you might like to make.

Mr. Gibbons.

Mr. GIBBONS. Thank you, Mr. Chairman. I am going to yield at this time to Mr. Neal of Massachusetts.

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

I would like to welcome our witnesses to the committee today. It is very important that we hear from individuals who represent our States and our cities. During the past few days, we have learned more about specific provisions of the Contract With America. We have heard from Treasury, economists, and real Americans.

We need to anticipate the impact the Contract will have in the end on cities and States. We need this knowledge to appropriately assist our States and our cities with all the challenges they face. Let me say I have never received a letter or a phone call from a Governor or from a mayor asking that they be allowed to return Federal funding.

As the former mayor of Springfield, I can relate to and understand the problems which confront you. Our urban areas have deteriorated in the last few years, and we certainly need to take bold action to make our cities livable again.

As I increase my learning curve about the Contract With America, I am concerned about several of its aspects and the impacts of the Contract on local governments. Treasury has estimated the cost of the Contract for 10 years to be $725.5 billion.

Several of the tax provisions do not provide elementary fairness. Fairness is the distribution of tax burden among families at different income levels. Fifty percent of the tax provisions of the Contract benefit families with incomes over $100,000. Are these the families who need our help? I agree with some of the tax proposals but they need to be targeted at the lower and middle class.

All of us are working to reduce the deficit. I think both sides of the aisle agree that this is our primary objective. We differ, however, on how we should reach this goal. Can we really afford to give broad tax breaks at this point in time? What positive impact will these tax breaks have on our cities? Again, I have never received a request from a mayor or a Governor to reduce their share of Federal funding.

One of the most important issues that needs to be addressed is the issue of welfare. I agree we should end welfare as we know it. However, I am concerned about some of the proposals that have been included in the Personal Responsibility Act. For instance, the legislation consolidates various nutrition programs including food stamps; the Supplemental Nutrition Program for Women, Infants and Children; the school lunch and school breakfast programs into one block grant.

A block grant would not be an entitlement program but would be subject to the annual appropriation process. This change would result in an uncertainty of funding. This type of provision will result in a loss of funding for State and local programs that have been highly successful.

What is going to happen to Meals on Wheels and school lunch programs? Which one of us is prepared to tell our senior citizens that they will no longer receive Meals on Wheels? And it appears that this proposal will break a promise rather than create a contract with the American people.

The Personal Responsibility Act provides State flexibility. We support the concept of State flexibility and believe that we need to encourage States to be innovative. States need to develop programs that work in their particular region. In the area of child support,

Massachusetts, under the leadership of Governor Weld, has been successful and should serve as a role model for the rest of the country.

When Secretary Shalala appeared before this committee, she told us improved child support collection would result in a 25-percent reduction in welfare expenditures. Massachusetts has increased its child support collection rate from 51 to 67 percent over a 3-year period. We need child support enforcement legislation at the Federal level. Unfortunately, child support enforcement is not adequately addressed by the Contract With America.

The Personal Responsibility Act would allow States to take themselves out of the current AFDC program and instead receive AFDC payments in the form of annual block grants. States would be required to follow minimal Federal standards. Under this proposal, Americans who meet eligibility requirements would no longer be guaranteed benefits. How will the reduction in benefits to the poorest among us help to improve our cities?

An appropriate type of program needs to be developed which does not permit States to be at-risk. We have to avoid a situation in which welfare recipients will shop from State to State looking for the best benefits.

Federal standards need to be in place to prevent disparities between States which would be harmful to the poor. There are some excellent training programs already in place in Massachusetts, and we should develop and expand upon these programs. We need to develop a program that provides the poor with the necessary skills and the training to become part of the work force. We cannot create a system that kicks those who are already down.

The more I reflect upon the Contract, I am concerned about its costs and how the Contract will be financed. The financing mechanisms of the Contract are very unclear. The Senate Budget Committee staff has a proposal which would require $22 billion in cuts in nondefense programs in fiscal year 1996 and entitlement savings of $41 billion.

Where will these cuts come from? What programs will become things of the past? According to yesterday's Boston Globe, the black infant mortality rate has reached the lowest level ever recorded. In Massachusetts, health officials credited Federal, State, and local initiatives in recent years in helping with the reduction in this racial disparity. However, more needs to be done. Should we decrease Federal initiatives that are just starting to show their success?

Financing of the Contract will surely result in future Medicare benefit reductions. The Contract will lower the taxes which are now deposited in the Medicare Trust Fund. How will our hospitals react to these changes? What happens when the Federal Government has trouble meeting these obligations? Massachusetts has some of the best hospitals in the world and we cannot sacrifice the quality of our health care.

Financing the Contract would result in cuts in Federal support for mass transit. These cuts would result in fewer transit routes, higher fares, or higher State and local taxes.

For an example, in Massachusetts, how will the State finish the central artery project and the cleaning of the Boston Harbor, the largest public works project in American history? Should we take

away the ability of Governors to receive Federal funding for necessary State expenditures? Should we discontinue the successful partnerships between States and the Federal Government?

President Eisenhower's commitment to the Federal highway system is an appropriate model. Financing the Contract could result in a decrease to programs which benefit our cities. I believe the community development block grant program is one of the most successful Federal initiatives. Has one mayor ever offered to return a dime of this funding?

Cities throughout the country are currently receiving community policing grants. How many of the mayors would return this financing?

Springfield was one of the cities to be designated as an enterprise community. The city has a well-thought-out plan to use the $3 million. Are we going to stop supporting this type of program in order to pay for the Contract?

Financing the Contract would result in the loss of successful and valuable programs. What would happen if Federal support ceased for school lunches for families with incomes of $22,000 for a family of three? The price of school lunch for those children would increase at least 30 cents a day. How will this help our children?

I think we all agree today that changes are needed and we need to take the action now to help our old cities. But are the benefits of the Contract the right approach? Is the Contract With America really worth its underlying costs? Can cities really manage without support from the Federal Government?

I am still waiting for that phone call from any mayor or any Governor who wishes to refuse Federal support. I look forward to this testimony and having many of these questions addressed.

I thank you, Mr. Chairman.

[The prepared statement follows:]

Congressman
RICHARD E. NEAL

131 Cannon Office Building • Washington, DC 20515 • Phone (202) 225-5601 • Fax (202) 225-8112

Serving the Cities and Towns of:

Agawam
Auburn
Bellingham
Blackstone
Brimfield
Brookfield
Chicopee
Charlton
Douglas
Dudley
East Brookfield
East Longmeadow
Hadley
Hampden
Holland
Hopedale
Leicester
Longmeadow
Ludlow
Mendon
Milford
Millbury
Millville
Monson
Northampton
Oxford
Palmer
South Hadley
Southbridge
Spencer
Springfield
Sturbridge
Sutton
Uxbridge
Wales
Ware
Warren
Webster
Wilbraham

January 12, 1995
Opening Statement by Mr. Neal of Massachusetts
Hearing on the Contract With America

Mr. Chairman, I would like to welcome our witnesses to the Committee today. It is very important that we hear from individuals whom represent our states and cities. During the past few days, we have learned more about specific provisions of the Contract With America. We have heard from Treasury, economists, and "real Americans." We need to anticipate the impact the Contract will have on states and cities. We need this knowledge to appropriately assist our states and cities with all the challenges they face. I have never received a letter or phone call from a governor or mayor asking to return federal funding!

As the former Mayor of the City of Springfield, I can relate to and understand the problems which confront you. Our urban areas have deteriorated in the last few years and we need to take bold action to make our cities livable again.

As I increase my learning curve about the Contract With America, I am concerned about several of its aspects and the impact of the Contract on local governments. Treasury has estimated the cost of the Contract for ten years to be $725.5 billion. Several of the tax provisions do not provide elementary fairness. Fairness is the distribution of the tax burden among families at different income levels. Fifty percent of the tax provisions of the Contract benefit families with incomes over $100,000. Are these the families whom need our help? I agree with some of the tax proposals, but they need to be targeted at the lower and middle class.

All of us are working to reduce to the deficit. I think both sides of the aisle can agree this is our primary goal. We differ on how we should reach this goal. Can we really afford to give broad tax breaks at this point in time? What positive impact will these tax breaks have on our cities? Again, I have never received a request from a mayor or governor to reduce their share of federal funding.

MASSACHUSETTS' SECOND DISTRICT
District Offices: Springfield–1550 Main Street • Springfield, MA 01103 • (413) 785-0325 • Milford–4 Congress Street • Milford, MA 01757 • (508) 634-8198

Printed on Recycled Paper with Soybean Ink

One of the most important issues that needs to be addressed is welfare. I agree we should end welfare as we know it. However, I am concerned about some of the various proposals that have been included in the Personal Responsibility Act. For instance, the legislation consolidates various nutrition programs including Food Stamps; the Supplemental Nutrition Program for Women Infants, and Children (WIC); and the school lunch and school breakfast programs-into one block grant. The block grant would not be an entitlement program, but would be subject to the appropriation process. This change would result in uncertainty of funding. This type of provision will result in a loss of funding for state and local programs that have been very successful. What is going to happen to Meals on Wheels and school lunches? Which one of us is prepared to tell senior citizens they are no longer entitled to Meals on Wheels? It appears the proposal would break a promise rather than create a contract with the American people.

The Personal Responsibility Act provides state flexibility. I support state flexibility, and the belief that we need to encourage states to be innovative. States need to develop programs that work for their particular state. In the area of child support, Massachusetts, under the leadership of Governor Weld, has been very successful and should serve as a role model for the rest of the country. When Secretary Shalala appeared before this Committee, she told us improved child support collection would result in a 25% reduction in welfare expenditures. Massachusetts has increased its child support collection rate from 51% to 67% over a three year period. We need child support enforcement legislation at the federal level. Unfortunately, child support enforcement is not adequately addressed in the Contract.

The Personal Responsibility Act would allow states to take themselves out of the current AFDC program and instead receive AFDC payments in the form of an annual block grant. States would be required to follow minimal federal standards. Under this proposal, Americans who meet certain eligibility requirements would no longer be guaranteed benefits. How will a reduction in benefits to the poorest among us help our cities improve? An appropriate type of program needs to be developed which does not permit states to be at risk. We have to avoid a situation in which welfare recipients will shop from state to state looking for the best benefits.

Federal standards need to be in place to prevent disparities between states which would be harmful to the poor. There are some excellent training programs already in place in Massachusetts and we need to expand upon these programs. We need to develop a program that provides the poor with the necessary skills and training to become part of the work force. We cannot create a system that kicks those who are already down.

The more I reflect upon the Contract I am concerned about its costs and how the Contract will be financed. The financing mechanisms of the Contract are unclear. The Senate Budget Committee Staff has a proposal which would require $22 billion in cuts in non-defense programs in FY96 and entitlement savings of $41 billion. Where will these cuts come from? What programs will become things of the past?

According to yesterday's Boston Globe, the black infant mortality rate has reached the lowest level ever recorded in Massachusetts. Health officials credited federal, state and local initiatives of recent years in helping with the reduction in racial disparity. However, more needs to do be done. Should we decrease federal initiatives that are just starting to show their success?

Financing of the Contract will result in future Medicare benefit reductions. The Contract will lower the taxes which are now deposited in the Medicare trust fund. How will our hospitals react to these changes? What happens when the federal government has trouble meeting its obligations? Massachusetts has some of the best hospitals in the world. We cannot sacrifice the quality of our health care.

Financing the Contract would result in cuts in federal support for mass transit. These cuts could result in fewer transit routes, higher fares, or higher state or local taxes. For example in Massachusetts, how will the state finish the central artery project and the cleaning of Boston Harbor? Should we take away the ability of governors to receive federal funding for necessary state expenditures? Should we discontinue the successful partnerships between states and the federal government? President Eisenhower's commitment to the federal highway system is an appropriate model.

Financing the Contract could result in a decrease to programs which benefit our cities. I believe community development block grant program is one of our most successful federal initiatives. Has one mayor ever offered to return a dime of this funding? Cities throughout the country are currently receiving community policing grants. How many of these mayors would like to return this funding?

Springfield was one of the cities to be designated as an "Enterprise Community." The City of Springfield has a well thought out plan to use the $3 million. Are we going to stop supporting these types of programs in order to pay for the Contract?

Financing the Contract would result in the loss of successful and valuable programs. What would happen if federal support ceased for school lunches for families with income above $22,800 for a family of three? The price of a school lunch for these children would increase at least 30 cents a day. How will this help our children?

I think we can all agree changes are needed. We need to take action now to help our cities. But are the benefits of the Contract the right approach? Is the Contract with America really worth its underlying costs? Can cities really manage without support from the federal government? I am still waiting for a phone call from any mayor or governor refusing federal support.

I look forward to hearing the testimony and having my questions answered.

Chairman ARCHER. I thank the gentleman for his statement. Without objection, any other statements that might be desired by members of the committee can be inserted in the record in writing.

[The following was subsequently received:]

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON THE CONTRACT WITH AMERICA
January 12, 1994

Mr. Chairman, I want to thank you for holding this excellent set of overview hearings on the Contract with America. This committee has certainly benefitted by hearing from a wide range of witnesses like the impressive panel before us this morning.

I am especially looking forward to the testimony from the state and local officials who are with us today. Time and again, Republicans have emphasized that Congress and the federal government have much to learn from accomplishments at the state and local levels.

Across the country, we are seeing state and local governments enact more innovative welfare reform, privatize more government functions and cut spending and taxes farther and faster than the federal government.

Governors and mayors can tell us what tax and welfare reforms work because they've already implemented them.

More importantly, I hope they tell us what hasn't worked because the federal government, with its over-reaching regulations and mandates, has gotten in the way.

I am also grateful that several citizens have volunteered their time to travel to Washington and speak before this committee. We need to hear more from Americans who pay the taxes, run the small businesses or care for loved ones who are ill. Only then can we understand the true impact of the reforms in the Contract with America and why they are so desperately needed.

Finally, I am pleased we will hear from several experts on business policy. Too often, past Congresses ignored or disregarded the fact that pro-business legislation and policy is essential for long-term economic growth and job creation.

Burdensome government regulations and mandates have had a profoundly negative impact on American business -- especially the small businesses which create 80 percent of the new jobs in this country.

I thank you all for being here today and look forward to your testimony.

CONGRESS
of the
United States of America

Ways and Means Committee

Andy Jacobs, Jr.

January 11, 1995

MR. CHAIRMAN:

I am pleased that Mayor Goldsmith is testifying before the Ways and Means Committee today.

I had the privilege of sitting with him at the witness table when he testified awhile back at the Public Assistance Subcommittee. It is not extravagant to say that Steve Goldsmith dazzled both Democrats and Republicans on the Subcommittee with his extemporaneous testimony. I believe the entire Ways and Means Committee will be equally impressed today.

ANDY JACOBS, JR.

2313 Rayburn Building
Washington, D.C. 20515-1410

46 East Ohio Street, Room 441-A
Indianapolis, Indiana 46204-1982

THE ROAD TO PEACE IS PAVED WITH JUSTICE

Chairman ARCHER. We should ask probing questions as we move along in our deliberations so that we will have a product that is the very best that we can make. We need to understand that perhaps the greatest enemy of our effort is perfection. Perfection is the greatest potential enemy of improvement, good and even the best.

Now I would like to recognize my colleague from New York, Mr. Rangel, to make an introduction.

Mr. RANGEL. Thank you, Mr. Chairman. In that search for perfection, I would like to introduce our newly elected Governor, a person who has served as mayor of the great city of Peekskill, was an outstanding State Assemblyman and Senator in the State of New York and has demonstrated a willingness to work in a bipartisan way with local and State officials, and we look forward to hearing his testimony.

And I would like to yield to my colleague, Mr. Houghton.

Mr. HOUGHTON. No further words. We are delighted to have you here, Governor. Thanks very much.

Chairman ARCHER. Before we commence the testimony, the audience and members of the committee should know that Governor Weld is not here because he is caught in a snowstorm in his home State. He is on his way, and we hope that he will get here before we complete our proceedings today. I am very happy when I hear about these things that I come from Houston, Tex., instead of from Massachusetts.

We are particularly delighted to have two Governors already with us today, Governor Dean of Vermont who needs no introduction and has received a great deal of publicity lately in some of his efforts to make this a better world. We normally have a rigid 5-minute rule on oral testimony with the ability to insert your written remarks in the record in full. I am not going to ask you to adhere precisely to that, but I would hope that you would keep your oral testimony as brief as possible so that we will have more time for questions.

Is Governor Pataki here?

STATEMENT OF HON. GEORGE E. PATAKI, GOVERNOR, STATE OF NEW YORK

Governor PATAKI. Thank you, Chairman Archer, and Congressman Houghton and Congressman Rangel and distinguished members of this committee.

I appreciate this opportunity to testify today before this panel as Congress prepares to act on the House Republicans' Contract With America. As the new Governor of New York, I am heeding our citizens' call to cut taxes, cut spending and control government. I look forward to working with Congress to assure that we travel the road to reform together.

I have prepared remarks that we will submit as a part of the record, Mr. Chairman. But rather than recite them at this point, let me just briefly outline to the members of this committee what we intend to do and what we would like to see happen here in Washington.

I am in the process of putting together my first budget. We are going to reform and change our Medicaid system dramatically. We

are going to look to put in place things like mandatory managed care.

And, Congressman Neal, I listened to your comments where you said you haven't heard a Governor or a mayor come here and say we are giving back some money to Washington. We intend to lower the cost of Medicaid in New York State dramatically this year and lower the cost to Washington to you to the tune of $2 billion. That would result in a $1 billion savings to the taxpayers of the State of New York and almost equal savings to the local governments in the State of New York and a $2 billion, approximately, savings here in Congress. We are going to be returning those funds or not claiming those funds that otherwise would have come to New York by virtue of our Medicaid reform package that we hope the legislature will support.

We are also looking to dramatically restructure welfare in New York State. We are going to have workfare, mandatory workfare put in place all across New York State. We are going to put in place front-end detection systems, computerized programs to reduce fraud and waste in the claims that are made inappropriately against the public Treasury. And we are going to look to put in place learnfare across New York State to encourage responsibility and give our children the chance through an education to avoid the cycle of dependency and become productive members of our society.

Now let me say what we would like you to do here in Washington. First, I do not fear the balanced budget amendment. I think it is a very good thing. I wish it had been in place here in Congress 20 years ago because I think we all would have been in a better position. We as Governors have to balance our budgets. We are looking in New York State at a $5 billion-plus budget gap. We are going to balance it. We are going to make tough decisions and tough choices, but that is what government should do and that is why we are elected. So I do not in any way fear the balanced budget amendment. I would like to see Congress pass it and impose discipline so that my children and grandchildren aren't saddled with the debts of this generation of elected officials.

Having said that, I think it is very important that Congress achieve a balanced budget without shifting costs and shifting programs from the Federal Government to the State government. In our process in Albany, we are looking to spend less money in absolute dollars in the upcoming year than we did in the past year. But we are looking to do that in a way that doesn't shift the cost of programs down to the local governments or the county governments.

We need to control government. We don't need to pass the buck from one level of government to another. So as you move toward a balanced budget here in Washington, we request that you don't shift the cost to local governments to State governments, but continue the support that is necessary and, in that sense, we think the absence of unfunded mandates, the requirement that mandates imposed by Washington be fully funded, is extremely important.

Third, there is talk about block grants to give greater flexibility to the States. I welcome that as well. I think as we have seen, the welfare systems of the States are very different, the populations, the needs are very different, and I would like to see us have maxi-

mum flexibility at the State level to tailor our programs to the needs of the people in our State.

Again, having said that, we want to see those block grants recognize the historic level of commitment in spending and support from the Federal Government and don't want to see those block grants cut the amount of support that comes from Washington to New York State or any of the States cut as you move toward a balanced budget.

And I know, in the context of block grants, there is some question, do we impose programs like workfare? Do we require States to have certain elements in their welfare programs? Let me make a suggestion that rather than mandating on the States that block grant package, have built-in incentives so that you would get a higher level of block grant if you achieve certain goals that Congress believes are appropriate for us as a society, such as moving people toward workfare or achieving a rate of error in eligibility that is below a norm set by Congress so that you could have a basic block grant, but that States that then achieve certain additional goals that Congress thinks appropriate, could achieve—could receive even more funds from Congress so that the Federal Government could reward States that have programs like workfare, front-end detection, and learnfare by having higher block grant appropriations.

A couple of other things you could do for us. When I talk about that $2 billion in savings to the Federal Government, by the changes we are looking to make in Medicaid, many of those changes require Federal waivers. We are concerned that those waivers either won't be granted or, if they are granted, it will take anywhere from 6 months to 1 year to achieve those waivers.

Why not in programs such as mandatory managed care where States like Rhode Island have already obtained waivers, allow States to have those waivers quick, if not automatically, quickly, so that we could begin moving toward those programs right away instead of having the 6 months to as much as a 1-year delay waiting to see whether or not that waiver is granted.

And second, when I talk about our Medicaid changes, it is something where I as Governor will be proposing them, but we need the support of the legislature to achieve those changes. It would be great, it would be in the interests of New York State, it would be in the interests of Congress if there were incentives built into the reimbursement rates for programs like Medicaid for States that reduce their level of expense.

Right now, in New York State, we get approximately a 50-percent reimbursement for our Medicaid program from Washington. Some States get reimbursement levels as high as 80 percent. If we are going to restructure our Medicaid program to achieve these savings, it would help me to get legislative approval, and I think it would help you to have more States moving toward reforming the systems in a way that would lower the costs if you would share some of those savings with the States. And one example would be in the form of a higher reimbursement rate so that we would move above 50-percent Federal reimbursement for Medicaid as we lowered the cost of that program to the people of the State and the people of the country.

So we have a very ambitious agenda in New York State. I am sure it is very different from the agenda of Governor Dean and our neighboring State of Vermont in many important ways because, while we have similarities, we have many differences and that is why I think the flexibility that the Contract With America talks about, the block grant approach are some things that would allow us to tailor our programs to meet the needs of our individual States.

So, Mr. Chairman, I thank you for this opportunity and for the chance to speak to you this morning.

[The prepared statement follows:]

TESTIMONY OF
THE HONORABLE GEORGE E. PATAKI
GOVERNOR OF THE STATE OF NEW YORK
TO
WAYS AND MEANS COMMITTEE
UNITED STATES HOUSE OF REPRESENTATIVES
JANUARY 12, 1995

Mr. Chairman, Members of the Committee:

I appreciate the opportunity to testify today before this distinguished panel as Congress prepares to act on the House Republicans' "Contract with America."

As the new Governor of New York, I am heeding our citizens call to cut taxes, cut spending, and control government. I look forward to working with Congress to be sure that we travel the road to reform together.

Cooperation on the course that change will take is especially important as we work to reform welfare. There may not be a single solution to the problems posed by the existing welfare system, but the search for solutions demands a united effort in Washington, in the state capitols and in city halls and town halls across our nation.

Given the complex array of programs and policies collectively known as welfare, it is obvious that no single solution will be found.

And considering the diversity of the people that welfare attempts to serve, it is equally clear that no single solution will work.

Yet, as we search for the best solutions, we should begin by agreeing to this point: Welfare isn't working.

Despite its noble intentions, welfare has only kept the poor from prospering. What began as a safety net has become a spider web, trapping the needy in a stranglehold of dependency.

The experience of New York and the nation, after more than a generation of new and bigger welfare programs, has taught us a valuable lesson about compassion. We have learned that we cannot view compassion as a commodity. It cannot be purchased with tax dollars, packaged like a gift and delivered by the government.

Real compassion, a truly caring approach to helping the needy, requires public policies that protect and preserve personal freedom and restore individual responsibility. When government takes responsibility for people, people stop taking responsibility for themselves.

In New York, we have a proud tradition of caring and compassion for our citizens most in need. As we begin our efforts to reform welfare in New York State, we are working to honor that tradition by honoring the dignity of work.

As we strive to replace welfare with work, New York will emphasize policies that recognize effort and reward achievement. In New York, we know that welfare reform requires tax reform.

Tax policies should not punish people for getting off welfare. The highest marginal tax rate in this nation is paid by people moving from welfare rolls to private payrolls. This terrible tax disincentive must end.

In Albany, I am pushing to lower New York's bottom tax rate, accelerate the benefits of New York's Earned Income tax credit, and institute a Family Tax Credit that would triple the tax benefits for child and dependent care. These steps will cut taxes for the working poor in New York State.

In Washington, Congress must take similar steps to reform the federal tax code in ways that reward people who leave the welfare rolls and go to work.

In New York, our welfare reform efforts have a clear, concise goal: Workfare must replace welfare.

Our effort to transform welfare into workfare starts with the conviction that welfare should not be a way of life. It should be a way for people to get temporary assistance, but it must also put people on the path to the dignity of self-sufficiency.

In New York State, there is a state/local program of public assistance called Home Relief. It is a program for needy New Yorkers, generally single and without children, who are not eligible for AFDC.

Various county governments within New York State have been putting Home Relief reform measures to the test. Westchester County, for example, has shown impressive results with a program called Pride in Work.

It involves rigorous initial checking to assure that all applicants are eligible. That step should be basic to any assistance program. No one -- conservative, moderate or liberal -- wants to be ripped off. I know that New Yorkers, who are as generous as any people on earth, resent people getting what they are not entitled to. Government has a clear obligation to do everything it can to eradicate fraud.

The Pride in Work program goes far beyond that first, basic step. All Home Relief recipients are assessed to determine if they are employable. Those capable of working are assigned to a public works job. Those deemed temporarily unemployable because of drug, alcohol, health or mental health problems are referred for treatment. Those determined to be permanently unemployable are referred for SSI or disability reviews.

In every case, appropriate review and action is taken. In no instance is it acceptable to let welfare become simply a routine matter of handing out checks. Those who can work are put to work. Those who need treatment receive it. Those with needs that cannot be served by Home Relief are referred to other programs.

Compliance is closely monitored, reported and tracked through Westchester County's computer system. Once word gets out that the Pride in Work contract of mutual responsibility is taken seriously, some individuals -- unwilling to enter into it -- never show up to apply. And those who do enter into it know there will be consequences if they fail to fulfill their end of the contract.

That is a brief description of the Pride in Work program. Westchester County has shown that welfare reform works. It works for the participants. It works for the community. It works for the taxpayers. For that reason, New York State plans to repeat the success of the Pride in Work program all across our state, in every county, as we work to reform New York State's Home Relief program.

The principles of welfare reform that New York is applying to Home Relief also apply to the AFDC program.

One significant addition to our credo in this regard is the tenet that both parents are responsible for supporting their children. Welfare reform must be innovative and aggressive in the enforcement of child support.

Welfare reform must also insist, through a learnfare program, that parents accept the responsibility of being involved in and concerned about their children's education. It is as true now as it has always been that education is one of the surest routes out of poverty.

The AFDC population is larger and more diverse, with the typical case presenting a more complex set of needs than the typical Home Relief case. Nonetheless, welfare reform must include a workfare requirement for AFDC. Everyone should be doing something to move themselves toward the next step, up the next rung on the ladder. Welfare recipients must become participants.

I am very aware, as a Governor who is preparing to present his state's budget plans at the beginning of February, of the need to reduce the cost of government, to eliminate wasteful spending, to eradicate fraud and abuse of tax dollar. The citizens of New York and this nation know that government, at all levels, has grown too large and too costly.

In New York, I am asking our local governments to be partners for change with state government. An essential element of that partnership is trust. I believe state government can trust counties, cities, towns and villages to fulfill their responsibilities without additional mandates from Albany. And New York's local government are trusting the state to end unfunded mandates.

New York State is ready to be the federal government's partner for change. And we are looking for an end to unfunded mandates as an essential element of that partnership.

Unfunded federal mandates cost New York State government more than $3 billion per year and they cost local governments in New York another $3 billion annually. We know we need mandate relief from Washington to confront New York's long-term budget problems.

So, I must emphasize the point I made at the start. There is no single answer to the welfare woes of this nation. A one-size-fits-all welfare reform just won't work. Tax reform, mandate relief and flexibility to allow local solutions to local problems are the watchword for welfare reform.

Welfare reform that focuses on personal responsibility and individual liberty can do what Americans have always done better than anyone in the history of the world: Give the next generation more hope, more opportunity, more freedom.

In New York, we strive for that American ideal with enthusiasm and energy. We will work to eliminate any state or federal welfare regulation that devalues work, discourages marriage or undermines family life. We will decentralize where we can, privatize where it makes sense, and count on communities to innovate in ways that best meet the needs and values of their citizens.

We will do it not to punish nor to pacify. We will do it because it is our responsibility, as protectors of the public trust, to pursue programs and policies that protect the freedom of our citizens to prosper and restores the individual's responsibility to exercise that freedom.

As I stated at the outset, I look forward to working with Congress as we all move forward to answering our citizens' call for change, by cutting taxes, cutting spending, and controlling government.

Thank you.

Chairman ARCHER. Governor, your testimony is very refreshing to this member and I think to most of the members of this committee, if not all. I can assure you that as you walk through the Capitol today, you will find a fresh spirit afoot to implement the Federalism which has been the basic tenet on which this country was founded. There is a high regard and a high respect for the authority and the responsibility of each State to meet the diverse requirements that exist across the land in this great country. You have articulated that which is why we are pleased to have Governors before us today as we reach out and tell the Nation that we want to return power to you because we believe, in many, if not most, instances, you can do it better than we can from on high up here in Washington.

Governor Dean, we would be pleased to hear your comments to the committee.

STATEMENT OF HON. HOWARD DEAN, M.D., GOVERNOR, STATE OF VERMONT, AND CHAIRMAN, NATIONAL GOVERNORS' ASSOCIATION

Governor DEAN. Thank you very much, Mr. Chairman. Let me say that I am extremely gratified and pleased to be asked to testify. I think it is very important to hear from the loyal opposition as we are now in the National Governors' Association as well as in Congress.

I have a lengthy written testimony which I will file for the record. While the written testimony that I file is not necessarily the position of the National Governors' Association, the remarks have been approved by both Republican and Democratic members, and so I will summarize and then I will——

Chairman ARCHER. Without objection, your entire testimony will be printed in the record.

Governor DEAN. Thank you very much, Mr. Chairman. I will summarize quickly so that we can go on to some questions and then make some remarks speaking as Governor of Vermont.

The other thing I would just wish to say before I start is that you will find that Governors generally—usually, although perhaps not as recently, operate on a bipartisan mode and that many of the views that Governor Pataki expressed are views that I share and are views that many Governors, both Democrats and Republicans, share. There are some differences in the details but not a lot of differences in the direction.

First, let me say that in terms of unfunded Federal mandates, we do have policy. We support the unfunded mandates bill that was in the Senate or went through the committee yesterday and are very appreciative of this body, and we don't want to see any changes in that.

Let me address the welfare bill, the personal responsibility bill. We do have policy at NGA, but no position on the Personal Responsibility Act. I am just going to read quickly some of the things that we have set off as bipartisan: Welfare is a transition to self-sufficiency; assistance for those not yet ready for employment or training; time-limited cash assistance, including education and training to help recipients prepare for work; improved child care and earned income tax credits for low-income working families; en-

hanced interstate child support enforcement; expanded programs to encourage family stability and limit teen pregnancy; and improved coordination between AFDC and food stamps programs. That is the bipartisan National Governors' policy.

Let me address very quickly welfare reform and the approach that is in the Contract. I think the vast majority of Governors, both Democrats and Republicans, believe that work ought to be a requirement for able-bodied recipients. I think the vast majority, both Democrats and Republicans, believe time limits are appropriate and job requirements after those time limits are appropriate.

I think where we have significant differences of opinion are—let me just say that the vast majority of Governors agree with the notion of block grants and increased State flexibility.

I speak as the Governor of the only State in the country that in fact has a statewide welfare reform program which incorporates both time limits and work requirements. We had to get a waiver for that. We would hope that under the legislation that comes out of this body, that those waivers—kinds of waivers will no longer be necessary, but our experience is somewhat different and somewhat at odds with what has been proposed recently in this Chamber.

First of all, we believe that welfare reform does not save money. We have had a terrible recession in the Northeast which we are just barely excelling out of and we have had to create public service jobs in order to find places to put people. Since there are people who were in the work force who can't find work, we naturally—the people who are in the work force who are on welfare are having an even more difficult time finding work, and we have created low-wage jobs in places like nursing homes, schools, libraries and so forth either for the State or mostly for nonprofits, and they will get welfare grants for those jobs if they cannot—if they cannot find a job in the private sector.

We prefer them to find a job in the private sector. There is child care and training and so forth. If they can, we think it is very important that they work and that the job in the private sector—in the public sector or the nonprofit sector be the appropriate way to deal with that. That costs money.

Second, the Democratic Governors have a great concern with the notion of breaking the entitlement and that is why. We believe that welfare is a national issue and this is a nation and it is not just simply a collection of 50 States. While we very firmly want to support you, Mr. Chairman, and the others in the leadership who are moving toward a more flexible situation with welfare, we believe there ought to be some sort of a national standard and we also—minimum standard.

And we also believe that if the entitlement is completely broken and block grants are level funded over the next several years, the first time there is a recession the States will then be forced to choose between a tax increase or literally putting people in the street, and the majority of the welfare caseload is of course children. That is something I don't believe is in the Nation's interest or the State's interest, so that is a major concern.

We are very interested in exploring how we might cope with the paternity question, and we applaud the leadership not for its particular suggestion, but for putting that issue on the table. It needs

to be resolved. We need to do much more in that area and we need to make it clear that fathers have equal responsibility in terms of providing for their children.

Let me just close this section by saying there is a significant amount of interest as opposed to rejection of Senator Kassebaum's initial proposal for swaps. Initially she proposed that the Federal Government would take Medicare and the States would get welfare. Governors I think of both parties are uncomfortable with that, not wanting to create one giant bureaucracy at the Federal level to handle health care.

There is now a proposal I believe she has advanced that the Federal Government would take primary responsibility for long-term care and disabled children and that the States would take primary responsibility to the acute care Medicaid and welfare that is a very attractive proposal for us, frankly, because even if funds are limited, they allow States to experiment without having to go through the waiver process with further health care reform, something many of us are extremely interested in.

Let me just conclude by talking about the tax cuts and the balanced budget amendment. The National Governors' Association, I think it is fair to say that although we don't have an official position on the balanced budget amendment, that most Governors, including myself, are in favor of a balanced budget amendment. We understand, and I think Governor Pataki made the point quite adequately, that we have got to balance the Federal budget and that is a severe problem for all of us and for our children.

The Democratic Governors have taken a position that, because of our past experience, we would prefer very strongly to see language in the balanced budget amendment, which require the same kinds of approach to unfunded mandates that you have in legislation. That would guarantee that a future Congress would have a good deal of trouble undermining that.

We do have trouble, however, or I do have trouble—and now I have to depart from my role as the National Governors' chair—with what might happen under the current scenario. And let me emphasize that I am speaking for myself and not necessarily any other Governor.

If you have a balanced budget amendment and if you take Social Security and defense, of course the national debt, off the table—I have a table that I am ready to share with you that I got from the Treasury Department last night which shows that the majority of the cuts would then have to come from programs, obviously, that are not off the table and those would include a large cut in all State moneys that go to us.

We have estimates, and I will share these with the committee, that New York State, for example, not including the tax cut proposals in the Contract would lose $10 billion. If Governor Pataki were not able to have any reforms at all that would cause him to have a 17-percent tax increase. If he institutes some of his reforms, unless he can find a way to save $10 billion, without even addressing his $5 billion shortfall or his tax cut, he has to raise taxes. I don't think Governor Pataki wants to do that, nor do I.

California would be short $7 billion. Texas would be short $4 billion at current service levels. Vermont, the numbers are much less,

smaller, but our entire Medicaid allocation for acute care would be wiped out and all we would be able to pay for—given across-the-board cuts and that includes the same equal cuts in Medicare, veterans pensions and other things that are going to be difficult for Congress to cut given across-the-board equal cuts to State revenues as well as some of the Federal programs that are not taken off the table—we would lose all of our acute care portion of the Medicaid and only be able to pay for long-term care. That is a real problem.

A number of Governors, both Republicans and Democrats, were elected promising tax cuts. If the Federal Government cuts taxes, the numbers are even higher. The numbers for New York are $11 billion. For California, $10 billion. This is a significant problem.

There are a number of us—but I will again speak for myself—who have problems with the nature of the tax cut proposed by the Federal Government. The tax cut proposed in the Contract appears to be loaded toward the income group that is above $100,000 a year, particularly the capital gains and the changes in the real estate tax.

If we are talking about Federal tax cuts and not very large cuts to State programs, let's just suppose we can be more efficient and cut some full things we agree we can cut. I think it is unlikely that we are going to be able to cut this to that degree because we are talking in some cases about 30 percent of our Federal entitlements, but we may have to raise taxes, particularly if there is a recession, we will have to raise taxes.

If we have to raise taxes, first of all, we would be very resistant to doing so. Second, if we have to raise taxes, our tax structure is such that the middle class will bear the brunt of the tax increase. Our income taxes are not as progressive as those for most States. I think New York and Vermont are perhaps exceptions to that because we compete with each other and can't afford to raise our income taxes but our sales taxes and our gasoline taxes and all those other taxes that we use are taxes that fall very heavily on the middle class.

So it is conceivable if the tax cut were passed as currently configured in the Contract or recently what would happen is that you would have a tax cut that would principally hit people over $100,000 at the Federal level and be made up for at the State level by taxes which principally hit people under $100,000. I don't think that is the intention of the leadership but that is the mathematics as we see it.

So we support a balanced budget amendment and we think it has to pass. We hope there is mandate language in the amendment. We, I think, probably will not be able to come to a conclusion in the National Governors' Association about the tax cuts. We are very, very concerned about the impact on States.

And I just will, as a final paragraph, I don't think it is fair to undermine somebody else's proposal without putting a few things on the table. And let me say that I believe everything has to be on the table, including Social Security. I do not believe you need to cut Social Security, but I do believe you need to look at the retirement age. The life expectancy of recipients has gone—expanded dramatically since the thirties when the program was created.

We have to look at everything because, if you don't look at all the Federal programs including Social Security and defense, you are simply going to pass a much bigger hit to the State governments and force middle-class people, working people to pick up the tab.

So my suggestion would be that we look at these block grants very carefully, that we not throw out the good programs with the bad. For example, food stamps we think there are a lot of problems with and encourage discussion of block granting and so forth. School nutrition programs we think are an excellent program. They have served very well. They are essentially a noncash program serving the neediest and most helpless people in society which are small children who are hungry.

Leave the nutrition program, the school lunch and breakfast program alone. Let's talk about block granting food stamps, but let's leave the programs alone that work well and let's concentrate our fire on those programs that clearly do not work and restructure those as we go along.

I thank you, Mr. Chairman, and I will submit my testimony for the record.

[The prepared statement and attachments follow:]

STATEMENT OF HON. HOWARD DEAN, M.D.
GOVERNOR, STATE OF VERMONT
THE NATIONAL GOVERNORS' ASSOCIATION

Mr. Chairman, thank you for the opportunity to appear before you today to discuss the Governors' perspective on the Contract with America. Implicit in the Contract is a major realignment of the relationship between state and federal government. The National Governors' Association (NGA) has strong policy advocating such a realignment and we would welcome the opportunity to work closely with you as you decide these major federalism issues.

My comments will focus on five areas:

1. Unfunded federal mandates;
2. the Personal Responsibility Act;
3. the Balanced Budget Constitutional Amendment;
4. the potential fiscal impacts of devolvement to the states; and
5. several recommendations on how to proceed.

Unfunded Federal Mandates

The unfunded mandates bill, H.R 5, is completely consistent with NGA policy and Governors strongly support this proposed legislation. It is a very workable bill that requires the Congressional Budget Office (CBO) to estimate the costs of mandates and the Congress to specify funding sources. It exempts constitutional rights, civil rights, and disability and handicapped legislation. (The bill sunsets any new mandates if no funding is provided or reduces the extent of the mandate to the level of funding at the agencies discretion.) We believe that this bill will go a long way toward alleviating the mandate problem in the future. The bill also initiates a study to

look at existing mandates. The Governors support this bill as currently drafted and would strenuously oppose any weakening amendments.

The Personal Responsibility Act

At present, the National Governors' Association (NGA) has no position on the Personal Responsibility Act, but our current policy, was adopted in July 1993, lays out a framework for welfare reform that calls for:

- welfare as a transition to self-sufficiency;
- assistance for those not yet ready for employment or training;
- time-limited cash assistance, including education and training to help recipients prepare for work;
- improved child care and earned income tax credits for low-income working families;
- enhanced interstate child support enforcement;
- expanded programs to encourage family stability and limit teen pregnancy; and
- improved coordination between the AFDC and food stamps programs.

In addition, the Governors have called for increased flexibility in welfare programs. We believe there is no one-size-fits-all solution to welfare, and states must have the flexibility to develop programs and services that will address the unique characteristics of their welfare populations and economic conditions within their individual states. Reform efforts should:

- afford states specific options to try different approaches to designing welfare programs without having to apply for waivers;
- allow states to complete the welfare demonstrations currently underway through waivers and to allow future experimentations;
- allow states flexibility to decide how to phase-in time limits, and expand target populations; and
- leave room for states to try many different paths to job creations.

Finally, the Governors have supported a role for federal financing including:

- full federal funding of any mandates and no new costs or a shift of federal costs to states, counties, and localities;
- recognition of the federal responsibility to provide for the long-term care needs of children and of persons who are physically or mentally disabled; and
- maintenance of the federal level of investment in new technology and training in order to achieve welfare reform.

During the next several weeks we will be discussing the welfare reform issue to see if our current policy should be amended or modified. These discussions will help to prepare for the welfare meeting with the President and Congressional leadership on January 28th, as well as our Winter Meeting the last three days of January. This is a key issue to every Governor, however, and we look forward to working with you on a bipartisan basis once we have completed a comprehensive review of alternative approaches and have finalized any policy changes.

A Balanced Budget Constitutional Amendment

Currently, the NGA has no specific policy on the balanced budget constitutional amendment. There is concern, however, that states may also need mandate constitutional protection. Whether this is a separate amendment or part of the balanced budget amendment is an issue that is unresolved within the association. I will say, however, that whether or not the states ultimately ratify the balanced budget amendment may depend on how Congress addresses the mandate constitutional issue and how the Congress works with states over the next two years to realign federal-state responsibilities.

The Potential Fiscal Impact on the States

Mr. Chairman, you are considering a number of issues whose cumulative fiscal impact on the states is potentially huge over the long-run and therefore, I would like to make a few additional comments on these issues.

Tax Cuts. First, be aware that the federal tax cut that you are considering will translate directly into an additional revenue reduction for most states since most are linked to the taxable income definition in the federal tax code. The exact impact on our individual state revenues will differ by state and will depend on the nature of the tax cut. For example, since most states rely on the federal definition of income, a change in the deduction for children will have less impact than a change in the definition of taxable income. While NGA has no existing policy on potential tax cuts, you need to be aware that most states will not raise rates to compensate for the reductions in revenues which will automatically force budget reductions in many states. The extent of these cuts

will, of course, depend upon the underlying growth in the economy. If the economy weakens next year, these cuts could be significant.

Collapasing Categorical Grants in Block Grants. Second, while NGA policy supports collapsing categoricals into block grants, we view this as a strategy to increase the efficiency and cost effectiveness of government. The administration of an excessive number of federal programs creates unnecessary costs at both the state and federal level. Moreover, the complexity of the categorical grant system discourages the development of coordinated community-based programs and often makes it difficult to secure the range of services needed to prevent or remedy complex problems. While some savings are certainly possible, substantial cuts in funding will result in substantial cuts in services or significant cost shifts to states and localities. This is a serious concern to the states.

Mr. Chairman, and members of the Committee, NGA is developing its own proposal to collapse the current state categorical grants into a small number of block grants. Such a proposal will have the advantage in having been extensively reviewed by all states. We hope that this proposal will be available in the next month. As Congress continues to consider the issue, I invite your members to meet with the NGA Executive Committee to negotiate the final structure and funding levels for these block grants. Block grants should increase government efficiency and preserve adequate federal financing for national concerns and priorities. Any approach that seeks to abandon those legitimate roles or to push unfunded national responsibilities on state and local governments will likely be opposed by most Governors.

Block Granting Low-income Entitlements. Finally, in order to meet your budget reduction goals in the next budget resolution, you also may be looking to make major changes in other low-income programs in addition to AFDC. In particular, I am referring to food stamps and Medicaid. With

respect to food stamps, NGA is currently working to revise its policy and hopes to have a new policy adopted at the Winter Meeting. In Medicaid, we would appreciate the ability to do managed care without a waiver, relief from the Boren Amendment, but more imprtantly, we need greater flexiblity in setting benefit levels, eligibility, and developing the service delivery system.

At this time, NGA does not have policy in support of block granting any of these low-income entitlements to states. In fact, some existing policy could be interpreted to oppose such an approach. I would add that a number of Governors have concerns over breaking the individual entitlement of these low-income programs. We will, however, continue to review our policy positions on these issues and look forward to working with you as our policy evolves and the legislation continues to move through the House and Senate.

In summary, states have the primary responsibility for critical services of high priority to citizens. Already hard pressed to meet these needs, federal budget cuts that merely shift costs will merely increase public dissatisfaction. The adoption of a balanced budget constitutional amendment, cuts in categorical grants, federal tax cuts that translate into state revenue cuts, and restructuring of AFDC, food stamps, and Medicaid will have a significant impact on states. It is imperative, therefore, that those decisions be made in close consultation with states and with a full understanding of their true impact on the federal system.

Several Recommendatons on How to Proceed

If Congress is truly serious about realigning the state-federal relationship, then I would like to offer some guidelines.

1. Start with a vision of what the federal-state relationship should be to maximize the various benefits.

This should not be an ad hoc process. Instead, this is an opportunity to debate and realign the relationships between the federal and state governments. This would mean not only carefully defining the federal role, but also looking at potential swaps, such as having the federal government take over long-term care portions of Medicaid in exchange for other domestic responsibilities. Turnbacks of federal revenue sources, such as a portion of the federal gasoline tax, with some responsibilities, should also be part of this evaluation.

2. Don't mix a budget reduction strategy with a realignment and devolution strategy.

Consolidating the 600 categorical grants to a small number of block grants and restructuring welfare, food stamps, and Medicaid all may make sense from the standpoint of a federalism and efficiency in government. But, to do it primarily as a budget reduction exercise may well skew the final results and cause more long-run structural problems.

3. Take the time to do it right.

A realignment of federal-state responsibilities is very complicated and will cause significant programs changes at all three levels of government—state, federal, and local. This should be an open process where Governors, on a bipartisan basis, are at the table as full partners in any restructuring.

4. Allow sufficient time for transition.

The potential realignments may be significant and sufficient time should be allowed for states to accommodate changes. For example, states will have to change many state laws to accommodate

the federal changes. Many state legislatures do not meet every year. A transition of severa years may be necessary for any major program changes. Also, if the federal role is to be reduced, states can better adjust if reductions are made over time. The impact of more efficient programs will be enhanced if the resources available for investment during the earlier years are preserved.

Mr. Chairman, again I appreciate the opportunity to be with you today on behalf of the nation's Governors. I am very serious when I say that we would like to work with you on a bipartisan basis as you restructure the federal-state relationship.

THE IMPACT OF A BALANCED-BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON STATE FINANCES

CONTENTS

SUMMARY TABLES:

Table 1. Balanced-Budget Amendment

Table 2. Balanced-Budget Amendment Plus Contract with America Tax-Reduction Proposals

INDIVIDUAL STATE REPORTS:

METHODOLOGY:

Table 1
Spending Reductions under Balanced Budget Amendment, FY 2002 ($mil)

	Cuts in Grants to State Governments					Required State Tax Increase	Cuts in Other Federal Spending		
State	Total	Medicaid	Highway	AFDC	Other		Total	Medicare	Other
U.S. Total	71,300	40,314	5,176	4,508	21,301	N.A.	176,492	77,475	99,017
Alabama	1,162	641	98	32	391	16.4%	3,058	1,157	1,900
Alaska	306	89	71	19	127	9.8%	576	44	532
Arizona	919	519	78	68	254	10.4%	2,397	949	1,447
Arkansas	723	416	65	16	225	16.5%	1,567	766	800
California	7,708	3,944	442	960	2,362	9.2%	20,321	9,101	11,220
Colorado	755	387	79	36	253	11.8%	2,764	721	2,044
Connecticut	1,008	587	105	63	253	11.2%	1,843	1,089	755
Delaware	158	70	18	9	61	7.2%	383	176	207
DC	697	183	17	24	473	20.4%	4,937	313	4,624
Florida	2,656	1,520	202	170	764	10.2%	9,782	5,336	4,446
Georgia	1,608	938	131	101	438	12.0%	3,790	1,392	2,398
Hawaii	328	117	62	24	125	6.8%	737	216	522
Idaho	254	118	33	8	95	9.9%	855	218	637
Illinois	2,576	1,354	174	155	892	11.6%	7,532	4,092	3,441
Indiana	1,490	956	123	54	357	13.8%	2,531	1,497	1,034
Iowa	630	328	69	35	197	10.9%	1,919	897	1,022
Kansas	622	355	52	29	186	13.0%	1,730	819	911
Kentucky	1,157	690	69	56	341	14.5%	2,111	952	1,159
Louisiana	1,966	1,500	94	48	324	27.8%	2,361	1,066	1,296
Maine	452	279	28	24	121	17.5%	717	385	331
Maryland	1,125	581	83	65	396	9.9%	6,253	1,377	4,876
Massachusetts	1,915	1,073	248	135	459	12.6%	4,683	2,449	2,234
Michigan	2,477	1,355	140	229	753	13.2%	4,988	3,333	1,655
Minnesota	1,177	679	102	83	314	9.4%	2,547	1,123	1,424
Mississippi	864	496	61	24	282	20.8%	1,672	713	959
Missouri	1,316	747	109	62	398	15.5%	3,942	1,781	2,161
Montana	277	123	52	12	89	19.8%	744	218	526
Nebraska	388	192	44	23	129	13.3%	1,213	482	732
Nevada	227	116	32	11	68	6.2%	1,005	258	747
New Hampshire	212	112	31	11	58	17.6%	563	270	293

Table 1
Spending Reductions under Balanced Budget Amendment, FY 2002 ($mil)

State	Cuts in Grants to State Governments					Required State Tax Increase	Cuts in Other Federal Spending		
	Total	Medicaid	Highway	AFDC	Other		Total	Medicare	Other
New Jersey	2,476	1,500	141	129	705	12.7%	4,653	2,894	1,759
New Mexico	524	233	70	28	193	12.9%	2,117	321	1,796
New York	8,181	5,442	274	535	1,930	17.4%	11,058	6,876	4,182
North Carolina	1,697	1,025	136	95	441	11.1%	3,217	1,432	1,785
North Dakota	229	105	35	8	81	19.7%	563	231	332
Ohio	2,826	1,718	170	212	727	14.4%	6,007	3,442	2,565
Oklahoma	770	424	51	51	244	12.4%	2,110	934	1,177
Oregon	706	342	54	47	263	12.2%	1,976	833	1,143
Pennsylvania	3,057	1,767	211	178	901	12.7%	8,555	5,120	3,435
Rhode Island	430	255	42	23	109	21.4%	619	347	272
South Carolina	1,003	644	68	31	260	14.3%	2,217	682	1,535
South Dakota	231	103	39	6	82	24.7%	577	205	372
Tennessee	1,537	989	78	60	411	19.5%	3,845	1,349	2,496
Texas	4,167	2,520	340	147	1,159	14.0%	10,758	4,280	6,479
Utah	422	190	49	22	160	11.4%	1,078	235	842
Vermont	207	89	37	13	68	17.4%	301	150	151
Virginia	1,005	490	72	49	393	8.2%	6,073	1,374	4,699
Washington	1,318	730	117	126	346	8.4%	3,569	1,107	2,463
West Virginia	765	488	45	32	199	20.6%	1,209	600	608
Wisconsin	1,250	694	111	96	349	10.3%	2,480	1,503	977
Wyoming	218	55	38	8	118	18.7%	286	96	191
State Total	70,172	40,271	5,093	4,480	20,328	12.6%	172,792	77,199	95,593
Undist. & Terr.	1,127	43	83	28	973	N.A.	3,700	276	3,424

Table 2
Spending Reductions under Contract with America, FY 2002 ($mil)

State	Cuts in Grants to State Governments					Required State Tax Increase	Cuts in Other Federal Spending		
	Total	Medicaid	Highway	AFDC	Other		Total	Medicare	Other
U.S. Total	97,825	55,312	7,102	6,185	29,226	N.A.	242,151	106,298	135,854
Alabama	1,594	879	135	44	536	22.5%	4,195	1,588	2,608
Alaska	420	123	98	26	174	13.5%	790	60	730
Arizona	1,261	712	108	93	348	14.2%	3,288	1,302	1,986
Arkansas	992	571	90	23	309	22.7%	2,150	1,052	1,098
California	10,576	5,412	607	1,317	3,241	12.6%	27,880	12,486	15,394
Colorado	1,036	531	108	49	347	16.2%	3,793	989	2,804
Connecticut	1,383	805	145	86	348	15.4%	2,529	1,494	1,035
Delaware	217	97	25	12	83	9.8%	526	241	284
DC	956	252	23	32	650	27.9%	6,774	429	6,345
Florida	3,644	2,086	277	233	1,048	14.0%	13,421	7,321	6,100
Georgia	2,206	1,286	180	138	601	16.5%	5,200	1,910	3,290
Hawaii	450	161	85	32	172	9.3%	1,012	296	716
Idaho	349	162	46	11	131	13.6%	1,173	299	874
Illinois	3,534	1,858	239	213	1,224	15.9%	10,334	5,614	4,721
Indiana	2,044	1,312	168	74	490	18.9%	3,473	2,054	1,419
Iowa	864	451	95	48	270	15.0%	2,633	1,231	1,402
Kansas	853	487	71	40	255	17.8%	2,374	1,124	1,249
Kentucky	1,587	947	95	77	468	19.8%	2,896	1,306	1,590
Louisiana	2,697	2,059	129	66	444	38.2%	3,240	1,462	1,778
Maine	621	383	38	33	166	24.0%	983	529	454
Maryland	1,543	798	113	89	543	13.5%	8,579	1,889	6,690
Massachusetts	2,627	1,472	340	185	630	17.3%	6,425	3,360	3,065
Michigan	3,398	1,859	192	314	1,034	18.1%	6,844	4,572	2,271
Minnesota	1,615	931	139	113	431	13.0%	3,494	1,541	1,954
Mississippi	1,185	681	84	33	387	28.5%	2,294	978	1,316
Missouri	1,806	1,025	149	85	547	21.2%	5,408	2,444	2,965
Montana	380	169	71	17	123	27.1%	1,021	298	722
Nebraska	533	264	60	31	177	18.3%	1,665	661	1,004
Nevada	312	159	44	15	94	8.6%	1,379	354	1,025
New Hampshire	291	154	43	16	79	24.1%	773	370	403

Table 2
Spending Reductions under Contract with America, FY 2002 ($mil)

State	Cuts in Grants to State Governments					Required State Tax Increase	Cuts in Other Federal Spending		
	Total	Medicaid	Highway	AFDC	Other		Total	Medicare	Other
New Jersey	3,397	2,059	194	177	968	17.5%	6,384	3,971	2,413
New Mexico	719	320	96	38	265	17.6%	2,904	440	2,464
New York	11,225	7,466	376	734	2,649	23.8%	15,172	9,435	5,738
North Carolina	2,329	1,406	187	130	605	15.2%	4,414	1,965	2,449
North Dakota	314	144	48	10	111	27.0%	773	317	455
Ohio	3,878	2,358	233	290	997	19.8%	8,242	4,722	3,520
Oklahoma	1,056	582	70	69	335	17.0%	2,896	1,281	1,615
Oregon	969	469	75	65	361	16.8%	2,711	1,143	1,568
Pennsylvania	4,194	2,424	290	244	1,237	17.4%	11,738	7,025	4,713
Rhode Island	590	350	58	32	150	29.3%	849	476	373
South Carolina	1,376	883	94	42	357	19.6%	3,042	935	2,106
South Dakota	316	142	53	9	113	33.8%	792	281	511
Tennessee	2,109	1,357	107	82	563	26.7%	5,275	1,850	3,425
Texas	5,717	3,457	466	202	1,591	19.2%	14,761	5,872	8,889
Utah	579	261	68	31	220	15.6%	1,479	323	1,156
Vermont	284	122	51	18	93	23.9%	413	206	207
Virginia	1,379	673	99	68	539	11.2%	8,332	1,885	6,447
Washington	1,809	1,001	161	172	474	11.5%	4,897	1,518	3,379
West Virginia	1,049	670	62	44	273	28.3%	1,658	824	835
Wisconsin	1,716	952	153	132	479	14.2%	3,402	2,062	1,340
Wyoming	300	75	52	10	162	25.7%	393	131	262
State Total	96,278	55,253	6,988	6,147	27,891	17.3%	237,075	105,919	131,155
Undist. & Terr.	1,547	59	114	38	1,335	N.A.	5,077	378	4,698

Balanced Budget Amendment
Estimation of State-by-State Effects

The following description provides information on the estimation and allocation of spending cuts under two scenarios that achieve a balanced budget by FY2002 without tax increases and with Social Security and defense excluded from spending reductions. The second scenario differs from the first in that it also incorporates a set of deficit-increasing provisions in the Contract with America (CWA). These provisions are all tax reductions except for a spending increase associated with relaxation of the Social Security earnings test. No specific defense spending increases discussed in the CWA are reflected in the simulations.

Step 1: *Derive size of aggregate budget cuts.*

Congressional Budget Office (CBO) baseline estimates of the Federal deficit were taken from Table 4 of the preliminary *Economic and Budget Outlook* dated January 5, 1995. Equal yearly deficit reductions, beginning in FY1996, were then computed which were sufficient to achieve a balanced budget by FY2002.

The required cuts take into account the interest savings that would result from lower deficits and debt; a 6.7 percent rate of interest was assumed throughout based on long-term CBO projections of the 10-year Treasury note rate. The estimates are static in nature and reflect no macroeconomic feedback--e.g., lower economic growth resulting from the contractionary effects of deficit reduction or higher growth resulting from lower tax rates. Deficit-reducing spending and tax changes of $248 billion, or 22.5 percent of noninterest, nondefense, non-Social Security spending, would have to be made in FY2002 to achieve a balanced budget. The required cumulative deficit reduction is approximately $1.3 trillion, of which about $0.2 trillion occurs through interest savings.

A similar procedure was used to derive required spending reductions with the CWA's tax cut and Social Security spending amounts (and associated interest carrying costs) added to the CBO deficit baseline. Estimated revenue effects of the proposed tax reductions were obtained from the Treasury Department, Office of Tax Analysis. Annual costs of the proposed relaxation of the Social Security earnings test were taken from a National Economic Council staff working paper, September 20, 1994. The required percentage spending reduction is 30.9 percent in this scenario. The aggregate required cuts in total spending in FY2002 total $340 billion.

Step 2: *Derive allocation parameters for states.*

Grants to state and local governments, as well as Social Security, defense, and other Federal spending, are reported in *Federal Expenditures by State for Fiscal Year 1993*. Our analysis divides intergovernmental grants into four components: Aid to Families with Dependent Children, Medicaid, highway trust fund grants, and all Other. It was assumed that all grants in the first three of these categories went directly to state governments. To estimate the local share of the Other category, we used estimates of total 1992 intergovernmental revenues from Federal to local governments in each state, as reported in the August 1994 Census publication

Government Finances, 1991-92: Preliminary Report. These state-by-state estimates were divided by the *Government Finances* estimates of Federal revenues to states and localities combined, less the values of AFDC, Medicaid, and highway grants from the FY1992 edition of *Federal Expenditures by State*. It should be emphasized that discrepancies between the *Government Finances* and *Federal Expenditures* aggregates, resulting from different definitions and sources, make this local vs. state decomposition of Other grants an imprecise process.

State tax revenues for the average of the 1990 and 1992 fiscal years was also taken from issues of *Government Finances*. The use of two years at different points in the business cycle was designed to mitigate cyclical influences on projected revenue.

Step 3: Project FY2002 Grants and State Taxes.

CBO's projected levels for FY2002 for Social Security, Medicare, and most other major spending categories were taken from the above-mentioned CBO report. For defense spending, the Administration's projection of FY2000 defense outlays was inflated by the annual rate of growth of total discretionary spending from FY2000 to FY2002 in the CBO projections.

The projection of grant amounts was also derived from the long-term CBO budget forecast. AFDC grants were projected using the ratio of 2002 to 1993 values of Other Mandatory spending as reported by CBO, respectively, in the January 5 report and on page 37 of *The Economic and Budget Outlook: Update* dated August 1994. (Unpublished figures on FY1993 Civil Service and military retirement spending were obtained from CBO.) Highway trust fund grants were projected using the ratio of 2002 to 1993 values of domestic discretionary spending; the 2002 value was estimated as estimated total nondefense discretionary spending multiplied by the FY2002 ratio of domestic to the sum of international and domestic discretionary spending in Table 4 of the January 5 report.

The category of Other grants was decomposed into discretionary and mandatory components. The Other mandatory component was defined to include: Agricultural Marketing Service funds for strengthening markets (Section 32); child nutrition programs; food stamp grants; special milk program; national grasslands payments to counties; social services block grants; foster care and adoption assistance; assistance for legalized aliens; other Administration for Children and Families grants; and Supplemental Security Income grants. These were projected in the same manner as AFDC, while the residual Other discretionary grants were projected in the same manner as highway grants.

Total baseline state taxes were projected to move in proportion to nominal U.S. Gross Domestic Product. The projection of GDP for calendar year 2000 was taken from Table 1 of the CBO January 5 report and increased by three years of assumed 2.3 percent real growth and 2.8 percent increases in the GDP price deflator. The growth in nominal GDP between 1991 and 2002 was converted to a per capita basis. Individual state taxes in FY2002 were then estimated by multiplying 1990-1992 average taxes by the product of 1991-2002 state population growth and the growth in U.S. per capita GDP. State population totals for 2000 and 2010 were drawn from

the 1994 Statistical Abstract, and our estimates for 2002 were interpolations of the 2000 and 2010 values.

Step 4: Derive required grant reductions and state tax increases.

The percentage reductions in FY2002 grants and other spending components necessary to achieve budget balance were, by assumption, equal to the aggregate percentage rate computed for all nondefense, non-Social Security spending. Finally, the percentage increase in the state tax levels necessary to make up the dollar loss in Federal grants to each state was computed.

Office of Economic Policy, Department of the Treasury, January 11, 1995

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 12, 1995

The Honorable Howard Dean, M.D.
Chairman, National Governors' Association
Office of the Governor
Montpelier, VT 05659

Dear Governor Dean:

I write to answer your request for information on the likely effects of passage of a balanced-budget amendment, accompanied by "Contract with America" federal tax reductions, on state budgets and state taxes.

Enclosed is a set of estimates that Treasury staff have constructed of the possible effect on states and their finances of a constitutional amendment requiring the balancing of the federal budget in 2002, accompanied by the tax reductions mentioned above. These estimates are based on the following assumptions: (I) that the federal budget would be balanced through spending cuts, (II) that Social Security and Defense spending would not be reduced below baseline, and thus (III) that the entire burden of balancing the federal budget would be placed on non-interest, non-Social Security, non-Defense spending, as proposed methods for balancing the budget and financing various tax cuts excludes Social Security and Defense.

The estimates assume that every expenditure--interest, Social Security, and Defense aside --would be reduced relative to baseline by the same proportional amount. The estimates assume that the deficit reduction will be phased in gradually, an equal amount in each year between now and 2002. This arrangement of the spending cuts results in substantial interest savings relative to the baseline in 2002, and thus reduces the amount of non-interest spending that must be cut in 2002 to balance the budget.

Nevertheless, the cuts required in 2002 would be severe. To help balance the budget and help offset the tax reductions noted above, federal grants to states would be cut by a total of $97.8 billion in fiscal 2002. Other federal spending that directly benefits state residents would be cut by $242.2 billion in fiscal 2002.

The cuts in grants--in Medicaid, highway funds, AFDC, and other grants--and the cuts in other spending--on Medicare and on other spending--were distributed across states proportionately to current levels of federal expenditures. Also reported is the amount by which total state taxes would have to be raised if the state wished to fully offset the reduction in federal grants.

Grants to states in the aggregate, to specific states, and to states for specific programs may be cut by more or by less than projected here. Yet, without further detail, the most reasonable method for illustrating the likely burdens on states is to assume across-the-board proportional cuts.

Note, also, that these estimates do not incorporate any significant feedback effects: it is possible that shifts in monetary policy would not be able to fully offset the downward macroeconomic impact of a balanced-budget amendment. To the extent that implementation of an amendment slows growth and reduces state revenues, the gap would be somewhat larger and the effect on state finances somewhat more severe. On the other hand, balancing the federal budget could have substantial positive effects on the U.S. economy, which would promise to raise state revenues as state economic activity increased. Such effects are not discussed here.

Note, finally, that this set of estimates is far from being a complete analysis of a balanced-budget amendment. Its principal function is to identify and evaluate the approximate impact on state government finances of a constitutional amendment that requires federal budget balance by 2002.

Sincerely yours,

Joyce Carrier
Deputy Assistant Secretary
for Public Liaison

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF ALABAMA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Alabama state government by $1.2 billion.

- $641 million per year in lost funding for Medicaid
- $98 million per year in lost highway trust fund grants
- $32 million per year in lost funding for welfare (AFDC)
- $391 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Alabama would have to increase state taxes by 16.4 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Alabama state government by $1.6 billion.

- $879 million per year in lost funding for Medicaid
- $135 million per year in lost highway trust fund grants
- $44 million per year in lost funding for welfare (AFDC)
- $536 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Alabama would have to increase state taxes by 22.5 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Alabama by $4.2 billion.

- $1.6 billion per year in Medicare benefits
- $2.6 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF ALASKA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Alaska state government by $306 million.

- $89 million per year in lost funding for Medicaid
- $71 million per year in lost highway trust fund grants
- $19 million per year in lost funding for welfare (AFDC)
- $127 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Alaska would have to increase state taxes by 9.8 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Alaska state government by $420 million.

- $123 million per year in lost funding for Medicaid
- $98 million per year in lost highway trust fund grants
- $26 million per year in lost funding for welfare (AFDC)
- $174 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Alaska would have to increase state taxes by 13.5 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Alaska by $790 million.

- $60 million per year in Medicare benefits
- $730 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF ARIZONA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Arizona state government by $919 million.**

- $519 million per year in lost funding for Medicaid
- $78 million per year in lost highway trust fund grants
- $68 million per year in lost funding for welfare (AFDC)
- $254 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Arizona would have to increase state taxes by 10.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Arizona state government by $1.3 billion.**

- $712 million per year in lost funding for Medicaid
- $108 million per year in lost highway trust fund grants
- $93 million per year in lost funding for welfare (AFDC)
- $348 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Arizona would have to increase state taxes by 14.2 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Arizona by $3.3 billion.**

- $1.3 billion per year in Medicare benefits
- $2.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF ARKANSAS[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Arkansas state government by $723 million.

- $416 million per year in lost funding for Medicaid
- $65 million per year in lost highway trust fund grants
- $16 million per year in lost funding for welfare (AFDC)
- $225 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Arkansas would have to increase state taxes by 16.5 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Arkansas state government by $992 million.

- $571 million per year in lost funding for Medicaid
- $90 million per year in lost highway trust fund grants
- $23 million per year in lost funding for welfare (AFDC)
- $309 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Arkansas would have to increase state taxes by 22.7 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Arkansas by $2.1 billion.

- $1.1 billion per year in Medicare benefits
- $1.1 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF CALIFORNIA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the California state government by $7.7 billion.**

- $3.9 billion per year in lost funding for Medicaid
- $442 million per year in lost highway trust fund grants
- $960 million per year in lost funding for welfare (AFDC)
- $2.4 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *California would have to increase state taxes by 9.2 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the California state government by $10.6 billion.**

- $5.4 billion per year in lost funding for Medicaid
- $607 million per year in lost highway trust fund grants
- $1.3 billion per year in lost funding for welfare (AFDC)
- $3.2 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *California would have to increase state taxes by 12.6 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in California by $27.9 billion.**

- $12.5 billion per year in Medicare benefits
- $15.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF COLORADO[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Colorado state government by $755 million.

- $387 million per year in lost funding for Medicaid
- $79 million per year in lost highway trust fund grants
- $36 million per year in lost funding for welfare (AFDC)
- $253 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Colorado would have to increase state taxes by 11.8 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Colorado state government by $1.0 billion.

- $531 million per year in lost funding for Medicaid
- $108 million per year in lost highway trust fund grants
- $49 million per year in lost funding for welfare (AFDC)
- $347 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Colorado would have to increase state taxes by 16.2 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Colorado by $3.8 billion.

- $989 million per year in Medicare benefits
- $2.8 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF CONNECTICUT[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Connecticut state government by $1.0 billion.**

- $587 million per year in lost funding for Medicaid
- $105 million per year in lost highway trust fund grants
- $63 million per year in lost funding for welfare (AFDC)
- $253 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Connecticut would have to increase state taxes by 11.2 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Connecticut state government by $1.4 billion.**

- $805 million per year in lost funding for Medicaid
- $145 million per year in lost highway trust fund grants
- $86 million per year in lost funding for welfare (AFDC)
- $348 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Connecticut would have to increase state taxes by 15.4 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Connecticut by $2.5 billion.**

- $1.5 billion per year in Medicare benefits
- $1.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF DELAWARE[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Delaware state government by $158 million.

- $70 million per year in lost funding for Medicaid
- $18 million per year in lost highway trust fund grants
- $9 million per year in lost funding for welfare (AFDC)
- $61 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Delaware would have to increase state taxes by 7.2 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Delaware state government by $217 million.

- $97 million per year in lost funding for Medicaid
- $25 million per year in lost highway trust fund grants
- $12 million per year in lost funding for welfare (AFDC)
- $83 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Delaware would have to increase state taxes by 9.8 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Delaware by $526 million.

- $241 million per year in Medicare benefits
- $284 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE DISTRICT OF COLUMBIA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the D.C. government by $697 million.

- $183 million per year in lost funding for Medicaid
- $17 million per year in lost highway trust fund grants
- $24 million per year in lost funding for welfare (AFDC)
- $473 million per year in lost funding for education, job training, the environment, housing, and other areas
- *D.C. would have to increase state taxes by 20.4 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the D.C. government by $956 million.

- $252 million per year in lost funding for Medicaid
- $23 million per year in lost highway trust fund grants
- $32 million per year in lost funding for welfare (AFDC)
- $650 million per year in lost funding for education, job training, the environment, housing, and other areas
- *D.C. would have to increase state taxes by 27.9 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in DC by $6.8 billion.

- $429 million per year in Medicare benefits
- $6.3 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF FLORIDA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Florida state government by $2.7 billion.

- $1.5 billion per year in lost funding for Medicaid
- $202 million per year in lost highway trust fund grants
- $170 million per year in lost funding for welfare (AFDC)
- $764 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Florida would have to increase state taxes by 10.2 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Florida state government by $3.6 billion.

- $2.1 billion per year in lost funding for Medicaid
- $277 million per year in lost highway trust fund grants
- $233 million per year in lost funding for welfare (AFDC)
- $1.0 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Florida would have to increase state taxes by 14.0 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Florida by $13.4 billion.

- $7.3 billion per year in Medicare benefits
- $6.1 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF GEORGIA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Georgia state government by $1.6 billion.

- $938 million per year in lost funding for Medicaid
- $131 million per year in lost highway trust fund grants
- $101 million per year in lost funding for welfare (AFDC)
- $438 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Georgia would have to increase state taxes by 12.0 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Georgia state government by $2.2 billion.

- $1.3 billion per year in lost funding for Medicaid
- $180 million per year in lost highway trust fund grants
- $138 million per year in lost funding for welfare (AFDC)
- $601 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Georgia would have to increase state taxes by 16.5 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Georgia by $5.2 billion.

- $1.9 billion per year in Medicare benefits
- $3.3 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF HAWAII[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Hawaii state government by $328 million.

- $117 million per year in lost funding for Medicaid
- $62 million per year in lost highway trust fund grants
- $24 million per year in lost funding for welfare (AFDC)
- $125 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Hawaii would have to increase state taxes by 6.8 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Hawaii state government by $450 million.

- $161 million per year in lost funding for Medicaid
- $85 million per year in lost highway trust fund grants
- $32 million per year in lost funding for welfare (AFDC)
- $172 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Hawaii would have to increase state taxes by 9.3 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Hawaii by $1.0 billion.

- $296 million per year in Medicare benefits
- $716 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF IDAHO[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Idaho state government by $254 million.

- $118 million per year in lost funding for Medicaid
- $33 million per year in lost highway trust fund grants
- $8 million per year in lost funding for welfare (AFDC)
- $95 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Idaho would have to increase state taxes by 9.9 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Idaho state government by $349 million.

- $162 million per year in lost funding for Medicaid
- $46 million per year in lost highway trust fund grants
- $11 million per year in lost funding for welfare (AFDC)
- $131 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Idaho would have to increase state taxes by 13.6 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Idaho by $1.2 billion.

- $299 million per year in Medicare benefits
- $874 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF ILLINOIS[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Illinois state government by $2.6 billion.

- $1.4 billion per year in lost funding for Medicaid
- $174 million per year in lost highway trust fund grants
- $155 million per year in lost funding for welfare (AFDC)
- $892 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Illinois would have to increase state taxes by 11.6 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Illinois state government by $3.5 billion.

- $1.9 billion per year in lost funding for Medicaid
- $239 million per year in lost highway trust fund grants
- $213 million per year in lost funding for welfare (AFDC)
- $1.2 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Illinois would have to increase state taxes by 15.9 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Illinois by $10.3 billion.

- $5.6 billion per year in Medicare benefits
- $4.7 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF INDIANA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Indiana state government by $1.5 billion.**

- $956 million per year in lost funding for Medicaid
- $123 million per year in lost highway trust fund grants
- $54 million per year in lost funding for welfare (AFDC)
- $357 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Indiana would have to increase state taxes by 13.8 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Indiana state government by $2.0 billion.**

- $1.3 billion per year in lost funding for Medicaid
- $168 million per year in lost highway trust fund grants
- $74 million per year in lost funding for welfare (AFDC)
- $490 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Indiana would have to increase state taxes by 18.9 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Indiana by $3.5 billion.**

- $2.1 billion per year in Medicare benefits
- $1.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF IOWA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Iowa state government by $630 million.

- $328 million per year in lost funding for Medicaid
- $69 million per year in lost highway trust fund grants
- $35 million per year in lost funding for welfare (AFDC)
- $197 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Iowa would have to increase state taxes by 10.9 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Iowa state government by $864 million.

- $451 million per year in lost funding for Medicaid
- $95 million per year in lost highway trust fund grants
- $48 million per year in lost funding for welfare (AFDC)
- $270 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Iowa would have to increase state taxes by 15.0 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Iowa by $2.6 billion.

- $1.2 billion per year in Medicare benefits
- $1.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF KANSAS[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Kansas state government by $622 million.

- $355 million per year in lost funding for Medicaid
- $52 million per year in lost highway trust fund grants
- $29 million per year in lost funding for welfare (AFDC)
- $186 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Kansas would have to increase state taxes by 13.0 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Kansas state government by $853 million.

- $487 million per year in lost funding for Medicaid
- $71 million per year in lost highway trust fund grants
- $40 million per year in lost funding for welfare (AFDC)
- $255 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Kansas would have to increase state taxes by 17.8 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Kansas by $2.4 billion.

- $1.1 billion per year in Medicare benefits
- $1.2 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF KENTUCKY[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Kentucky state government by $1.2 billion.

- $690 million per year in lost funding for Medicaid
- $69 million per year in lost highway trust fund grants
- $56 million per year in lost funding for welfare (AFDC)
- $341 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Kentucky would have to increase state taxes by 14.5 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Kentucky state government by $1.6 billion.

- $947 million per year in lost funding for Medicaid
- $95 million per year in lost highway trust fund grants
- $77 million per year in lost funding for welfare (AFDC)
- $468 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Kentucky would have to increase state taxes by 19.8 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Kentucky by $2.9 billion.

- $1.3 billion per year in Medicare benefits
- $1.6 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF LOUISIANA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Louisiana state government by $2.0 billion.**

- $1.5 billion per year in lost funding for Medicaid
- $94 million per year in lost highway trust fund grants
- $48 million per year in lost funding for welfare (AFDC)
- $324 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Louisiana would have to increase state taxes by 27.8 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Louisiana state government by $2.7 billion.**

- $2.1 billion per year in lost funding for Medicaid
- $129 million per year in lost highway trust fund grants
- $66 million per year in lost funding for welfare (AFDC)
- $444 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Louisiana would have to increase state taxes by 38.2 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Louisiana by $3.2 billion.**

- $1.5 billion per year in Medicare benefits
- $1.8 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MAINE[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Maine state government by $452 million.**

- $279 million per year in lost funding for Medicaid
- $28 million per year in lost highway trust fund grants
- $24 million per year in lost funding for welfare (AFDC)
- $121 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Maine would have to increase state taxes by 17.5 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Maine state government by $621 million.**

- $383 million per year in lost funding for Medicaid
- $38 million per year in lost highway trust fund grants
- $33 million per year in lost funding for welfare (AFDC)
- $166 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Maine would have to increase state taxes by 24.0 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Maine by $983 million.**

- $529 million per year in Medicare benefits
- $454 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MARYLAND[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Maryland state government by $1.1 billion.**

- $581 million per year in lost funding for Medicaid
- $83 million per year in lost highway trust fund grants
- $65 million per year in lost funding for welfare (AFDC)
- $396 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Maryland would have to increase state taxes by 9.9 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Maryland state government by $1.5 billion.**

- $798 million per year in lost funding for Medicaid
- $113 million per year in lost highway trust fund grants
- $89 million per year in lost funding for welfare (AFDC)
- $543 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Maryland would have to increase state taxes by 13.5 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Maryland by $8.6 billion.**

- $1.9 billion per year in Medicare benefits
- $6.7 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MASSACHUSETTS[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Massachusetts state government by $1.9 billion.

- $1.1 billion per year in lost funding for Medicaid
- $248 million per year in lost highway trust fund grants
- $135 million per year in lost funding for welfare (AFDC)
- $459 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Massachusetts would have to increase state taxes by 12.6 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Massachusetts state government by $2.6 billion.

- $1.5 billion per year in lost funding for Medicaid
- $340 million per year in lost highway trust fund grants
- $185 million per year in lost funding for welfare (AFDC)
- $630 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Massachusetts would have to increase state taxes by 17.3 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Massachusetts by $6.4 billion.

- $3.4 billion per year in Medicare benefits
- $3.1 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MICHIGAN[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Michigan state government by $2.5 billion.**

- $1.4 billion per year in lost funding for Medicaid
- $140 million per year in lost highway trust fund grants
- $229 million per year in lost funding for welfare (AFDC)
- $753 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Michigan would have to increase state taxes by 13.2 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Michigan state government by $3.4 billion.**

- $1.9 billion per year in lost funding for Medicaid
- $192 million per year in lost highway trust fund grants
- $314 million per year in lost funding for welfare (AFDC)
- $1.0 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Michigan would have to increase state taxes by 18.1 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Michigan by $6.8 billion.**

- $4.6 billion per year in Medicare benefits
- $2.3 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MINNESOTA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Minnesota state government by $1.2 billion.**

- $679 million per year in lost funding for Medicaid
- $102 million per year in lost highway trust fund grants
- $83 million per year in lost funding for welfare (AFDC)
- $314 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Minnesota would have to increase state taxes by 9.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Minnesota state government by $1.6 billion.**

- $931 million per year in lost funding for Medicaid
- $139 million per year in lost highway trust fund grants
- $113 million per year in lost funding for welfare (AFDC)
- $431 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Minnesota would have to increase state taxes by 13.0 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Minnesota by $3.5 billion.**

- $1.5 billion per year in Medicare benefits
- $2.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MISSISSIPPI[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Mississippi state government by $864 million.**

- $496 million per year in lost funding for Medicaid
- $61 million per year in lost highway trust fund grants
- $24 million per year in lost funding for welfare (AFDC)
- $282 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Mississippi would have to increase state taxes by 20.8 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Mississippi state government by $1.2 billion.**

- $681 million per year in lost funding for Medicaid
- $84 million per year in lost highway trust fund grants
- $33 million per year in lost funding for welfare (AFDC)
- $387 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Mississippi would have to increase state taxes by 28.5 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Mississippi by $2.3 billion.**

- $978 million per year in Medicare benefits
- $1.3 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MISSOURI[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Missouri state government by $1.3 billion.**

- $747 million per year in lost funding for Medicaid
- $109 million per year in lost highway trust fund grants
- $62 million per year in lost funding for welfare (AFDC)
- $398 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Missouri would have to increase state taxes by 15.5 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Missouri state government by $1.8 billion.**

- $1.0 billion per year in lost funding for Medicaid
- $149 million per year in lost highway trust fund grants
- $85 million per year in lost funding for welfare (AFDC)
- $547 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Missouri would have to increase state taxes by 21.2 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Missouri by $5.4 billion.**

- $2.4 billion per year in Medicare benefits
- $3.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MONTANA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Montana state government by $277 million.**

- $123 million per year in lost funding for Medicaid
- $52 million per year in lost highway trust fund grants
- $12 million per year in lost funding for welfare (AFDC)
- $89 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Montana would have to increase state taxes by 19.8 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Montana state government by $380 million.**

- $169 million per year in lost funding for Medicaid
- $71 million per year in lost highway trust fund grants
- $17 million per year in lost funding for welfare (AFDC)
- $123 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Montana would have to increase state taxes by 27.1 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Montana by $1.0 billion.**

- $298 million per year in Medicare benefits
- $722 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEBRASKA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Nebraska state government by $388 million.**

- $192 million per year in lost funding for Medicaid
- $44 million per year in lost highway trust fund grants
- $23 million per year in lost funding for welfare (AFDC)
- $129 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Nebraska would have to increase state taxes by 13.3 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Nebraska state government by $533 million.**

- $264 million per year in lost funding for Medicaid
- $60 million per year in lost highway trust fund grants
- $31 million per year in lost funding for welfare (AFDC)
- $177 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Nebraska would have to increase state taxes by 18.3 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Nebraska by $1.7 billion.**

- $661 million per year in Medicare benefits
- $1.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEVADA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Nevada state government by $227 million.**

- $116 million per year in lost funding for Medicaid
- $32 million per year in lost highway trust fund grants
- $11 million per year in lost funding for welfare (AFDC)
- $68 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Nevada would have to increase state taxes by 6.2 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Nevada state government by $312 million.**

- $159 million per year in lost funding for Medicaid
- $44 million per year in lost highway trust fund grants
- $15 million per year in lost funding for welfare (AFDC)
- $94 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Nevada would have to increase state taxes by 8.6 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Nevada by $1.4 billion.**

- $354 million per year in Medicare benefits
- $1.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEW HAMPSHIRE[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the New Hampshire state government by $212 million.**

- $112 million per year in lost funding for Medicaid
- $31 million per year in lost highway trust fund grants
- $11 million per year in lost funding for welfare (AFDC)
- $58 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Hampshire would have to increase state taxes by 17.6 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the New Hampshire state government by $291 million.**

- $154 million per year in lost funding for Medicaid
- $43 million per year in lost highway trust fund grants
- $16 million per year in lost funding for welfare (AFDC)
- $79 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Hampshire would have to increase state taxes by 24.1 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in New Hampshire by $773 million.**

- $370 million per year in Medicare benefits
- $403 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEW JERSEY[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the New Jersey state government by $2.5 billion.**

- $1.5 billion per year in lost funding for Medicaid
- $141 million per year in lost highway trust fund grants
- $129 million per year in lost funding for welfare (AFDC)
- $705 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Jersey would have to increase state taxes by 12.7 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the New Jersey state government by $3.4 billion.**

- $2.1 billion per year in lost funding for Medicaid
- $194 million per year in lost highway trust fund grants
- $177 million per year in lost funding for welfare (AFDC)
- $968 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Jersey would have to increase state taxes by 17.5 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in New Jersey by $6.4 billion.**

- $4.0 billion per year in Medicare benefits
- $2.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEW MEXICO[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the New Mexico state government by $524 million.**

- $233 million per year in lost funding for Medicaid
- $70 million per year in lost highway trust fund grants
- $28 million per year in lost funding for welfare (AFDC)
- $193 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Mexico would have to increase state taxes by 12.9 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the New Mexico state government by $719 million.**

- $320 million per year in lost funding for Medicaid
- $96 million per year in lost highway trust fund grants
- $38 million per year in lost funding for welfare (AFDC)
- $265 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Mexico would have to increase state taxes by 17.6 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in New Mexico by $2.9 billion.**

- $440 million per year in Medicare benefits
- $2.5 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEW YORK[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the New York state government by $8.2 billion.**

- $5.4 billion per year in lost funding for Medicaid
- $274 million per year in lost highway trust fund grants
- $535 million per year in lost funding for welfare (AFDC)
- $1.9 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *New York would have to increase state taxes by 17.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the New York state government by $11.2 billion.**

- $7.5 billion per year in lost funding for Medicaid
- $376 million per year in lost highway trust fund grants
- $734 million per year in lost funding for welfare (AFDC)
- $2.6 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *New York would have to increase state taxes by 23.8 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in New York by $15.2 billion.**

- $9.4 billion per year in Medicare benefits
- $5.7 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NORTH CAROLINA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the North Carolina state government by $1.7 billion.**

- $1.0 billion per year in lost funding for Medicaid
- $136 million per year in lost highway trust fund grants
- $95 million per year in lost funding for welfare (AFDC)
- $441 million per year in lost funding for education, job training, the environment, housing, and other areas
- *North Carolina would have to increase state taxes by 11.1 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the North Carolina state government by $2.3 billion.**

- $1.4 billion per year in lost funding for Medicaid
- $187 million per year in lost highway trust fund grants
- $130 million per year in lost funding for welfare (AFDC)
- $605 million per year in lost funding for education, job training, the environment, housing, and other areas
- *North Carolina would have to increase state taxes by 15.2 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in North Carolina by $4.4 billion.**

- $2.0 billion per year in Medicare benefits
- $2.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NORTH DAKOTA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the North Dakota state government by $229 million.**

- $105 million per year in lost funding for Medicaid
- $35 million per year in lost highway trust fund grants
- $8 million per year in lost funding for welfare (AFDC)
- $81 million per year in lost funding for education, job training, the environment, housing, and other areas
- *North Dakota would have to increase state taxes by 19.7 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the North Dakota state government by $314 million.**

- $144 million per year in lost funding for Medicaid
- $48 million per year in lost highway trust fund grants
- $10 million per year in lost funding for welfare (AFDC)
- $111 million per year in lost funding for education, job training, the environment, housing, and other areas
- *North Dakota would have to increase state taxes by 27.0 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in North Dakota by $773 million.**

- $317 million per year in Medicare benefits
- $455 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF OHIO[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Ohio state government by $2.8 billion.

- $1.7 billion per year in lost funding for Medicaid
- $170 million per year in lost highway trust fund grants
- $212 million per year in lost funding for welfare (AFDC)
- $727 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Ohio would have to increase state taxes by 14.4 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Ohio state government by $3.9 billion.

- $2.4 billion per year in lost funding for Medicaid
- $233 million per year in lost highway trust fund grants
- $290 million per year in lost funding for welfare (AFDC)
- $997 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Ohio would have to increase state taxes by 19.8 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Ohio by $8.2 billion.

- $4.7 billion per year in Medicare benefits
- $3.5 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF OKLAHOMA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Oklahoma state government by $770 million.**

- $424 million per year in lost funding for Medicaid
- $51 million per year in lost highway trust fund grants
- $51 million per year in lost funding for welfare (AFDC)
- $244 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Oklahoma would have to increase state taxes by 12.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Oklahoma state government by $1.1 billion.**

- $582 million per year in lost funding for Medicaid
- $70 million per year in lost highway trust fund grants
- $69 million per year in lost funding for welfare (AFDC)
- $335 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Oklahoma would have to increase state taxes by 17.0 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Oklahoma by $2.9 billion.**

- $1.3 billion per year in Medicare benefits
- $1.6 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF OREGON[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Oregon state government by $706 million.

- $342 million per year in lost funding for Medicaid
- $54 million per year in lost highway trust fund grants
- $47 million per year in lost funding for welfare (AFDC)
- $263 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Oregon would have to increase state taxes by 12.2 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Oregon state government by $969 million.

- $469 million per year in lost funding for Medicaid
- $75 million per year in lost highway trust fund grants
- $65 million per year in lost funding for welfare (AFDC)
- $361 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Oregon would have to increase state taxes by 16.8 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Oregon by $2.7 billion.

- $1.1 billion per year in Medicare benefits
- $1.6 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF PENNSYLVANIA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Pennsylvania state government by $3.1 billion.

- $1.8 billion per year in lost funding for Medicaid
- $211 million per year in lost highway trust fund grants
- $178 million per year in lost funding for welfare (AFDC)
- $901 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Pennsylvania would have to increase state taxes by 12.7 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Pennsylvania state government by $4.2 billion.

- $2.4 billion per year in lost funding for Medicaid
- $290 million per year in lost highway trust fund grants
- $244 million per year in lost funding for welfare (AFDC)
- $1.2 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Pennsylvania would have to increase state taxes by 17.4 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Pennsylvania by $11.7 billion.

- $7.0 billion per year in Medicare benefits
- $4.7 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF RHODE ISLAND[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Rhode Island state government by $430 million.**

- $255 million per year in lost funding for Medicaid
- $42 million per year in lost highway trust fund grants
- $23 million per year in lost funding for welfare (AFDC)
- $109 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Rhode Island would have to increase state taxes by 21.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Rhode Island state government by $590 million.**

- $350 million per year in lost funding for Medicaid
- $58 million per year in lost highway trust fund grants
- $32 million per year in lost funding for welfare (AFDC)
- $150 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Rhode Island would have to increase state taxes by 29.3 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Rhode Island by $849 million.**

- $476 million per year in Medicare benefits
- $373 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF SOUTH CAROLINA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the South Carolina state government by $1.0 billion.**

- $644 million per year in lost funding for Medicaid
- $68 million per year in lost highway trust fund grants
- $31 million per year in lost funding for welfare (AFDC)
- $260 million per year in lost funding for education, job training, the environment, housing, and other areas
- *South Carolina would have to increase state taxes by 14.3 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the South Carolina state government by $1.4 billion.**

- $883 million per year in lost funding for Medicaid
- $94 million per year in lost highway trust fund grants
- $42 million per year in lost funding for welfare (AFDC)
- $357 million per year in lost funding for education, job training, the environment, housing, and other areas
- *South Carolina would have to increase state taxes by 19.6 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in South Carolina by $3.0 billion.**

- $935 million per year in Medicare benefits
- $2.1 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF SOUTH DAKOTA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the South Dakota state government by $231 million.**

- $103 million per year in lost funding for Medicaid
- $39 million per year in lost highway trust fund grants
- $6 million per year in lost funding for welfare (AFDC)
- $82 million per year in lost funding for education, job training, the environment, housing, and other areas
- *South Dakota would have to increase state taxes by 24.7 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the South Dakota state government by $316 million.**

- $142 million per year in lost funding for Medicaid
- $53 million per year in lost highway trust fund grants
- $9 million per year in lost funding for welfare (AFDC)
- $113 million per year in lost funding for education, job training, the environment, housing, and other areas
- *South Dakota would have to increase state taxes by 33.8 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in South Dakota by $792 million.**

- $281 million per year in Medicare benefits
- $511 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF TENNESSEE[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Tennessee state government by $1.5 billion.**

- $989 million per year in lost funding for Medicaid
- $78 million per year in lost highway trust fund grants
- $60 million per year in lost funding for welfare (AFDC)
- $411 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Tennessee would have to increase state taxes by 19.5 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Tennessee state government by $2.1 billion.**

- $1.4 billion per year in lost funding for Medicaid
- $107 million per year in lost highway trust fund grants
- $82 million per year in lost funding for welfare (AFDC)
- $563 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Tennessee would have to increase state taxes by 26.7 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Tennessee by $5.3 billion.**

- $1.9 billion per year in Medicare benefits
- $3.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF TEXAS[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Texas state government by $4.2 billion.**

- $2.5 billion per year in lost funding for Medicaid
- $340 million per year in lost highway trust fund grants
- $147 million per year in lost funding for welfare (AFDC)
- $1.2 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Texas would have to increase state taxes by 14.0 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Texas state government by $5.7 billion.**

- $3.5 billion per year in lost funding for Medicaid
- $466 million per year in lost highway trust fund grants
- $202 million per year in lost funding for welfare (AFDC)
- $1.6 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Texas would have to increase state taxes by 19.2 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Texas by $14.8 billion.**

- $5.9 billion per year in Medicare benefits
- $8.9 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF UTAH[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Utah state government by $422 million.

- $190 million per year in lost funding for Medicaid
- $49 million per year in lost highway trust fund grants
- $22 million per year in lost funding for welfare (AFDC)
- $160 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Utah would have to increase state taxes by 11.4 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Utah state government by $579 million.

- $261 million per year in lost funding for Medicaid
- $68 million per year in lost highway trust fund grants
- $31 million per year in lost funding for welfare (AFDC)
- $220 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Utah would have to increase state taxes by 15.6 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Utah by $1.5 billion.

- $323 million per year in Medicare benefits
- $1.2 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF VERMONT[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Vermont state government by $207 million.

- $89 million per year in lost funding for Medicaid
- $37 million per year in lost highway trust fund grants
- $13 million per year in lost funding for welfare (AFDC)
- $68 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Vermont would have to increase state taxes by 17.4 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Vermont state government by $284 million.

- $122 million per year in lost funding for Medicaid
- $51 million per year in lost highway trust fund grants
- $18 million per year in lost funding for welfare (AFDC)
- $93 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Vermont would have to increase state taxes by 23.9 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Vermont by $413 million.

- $206 million per year in Medicare benefits
- $207 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF VIRGINIA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Virginia state government by $1.0 billion.**

- $490 million per year in lost funding for Medicaid
- $72 million per year in lost highway trust fund grants
- $49 million per year in lost funding for welfare (AFDC)
- $393 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Virginia would have to increase state taxes by 8.2 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Virginia state government by $1.4 billion.**

- $673 million per year in lost funding for Medicaid
- $99 million per year in lost highway trust fund grants
- $68 million per year in lost funding for welfare (AFDC)
- $539 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Virginia would have to increase state taxes by 11.2 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Virginia by $8.3 billion.**

- $1.9 billion per year in Medicare benefits
- $6.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF WASHINGTON[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Washington state government by $1.3 billion.**

- $730 million per year in lost funding for Medicaid
- $117 million per year in lost highway trust fund grants
- $126 million per year in lost funding for welfare (AFDC)
- $346 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Washington would have to increase state taxes by 8.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Washington state government by $1.8 billion.**

- $1.0 billion per year in lost funding for Medicaid
- $161 million per year in lost highway trust fund grants
- $172 million per year in lost funding for welfare (AFDC)
- $474 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Washington would have to increase state taxes by 11.5 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Washington by $4.9 billion.**

- $1.5 billion per year in Medicare benefits
- $3.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF WEST VIRGINIA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the West Virginia state government by $765 million.**

- $488 million per year in lost funding for Medicaid
- $45 million per year in lost highway trust fund grants
- $32 million per year in lost funding for welfare (AFDC)
- $199 million per year in lost funding for education, job training, the environment, housing, and other areas
- *West Virginia would have to increase state taxes by 20.6 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the West Virginia state government by $1.0 billion.**

- $670 million per year in lost funding for Medicaid
- $62 million per year in lost highway trust fund grants
- $44 million per year in lost funding for welfare (AFDC)
- $273 million per year in lost funding for education, job training, the environment, housing, and other areas
- *West Virginia would have to increase state taxes by 28.3 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in West Virginia by $1.7 billion.**

- $824 million per year in Medicare benefits
- $835 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF WISCONSIN[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Wisconsin state government by $1.3 billion.**

- $694 million per year in lost funding for Medicaid
- $111 million per year in lost highway trust fund grants
- $96 million per year in lost funding for welfare (AFDC)
- $349 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Wisconsin would have to increase state taxes by 10.3 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Wisconsin state government by $1.7 billion.**

- $952 million per year in lost funding for Medicaid
- $153 million per year in lost highway trust fund grants
- $132 million per year in lost funding for welfare (AFDC)
- $479 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Wisconsin would have to increase state taxes by 14.2 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Wisconsin by $3.4 billion.**

- $2.1 billion per year in Medicare benefits
- $1.3 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF WYOMING[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Wyoming state government by $218 million.**

- $55 million per year in lost funding for Medicaid
- $38 million per year in lost highway trust fund grants
- $8 million per year in lost funding for welfare (AFDC)
- $118 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Wyoming would have to increase state taxes by 18.7 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Wyoming state government by $300 million.**

- $75 million per year in lost funding for Medicaid
- $52 million per year in lost highway trust fund grants
- $10 million per year in lost funding for welfare (AFDC)
- $162 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Wyoming would have to increase state taxes by 25.7 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Wyoming by $393 million.**

- $131 million per year in Medicare benefits
- $262 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

---

[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

Chairman ARCHER. Thank you, Governor Dean.

We have listened very carefully to your input, both of you, and we want to reach out and form a better working partnership with you because it is in the best interests of the American people, the Federal Government, and State governments.

All of us appreciate the fact that the landscape is very different today in this country than it was 4, 5, 10 or 20 years ago. I happen to believe that one of the reasons so many Federal programs emerged was because we had unlimited borrowing capacity and it was much easier to come to Washington than to go to a State Governor where 42 of the States have to live under a mandated balanced budget concept. They had to dramatically, in a tough way, cut spending or raise taxes. It is always easier to borrow and to postpone it, and put the load on our children and the next generation.

Whether or not we pass a constitutional amendment to mandate a balanced budget, which I happen to support as a discipline for all society, there will be some form of discipline and constraint that pushes the Federal Government into a lesser borrowing entity. As we move toward reducing our deficits, so the landscape must change for all of us and we must reevaluate what is the appropriate role of government, not just between the Federal Government and State government, but what is the appropriate role of government at any level compared to the private sector. We need to focus on how can we create a better country with opportunity and caring for all Americans and whether it is better done by the private sector or by government.

I will give you an anecdotal example. We all care about the homeless. They reach out and grab our hearts regardless of where we are. But what is the most efficient way to take care of that problem?

In Houston, Tex., there is a hostelry that takes care of homeless people, 250 a day. It does it with no government funds at any level of government, and it does it at a cost of $2.50 a day. It provides hot food, clothing, clean bedding, medical care, and job counseling. Over 50 percent of the people work but they don't have any place to live so they come back to stay there at night. The cheapest Federal program is $40 to $50 per day per person.

Now, we can talk about caring for people, but in the end, we must seek the most efficient way in our society to do it and that is what we hope to be able to do from our level. It is one reason that we think you can be more efficient than we are. We also believe that where the private sector can do it will be even more efficient than you can do it. So we hope to make this a partnership where we can embrace each other and find new ways to reach out to our problems and restore federalism as the bulwark and foundationpiece for the United States of America. I hope we can establish a greater working bond between you and us and then, between you and the private sector in your States. We can truly move this country ahead in a way that will benefit to the greatest degree all Americans.

Now, I recognize my friend and colleague, the ranking Democrat on the committee, for inquiry.

Mr. Gibbons.

Mr. GIBBONS. Thank you, Mr. Archer.

Governor Pataki, Governor Dean. I want to address my remarks to you, Governor Dean, because I recognize that you have had a distinguished career as being Governor and had a lot of experience under your belt and the National Governors' Association has seen fit to elect you as their chairman. I know that is quite an honor and quite a responsibility and I imagine quite a headache sometimes, too.

I think as I listened to this debate, one of the messages that came through, one of the big votes that we are going to have here in this committee is whether we cut the aid to families with dependent children program, a program that is 55, 60 years old and with time has stretched through our society.

There has always been an individual entitlement money made available based upon the entitlement of the children in that program. There are some on this committee and in this Congress who want to cut off that entitlement and work through the appropriations or some other way. Based upon your experience as Governor of a State, do you feel that the State of Vermont with you as Governor would welcome the destruction of that entitlement bond that has been so long a basic part of the aid to families with dependent children program?

Governor DEAN. I thank you for the question. It is a tough issue and I have thought about it a lot, because I did not have a position when I was first confronted with this notion.

The problem is, how do you reform welfare and reintroduce the ethical value of work to families without hurting children? I believe that welfare reform, in fact our welfare reform, does not save money. We have had to increase a relatively small amount in order to pay for training and so forth, but I believe in the value of work so firmly that I was willing to spend more money to make sure that everybody who could work did work.

And interestingly enough, the person who tells the best story I ever heard about it is the President of the United States when he was working on a welfare reform program in Arkansas, went to a school and said—explained his welfare program. And the teacher turned to one of the kids and said, well, what does welfare reform mean to you? And he said, welfare reform means to me, teacher, that when somebody asks me what my mother does, I say she works in the library not she is on welfare.

That changes the whole dynamic of what kids think about parents and what kids think about themselves and what parents think about themselves and that is why I think we have to reform the welfare system. I don't think—I am not in it to save money. I understand we have a deficit problem. I am not sure it can be done right without really hurting children.

We looked—when we did our welfare reform proposal, we looked at cutting off benefits, whack, after 2, 2½ years, just bang, out in the street. The problem is, what do you do with irresponsible parents or parents who for whatever reason don't get into the work force. First thing, suppose you have a recession and working people are out of their jobs for a long time and this Congress had to extend unemployment benefits during the last one. The worst.

The first thing, make sure everybody has employment, otherwise you are essentially cutting people off a public support system who for a long time have been crippled by the system and made to be dependent and putting them in a rowboat and sending them out on the lake with no way of getting around. So if we are going to make people work, which I strongly believe we have to do, we have got to do it in a way that jobs are available and that the kids don't go hungry.

So we decided we wouldn't cut off benefits, bang, we will simply eliminate cash assistance if folks didn't cooperate with the program. And of course there will always be some that don't cooperate but that is a big enough stick to get them into the program.

What is our experience so far? It has been in operation since July 1. What has happened, the welfare caseload has actually gone up slightly because we are still in a serious recession, but the expense for each case has gone down significantly because we got rid of things like the 100-hour rule, which I encourage all of you to get rid of, and that allows people to go to work and they don't make enough to get off of welfare, they don't give up their job and go back to the system, they work and they get supplemented benefits.

So I think, Congressman, that the approach that we ought to take is a thoughtful approach and the emphasis ought to be on getting people back into productive lives, and it is going to take some requirements, not just a matter of the carrots. We all know that a lot of training programs and this and that don't do it. We have got to require them to work. We have got to limit the access to benefits if they don't work and we have got to craft it in such a way so that the kids who are, through no fault of their own, who are going to be victimized by whatever we do to the parents, are not victimized.

And if you break the entitlement, kids will be victimized in my view because—and I am not saying you have to have an entitlement at the current level of welfare. I actually don't agree with my colleague from New York. I think that you don't have to guarantee us the same amount of money that we had before. I would be happy if you would guarantee some minimum level of decency for the whole country which is an entitlement and block grant which you have got and go ahead and make us do different things and be flexible and so on.

But I think there should still be a national program with a lot fewer strings attached, and I think the individual entitlement has to be there because, in the next recession, children are going to be the ones that are in trouble, not the parents that we want to get back in the work force.

Mr. GIBBONS. Thank you, Mr. Chairman.

Chairman ARCHER. I should have announced earlier that Governor Pataki, because of his very tough schedule and the big problems in his State, has told us that he could only be here until 11 o'clock; is that correct?

Governor PATAKI. That is correct.

Chairman ARCHER. We wish you could extend that a little bit. If members will keep their inquiries as brief as possible, we can take the greatest advantage of Governor Pataki's visit here. I would encourage members to direct their questions to you while we have

still got you because we will have Governor Dean for a longer period of time.

The Chair recognizes the ranking Republican from Illinois, Mr. Crane, for inquiry.

Mr. CRANE. Thank you, Mr. Chairman. And thank you both for your testimony.

On "60 Minutes" some years ago, they had a report where a darkened car was going down the streets of New York City. Maybe you saw that. They had a hidden camera in the back seat and they pull up to a prostitute at the corner and asked her how much she charges, and she said $100. And they said, what if we pay you in food stamps. And she promptly said, $200.

And they went on a little further and here was a dope trafficker, and I forget what the measurement was of whatever drug he was selling, but the thing was that he knew immediately that whatever the going price was, if you paid in food stamps, it was double just like with the prostitute. And they went on to point out that they were offered weapons, including stingray missiles, for food stamps.

And then they showed a couple of crooked grocery stores where the prostitute could come in and make the transaction turning in the food stamps and the grocer would give her $150 in cash and he pocketed 50 bucks in cash, too, for the simple transaction.

I don't know how extensive that sort of thing is, but I have heard other instances where, in poker games, food stamps were used. I mean, it is a currency and the people who work in that realm obviously know it is worth 50 cents on the dollar.

I remember back when I was a kid in Chicago we had township commissioners that delivered, literally delivered, food on a routine basis to those people in need and they were in a position then to maintain ongoing checks on their welfare. I am wondering if there is some reform in this category which you Governors have considered because this system obviously is abusive and it needs reform. But giving you block grants and letting you look at how to solve some of those problems, to me, is a sound concept and I wonder if you have any thoughts on that.

Governor PATAKI. I do. I think the problem that you are talking about is a very real one and I, as well, have heard the anecdotal reports of the use of food stamps as a type of currency for every other commodity but food that we would like to see. Let me agree with Governor Dean here very briefly when he pointed out how the school breakfast and lunch programs work because they were not a cash program, they were a program run through an agency that provided a direct service to the people so that there was minimal risk of abuse.

That doesn't exist with food stamps. It is a very real problem. I know that some States have looked at things like electronic benefit transfers where you would have a debit card instead of the stamps where the card would be charged and that could then be used in supermarkets where it would be run through like a credit card and the outstanding balance would be reduced as the commodities were purchased.

This type of change in the system can reduce fraud and allow us to continue what we in New York have always had, which is a very strong sense of compassion and support for those in need, but get

away from a system that has far too much fraud involved right now.

So, again, I think what Governor Dean said where you have the direct delivery of a service through something like a school, that program makes sense. But when you have the potential for abuse as with food stamps, give us block grants and allow us to experiment as Texas and some other States have done with things like debit cards, and electronic benefit transfers. That is the type of thing that can be done in a laboratory of democracy where the States can try various approaches to see which works most effectively to deliver the service at the lowest possible cost.

Mr. CRANE. Well, I remember one other incident, and I can't help but feel that you folks have got more creative solutions to the problems than we have addressed here in this town, but so many instances beyond what I described of abuse and one as a well-dressed mother in front of me in the checkout line in the supermarket and she had a quart of ice cream or something and she gave him $20 in food stamps and they gave her change.

Now, that is illegal, but what are you going to do, put a cop at the end of every checkout counter? And she could take the money that she got returned to her and buy booze or buy cigarettes or whatever. So obviously it is something in need of reform and we look forward to working with you.

Chairman ARCHER. The gentleman's time has expired.

Mr. Thomas of California.

Mr. THOMAS. Thank you, Mr. Chairman. I thank both the Governors for their testimony, collectively, at least in your verbal remarks and I have been trying to look through your written remarks. The positions that you take seem to be relatively consistent in terms of the recent discussions about the way in which the Federal-State relationship could change. You are more than willing to accept the ability to make decisions in areas—for example, on page 6, Governor Dean, you say: In summary, States have the primary responsibility for critical services of high priority to citizens.

Clearly in Governor Pataki's testimony about moving to a block grant, maximum flexibility for the State, he wants historic levels of support. You said that is not totally necessary, but you need great flexibility. You really don't want to have to deal with taxes at the State level because, if there was a downturn in the economy, you would have to raise taxes. But you are in favor of a balanced budget amendment which, if it occurred at the Federal level, and there is a downturn in the economy, we are going to have to raise taxes to continue to fund you folks.

I believe the Chairman correctly pointed out one of the reasons it was so easy to do at the Federal level historically was because we simply ran up the national debt in providing you with the money. If we are going to have a balanced budget amendment, somebody is going to bite the bullet and raise taxes, you don't want it to be you, you want it to be us.

I guess in summary my response to you is, don't ask us what we can do for you but rather what are you willing to do for yourselves. And I mean it this way. If you want the areas of responsibility, instead of talking to us about the fact that we have to fund it, and Governor Dean, I appreciate your comment about everything on the

table, but what you talked about with everything on the table were all Federal programs. You had to have Social Security on the table. For me, everything on the table is everything that you do as well.

Governor DEAN. That is right.

Mr. THOMAS. Now then, moving the discussion not to just moving responsibilities down to the State level but moving guaranteed revenue sources as well which are at the option of the State to use or other revenue sources if the State so chooses, but the Federal Government would believe that the funding mechanism sent with the responsibilities is sufficient but the choice of levying it or adjusting it would be yours.

What is your reaction to that idea?

Governor DEAN. My reaction is, nobody wants to raise taxes. We don't want to it do it and you don't want to do it, so if we are going to share responsibility, let us both share the responsibility of raising taxes if necessary, cutting popular programs if necessary. The reason I mentioned putting Social Security on the table is, one, it is anathema of cutting for every Member of Congress no matter what party you are in.

Mr. THOMAS. It is not to this Member of Congress. I have said from a long history that we have to look at everything. My point, you don't want unfunded mandates, you want funded mandates, you want us to fund it and you folks to make the decisions. I believe those are not the only two choices in front of us.

How about financed mandates in which you control not only the bulk of the decisions about the program but the bulk of the decisions about the financing as well?

The Federal Government carves out areas and says we will not tax at the Federal level, we will move it to the State level and the decision is yours, do you like that or not?

Governor DEAN. I think, again, Congressman, the Devil would be in the details. And I think we are going to have to discuss a lot of which kinds of taxes we could raise and which we couldn't. The income tax, for example, is a very difficult tax for States to raise because, if I raise my tax, then my businesses go to New York State and vice versa.

Mr. THOMAS. There are any number of taxes at the Federal level that we can move to the State. It is the concept that I am interested in.

Governor DEAN. I think it is certainly worth pursuing that.

Mr. THOMAS. At least that is a foot in the door.

Thanks.

Chairman ARCHER. The gentleman's time has expired. Thank you.

Mr. Rangel.

Mr. RANGEL. Governor Pataki, because of the shortness of time, I am going to send to you a lot of questions I need answers to in order to be guided as to what decisions we make here.

Politically, everyone talks about work, work, work, work, and it sounds good politically. I go back home and people keep talking about jobs, jobs, jobs, jobs. Now, you know that where we have most of these problems with welfare mothers is where the unemployment rates in these communities are two, three, four times the national average.

You also know that these kids that are involved in irresponsible acts have no training, have no ability to work. We have laid off so many in the low-skilled jobs. We have other jobs that people used to get in poor communities going to less developed countries. And so in this Contract there are no provisions as to what happens when there are no jobs, when there is no money for training, but it sounds good politically and so, what the heck, I am for making certain everyone works.

But we know that having—creating jobs and having training for jobs and getting the private sector to work with us avoids these unwanted pregnancies. Jobs mean dignity, pride, it means family values, planning for children. It means having hope for the future. It means not having pregnancies that you don't want. It means not getting involved in drugs and violence and crime. It means that you feel a part of America. But just saying you should work, it ain't going to work out.

You didn't say you support this Contract With America and so, therefore, we have to find out what this Contract means for the people of the great State of New York. Everyone wants block grants and flexibilities. How much money do we get now?

If you are for the Contract, you are for a balanced budget. If you take off 50 percent of the cuts in order to balance the budget, New York City is a big target, New York State is a big target, and if we lose entitlements, don't trust the Appropriations Committee because they don't sign any contract as to where they are going to cut.

And so before you sign the Contract, please ask our friends on the other side to produce for you where they are going to raise the money to balance the budget because we have more than our share of poor, because we have more than our share of newcomers into the country. We have more than our share of people that are entitled and if we can't do it with partnership with the States, our constitution requires that we in the State of New York take care of these people. So I know your time is limited, but we have to talk before we sign the papers.

Governor PATAKI. Congressman, let me just say that I appreciate your comments, particularly about jobs. And I was trying to chuckle inside when Governor Dean was talking about what happens if we have a recession because, in New York State, we have missed out in the national recovery. There have been millions of new jobs created nationally since April 1991 and, in that same timeframe, New York State lost 300,000 jobs while the rest of the country was growing.

And I think it is because we tax too much, we spend too much, and we overregulate, and we have got to dramatically change New York State's economic climate to create those jobs because you are absolutely right. It is a job that creates the support for the family and the ability to have the sense of pride and self-worth that comes with being a contributing member of society and we have got to do that at the State level and we are going to.

But when we talk about welfare reform, it is not simply private-sector jobs, it is also as was done in Westchester County where, when they put in place their pride in work program, they came up with community service and they required the home relief category

of welfare recipient to show up during the week to go to job training, to go to drug and alcohol abuse training so that they would then be able to work. And in the absence of a private-sector job, they performed community service. The results in Westchester County were that the home relief rolls fell by over 25 percent in 1 year.

And I think we can replicate that in the city of New York, in the State of New York, and that is why I have named as our social services commissioner the commissioner from Westchester who put in place that program in New York—in Westchester County, so I think we have to do both. We have to create the job training and the support so that the people do have the sense of self-worth to go out and work and that comes from community service, but we also have to change the economic climate in the State to start attracting the private-sector jobs that have gone elsewhere and not in New York State.

You talked about, in the balanced budget, how is Congress going to raise the money. I don't think it is simply a question of raising money. I think it is also a question of cutting spending. I think that is something you have to look very seriously at as we are looking very seriously at in Albany. We are going to spend less money in 1995–96, fiscal year of our State, than we did in 1994–95.

The mayor of New York City is spending less money in this fiscal year than he did last year. The Governor of New Jersey did it last year, spent less than the year before. And I think Washington has to look not simply at taxes as the solution to a budget that is out of balance but also where spending can be cut.

And if I just might make one further comment. I want to repeat the request I made, Mr. Chairman, at the beginning that in response to Mr. Neal's comment, that we are looking to reduce our Medicaid costs in New York State to the Federal Government next year by $2 billion, approximately. If there were an incentive at the Federal level for States that lower the costs of their entitlement programs, whether they be Medicaid, long-term Medicaid, acute care home relief, AFDC, any of these programs, if there is an incentive at the Federal level where the Federal Government will share some of saving, they get with States that lower their costs, I think we could both help you to move toward a balanced budget by lowering the obligations, the bills that the State send to you and help us to achieve the reforms necessary to balance our budgets and break the entitlement cycle of dependency where it is not a question of how much we spend, it should be a question of how successful we are in moving people from these entitlement programs to a life of self-worth and contributing to society.

So, Congressman, thank you for the question.

Mr. Chairman, thank you for the opportunity to be here. I am sorry that I do have to leave but this was something that I think is very important and I look forward to the changes coming out of Washington and hope that we continue to have a cooperative dialog between the Governors and certainly me and the members of this committee in the House.

Chairman ARCHER. Governor, thank you very much for your outstanding input today. Our door will continue to be open for dialog but, not only that, we will be knocking on your door so that we can

continue to have this pattern of reaching out in cooperation, exchange, input, so we can develop a program that is the very best for the American people.

We understand your schedule and you are excused. We thank you for being with us.

Governor PATAKI. Thank you.

Chairman ARCHER. I would like to, with the indulgence of the committee, also intrude on the normal inquiry procedures by recognizing that we now have with us Governor Weld of Massachusetts. We fully understand what delayed you and we regret that you could not be here earlier, but we are prepared at this time to entertain your testimony.

As I mentioned to your colleagues a little earlier, you will not be limited by our normal 5-minute rule, but we would hope you would keep your oral presentation as short as possible and any written testimony that is more extensive, without objection, will be inserted in the record.

Welcome, Governor Weld. You got a real introduction because I think you are probably by now pretty well known to most Americans.

STATEMENT OF HON. WILLIAM F. WELD, GOVERNOR, COMMONWEALTH OF MASSACHUSETTS

Governor WELD. Well, thank you so much, Mr. Chairman, and members of the committee, and especially my former boss, Representative Crane. It is a real pleasure to appear before you.

I think a lot of what we have gone through in Massachusetts in the last 4 years really connects with the Contract With America both in letter and in spirit. If I have just one message for the members of the committee based on our experience, it is to be bold and strike at the outset while the iron is hot. That is what we did back in 1991.

As Congressman Neal could tell you, Massachusetts was a basket case at the beginning of 1991 when I came into office. On a budget of about $13 billion, we had an $850 million shortfall for the current year and a $2 billion shortfall for the year we were just coming into for about a $2.5 billion deficit that we had to close in a big hurry. We did close that deficit, and we did it without raising taxes.

The first thing we had to do was change the culture. During prior years, Massachusetts had gotten into the habit of deciding how much money it wanted to spend at the beginning of the year and then adjusting the tax rates upward or going to Wall Street at the end of the year to help get a sufficient amount of funds to meet the plan.

We had to make the culture the opposite; to figure out how much money we are going to have and to budget accordingly.

And we did as Governor Pataki was just referring to, we did cut spending in absolute dollars between 1991 and 1992. We spent less in 1992 than we did in 1991 and there were a lot of howls of protest, although I would say, in my judgment, the howls were mainly from advocates for various interests that had been well represented in the past—often paid advocates—

And the conversation that we had time and again with the people who were complaining about budget cuts was: We know this isn't like 1988, but that was then and this is now. We have not only had an election in which the bombthrowers won the primaries in both the Republican and Democratic parties in 1990 in my State, but we also had an economic situation that people would just not put up with.

So we had to find that $2 billion—and that is equivalent to about $200 billion in your budget—and we did it by going after the big ticket items, the so-called budget busters, and our iron was hot because we were almost in bankruptcy. The iron is hot down here now more for political reasons but the lesson is the same.

I will spare you the details, Mr. Chairman, but we significantly cut Medicaid sharply by moving to a managed care system. We significantly cut spending in the transportation area by flattening the management structure, moving from 13 layers to 5. We consolidated our Department of Revenue but because they put in private-sector mechanisms, they are raising more money than ever before.

The Contract proposes to do more with less. That has been more than a slogan in Massachusetts in the last 4 years, and I think it can and will be here. Personally, I consider the balanced budget amendment to be the cornerstone of the Contract. All the States balance their budget every year, Mr. Chairman. Forty-nine States, all except my brother State here, have a balanced budget requirement in their constitution. He is such a good frugal person, he balances his budget anyway.

But you know we haven't raised taxes. We haven't gone to Wall Street to borrow a dime. We cut the State work force by 12 percent the first year, from 72,000 to 64,000. We have cut taxes nine times. We cut the capital gains, the estate tax, the income tax, and the sales tax—and what happened? Our tax revenues went up. They didn't go down because people began to think maybe this isn't "Taxachusetts" so maybe we will invest here. So our tax cuts very much mirrored those in the Contract, which I would endorse.

Finally, we are reforming welfare. I think the block grant proposals that are kicking around the Hill are very much worthy of adoption. I note that the States can make huge savings if they are given the authority to manage these programs. I could save $60 million a year if I just managed the supplemental security income program. I have given Congressman Kasich a proposal that would save him $2.5 billion if the States had authority to manage that program because we would impose a meaningful screen, which is not being done now.

I would also endorse the provisions in the Contract about child support enforcement and adoption. Those are two areas that really need to be emphasized. That spans the Liberal-Conservative spectrum, too.

So I would just say in closing, Mr. Chairman, I have yet to receive a single letter complaining about those 8,000 people who don't work for the State anymore, and I think something like the same in percentage terms can be done at the Federal level. I congratulate you all.

[The prepared statement follows:]

THE COMMONWEALTH OF MASSACHUSETTS
EXECUTIVE DEPARTMENT
STATE HOUSE • BOSTON 02133
(617) 727-3600

WILLIAM F. WELD
GOVERNOR

ARGEO PAUL CELLUCCI
LIEUTENANT-GOVERNOR

Testimony of Governor William F. Weld

Hearing on the *Contract with America*

Before the Committee on Ways and Means
Thursday, 12 January 1995
Washington, D.C.

Thank you, Mr. Chairman.

I appreciate this opportunity to testify, because much of what we have accomplished in Massachusetts over the past four years connects with the Contract, both in its specific provisions and its spirit.

As Congressman Neal could tell you, the recession hit Massachusetts first and struck deeply into our economy. When we came into office in January of 1991, state government had an $850 million deficit we had to cut in our first month, and a $1.8 billion structural deficit we had to resolve by June of 1991. Put another way, if Massachusetts had been a person the State House might have been sold at auction.

We did close the deficit, however, without raising taxes or borrowing, and we faced many of the same obstacles that I suspect will confront the Congress as it works to enact the Contract.

First, we had to change the culture in Massachusetts. We had to reverse the ethos that equated raising taxes with courage. Second, given our blood oath not to increase taxes, we had to cut the budget, with howls of protest ringing in our ears.

Since $2 billion dollars in the Massachusetts budget is equivalent to about $200 billion in the federal budget, we were talking about a general anesthesia, in-patient operation -- not just a trip to the pharmacy. We had to go after the so-called "budget-busters," big money programs with broad constituencies.

The first of these was Medicaid. Medicaid spending in Massachusetts grew by 90 percent from 1987 to 1991. Since we implemented managed care Medicaid in 1991, however, Medicaid spending has grown by less than five percent each year, and by only two-point-nine percent last year.

Managed care has not only helped us to balance our budgets, it has improved the quality of service. Four years ago, most of the children relying on Medicaid had no primary-care physician and no access to decent prevention. Many were not even getting their shots. Now, a little girl with an earache need not resort to an emergency room visit to receive medical attention; she has her own doctor who knows her by name.

Another "budget buster" was the mass transit system serving Greater Boston, which some of you know as the "T." Back in 1991, our Transportation Secretary saw a news report that showed subway workers putting in two-hour days. When he inquired about firing those workers, a word I use ironically in this case, he

discovered thirteen -- thirteen -- layers of management between him and the problem. Now there are five. Owing partly to this change, our Transit Authority has reduced its operating budget by $70 million over the last two fiscal years. This is big money in a $16 billion state budget, and we were able to accomplish the cost reduction without reducing services.

There is a similar story to tell about our Department of Revenue. Despite having twenty percent fewer employees and a reduced budget, they are still able to process returns and send refunds faster than before the reductions. By using computers and adopting private sector management techniques, they can now get refunds out in four days for those who file by phone, and at half the cost of the old paper system.

The Contract proposes to do "more with less." That has been more than a slogan in Massachusetts, and it can be here, as well. I consider the Balanced Budget Amendment to be the Contract's cornerstone, and balanced budgets are achievable. We not only have balanced our budgets, but we ended last year with a $326 million surplus. We've reduced the state workforce by 12 percent, from 72,000 to 64,000. And we've cut taxes nine times.

Many of our tax cuts mirror those in the Contract, such as a Research and Development Tax Credit and a repeal of our estate tax. We even recently approved a capital gains tax phase-out. After cutting taxes nine times in four years, my sincere hope is the Taxachusetts label is dead and buried.

I was pleased to see the Congress act quickly on the Contract's call for a three-fifths majority to pass a tax increase, something I would support even if the Constitution needs to be amended. Tax increases touch upon freedom, the central concern of both the Constitution and the Contract, and that makes the supermajority requirement sufficiently weighty to deserve Constitutional attention, if statutory action is impermissible.

We are also reforming welfare in Massachusetts, and the block grant provision I've been working on with Governors Engler and Thompson and Congressional leaders would give us the freedom to make the radical change we believe is necessary, and give other states the same freedom to follow their own lights. In Massachusetts, we want to implement a work requirement after 60 days and abolish the cash grant. To replace the cash grant, we want to give people the supports necessary for them to go to work: day care and health care.

We have recognized, as well, that child support enforcement and adoption are natural complements to welfare reform. We have more than doubled the number of AFDC families leaving welfare because of increased child support enforcement. We have also set a new record for the adoption of children in state custody. Child support enforcement and adoption are two more elements of the Contract that I endorse unreservedly.

Government flatters itself when it attempts to match every tendency and affliction in society with a program, regulation, or mandate. I do believe that what we have done in Massachusetts asserts the possibility of revolutionary contraction within government, the expansion of freedom outside of government, and prepares our state to function within the entrepreneurial mood that the Contract itself asserts. We did hear howls of protest in 1991, but despite large budget cuts and vast change, we have not heard genuine cries of pain. So my most general message to the Committee is to stay true to the spirit of the Contract, and strike while the iron is hot.

Thank you.

Chairman ARCHER. Governor, thank you for your outstanding testimony. We will continue now with the order of inquiry, and the next in line is Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman, and I would like to thank the Governors for being here and their enlightened testimony.

I would like to ask both of the Governors if your States were permitted to run their own welfare program using Federal funding with minimal interference from the Federal Government, would the residents of your State benefit and would you explain how they would benefit?

Governor DEAN. Well, as I have—for the record, let me just say, while we are all talking about what we have done in our budgets, I am about to submit my fifth budget in a row that is less than the rate of inflation. And when I became Governor—since I have become Governor, I cut the highest tax bracket in Vermont from 40 percent of the Federal levy to 25 percent and everybody else is from 28 to 25.

I just want to establish my credentials as a fiscal conservative since my colleague has insulted me by saying our State constitution, which is perfectly true, doesn't require a balanced budget.

Let me respond just briefly by saying or by reiterating what I said earlier about our welfare program. We have a statewide welfare reform program so the risk for us with welfare reform is pretty much on the downside, that is, we have already required work, we have already limited benefits after a certain time period.

The risk for us would be the problem that I laid out earlier, if you really block grant the whole thing with minimal interference, the big risk for us is that kids in a recession will be the victim of a political fight about whether we are going to raise taxes to have a minimum standard of decency or whether we are going to simply cut people off the rolls because there is no longer a Federal entitlement, so I believe we ought to have more flexibility.

I fully concede that States are—to Mr. Thomas' point that States will have to contribute to that and we will not do as well budgetarily. I just ask that we share that pain so that we all take political heat for the things we have to do in our particular case because we have already had welfare reform. I am concerned about the children being at-risk if the entitlement is broken.

Mr. BUNNING. Governor Weld.

Governor WELD. Well, Mr. Congressman, I think both Federal and State taxpayers would be big winners if that program were adopted. There would be no loss of services. Governor Engler, and myself, and Governor Thompson have proposed a block grant approach whereby States would be capped at the average of 1992 to 1994 AFDC spending. The Feds would not put in any more money for the next 5 years until the year 2000. That would mean, next year, for me, a $20 million cut in Federal aid—money you all would have to balance the budget with.

But I would be more than happy to make that trade. As I mentioned a moment ago, I could save $60 million if I were permitted to manage the eligibility for the supplementary security income program.

We had a State welfare program my first year, all-State, which I vetoed down to zero. I said, you have got to make it not an entitlement if you want me to put any money in this program. And so it was made not an entitlement and we imposed a meaningful screen. The spending in that program went from $270 million to $104 million the first year. That is $160 million which is real money for my State.

You know, I understand what Governor Dean is saying about possible downside risk. But Governors are elected to be leaders of their States; I don't know any 1 of the 50 Governors who is terribly interested in seeing kids starve out there on the grates. I think we are smart enough to make choices that will prevent our most vulnerable populations from really taking it on the chops.

Chairman ARCHER. The gentleman's time has expired.

Mr. Ford.

Mr. FORD. Thank you very much, Mr. Chairman.

And to the Governors, let me thank you for your testimony.

Governor Weld, you mentioned in your closing statement about child support enforcement. Should child support enforcement be included in this block grant program itself?

Governor WELD. I think child support enforcement should be left to the States. I think that it is really coming into its own as a topic of focus. In my State, we publish 10 most wanted posters, 10 fathers, or usually fathers, that owe the most in child support enforcement—just like in the post office.

Mr. FORD. That hasn't been true in most States. The Federal Government really has been the one that stepped in to enforce child support enforcement over the years, has it not been?

Governor WELD. Our Department of Revenue has really run with that issue, and I think the States are now vying with each other to be more aggressive in child support enforcement. I think the obligation of fathers—it had been left on kind of a side burner, but I think as a political and moral and social issue, that is really getting huge emphasis now in the States.

Governor DEAN. Let me respond to that, if I may, Congressman.

Mr. FORD. Go right ahead.

Governor DEAN. What you are hearing from me is sort of the most people could accuse me of being a raging Moderate. I am anxious to have some of these changes, but I am not anxious to totally restructure everything and the reason is this: States already have, at least in New England, taken the ball and run with it on child support.

We have the highest child support collection in the country right now. It is not very good. It is in the 20-percent area but it appears to be the highest in the country. Without some kind of Federal participation, it is not possible to do this because the toughest time that we have is fathers who have moved out of State and we can't find them.

I am not—you know, we are not here as Governors saying, get out of our face and let us do everything. We need the help of the Federal Government in some areas. I think Congressman Thomas' point is well taken, we can't be hypocritical about this and we are going to take some hits.

We are not looking to divorce ourselves from the Federal Government and I would submit that there is a role for child support enforcement at the Federal level. We can argue about what that role is, but I don't think it is a reasonable position to suggest there is no role.

Mr. FORD. You know, there is very little child support enforcement in the Contract With America under the Republican's bill. Would you suggest, Governor Weld, that we would include the child support enforcement in any welfare reform or block grant program to the States?

Governor WELD. I had thought there was more than reference in there to child support enforcement so I would say yes.

Mr. FORD. And do you think that we ought to really focus, you know, on the deadbeat dads a little bit more than trying to just focus on children and women after welfare and penalizing women and children and not going after the deadbeat dads?

Governor WELD. Yes, Mr. Congressman, I completely agree with that. Our welfare proposal in Massachusetts envisions that 7,000 out of our 107,000 families would be off the rolls as a result of stepped up child support enforcement.

Mr. FORD. So child support enforcement, you, Governor Dean and Governor Weld, feel strongly that it should be included in this welfare reform package that we are going to probably adopt in this Congress?

Governor DEAN. I think that is an excellent idea. I have said before and I say again that we have got to make sure that fathers have a much greater responsibility for their kids, both in and out of wedlock, and I think anything to do with child support or paternity establishment is a good idea.

Mr. FORD. Thank you very much, Mr. Chairman.

Chairman ARCHER. I thank you for your responses on that. There is clearly total bipartisan support in the Congress for the toughest possible child support enforcement. It was accelerated dramatically during the Bush administration and we have to continue to pursue every part of what is our appropriate role, as you mentioned, Governor Dean, in assuring that that does come to pass in any welfare reform.

Mr. FORD. Mr. Chairman, just in my comments, though, I did think the issue, how soon will we get to the child support enforcement? Will we combine or will we merge child support enforcement with welfare reform? And if not, how soon will we get into the child support enforcement?

Chairman ARCHER. The subcommittee has been instructed to concentrate on this issue and make it a priority in the development of this policy.

Mr. CAMP. Mr. Chairman, in Mr. Shaw's absence, as a member of the Human Resources Subcommittee, we plan to do that in the next several months and we will have a bill this year.

Chairman ARCHER. Mr. McCrery will inquire.

Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

Governor Dean, I read with interest the Washington Post article which reiterated your comments about the Republican welfare proposal. And, you know, if my wife had read that or someone not in

politics and not accustomed to being barraged by the press all the time, she might get mad or somebody might get mad. I don't and I don't think anybody here did because we understand that in an unguarded moment when a question is put to you by the press, and you may say some things that you don't really mean or you would like to take back and maybe look at it a little more closely, so I am not going to go over all those things with you.

But Governor Weld is right, we have an opportunity here to strike while the iron is hot and I think the Governor's advice is going to be very well taken by the majority in the House and I think in the Senate.

We are going to do some things, perhaps very drastic things with respect to welfare reform and other areas of the Federal budget, so we are hopeful that you and your association, even the Democrat Governors around the country will work with us and help provide us good information, as you are trying to do today, so that we can fashion some policies that make sense for the country and for the States.

Governor Weld, before you arrived, Governor Dean said that, in his opinion, you can't have real welfare reform without spending more money. Do you agree with that proposition?

Governor WELD. No, actually I don't, Mr. Congressman. I am basing that answer on my experience in my State. As I say, we were able to cut the amount for the general relief welfare program very substantially by just managing it more tightly. Beyond that, if we do move in the direction of more of a block grant approach, as opposed to the Governors having to go to Health and Human Services for a waiver any time we want to try anything a little bit different, I think that we are going to save money.

I think that a certain number of cents on the dollar, whether it is 5 or 10 or 15 or 25, gets peeled off when the money is coming down to Washington and coming all the way back down to Main Street.

Mr. MCCRERY. Thank you for that acknowledgment. And thank you for sharing with us the benefit of your experience in Massachusetts.

Frankly, Governor Dean, I think if this Congress were to propose a welfare reform proposal that spent more money on welfare than we are currently spending in the Nation, we would get laughed out of here by most of the constituents who elected us, so we are going to—I am hopeful that we are going to pass a welfare reform proposal that is tough, that does save money, and yet does not throw people out in the streets and all those harsh things.

So I hope that all of you will work with us to try to fashion something that will save money for the American people and yet deliver a compassionate safety net for our population.

Thank you, gentlemen.

Chairman ARCHER. Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman.

I want to thank both of the Governors for their testimony. Governor Weld, you have touched on this in an answer to Congressman Bunning, one of the arguments used in maintaining the status quo or the Federal entitlement nature of many welfare programs is their role as sort of automatic stabilizers depending on bad eco-

nomic times, welfare spending increases automatically and that helps locally in regions of the country.

If we do attempt to adopt a block grant proposal, do you believe that that can be drafted to adjust for that concern?

Governor WELD. Well, at one level, Mr. Congressman, I would say that Governors are constantly adjusting to changing economic times. States go through both local and national business cycles. So to some extent, we always have to adjust and juggle our priorities as we go along.

Beyond that, there is a whole range of options for the Federal Government to take in designing a block grant program. You could design a block grant welfare program, as I think some members of the subcommittee may have in mind, saying here is the money but we want a work requirement, we want some time limits, and we want to cut down on illegitimacy among teenage—children born to teenagers. You can make those conditions of the money.

Governor Engler and I would prefer you not go quite so far. Maybe you could adopt a model that would be more along the lines of an assessment, saying we are going to suggest these things as goals and we are going to assess how you are doing. Well, if you in Massachusetts don't do anything to reduce illegitimacy and at the end of 1 or 2 years your illegitimacy rate among teenagers is 49 percent and everyone else's is 12 percent, well maybe some tripwire will be kicked and you will lose some money or we will tell you you have got to do something.

That would be perhaps an approach that would put a little bit more freedom in the hands of the States. In any event, I don't think we would be really any more subject to the swings of business cycle than we already are. I think we could use the savings that would be engendered at the State level to perhaps build up our rainy day fund against that day. When I came in, we had no rainy day funds. Now we are running a $300 million surplus and we have developed a very substantial rainy day fund.

Mr. CAMP. Governor Dean, you mentioned that you wanted to explore the paternity establishment question a little more and I wonder if you had any specific conditions to what is contained in the majority bill that you would like to tell us about.

Governor DEAN. I don't. I think that there are times when it is probably not reasonable to expect that the paternity can be established and to put off benefits entirely as a result of that is probably a mistake. But I don't—I want to be careful in my remarks because I think it is a question that needs to be addressed and I think the only recommendation I would make is that we be careful, again, to think of children and how they are going to be treated in this system.

So that I probably wouldn't go quite as far as what is in the majority bill, but I think something along those lines needs to be done, and I would be happy to work with you as an individual or get the NGA to work with you in that regard.

Mr. CAMP. Thank you very much.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman. I would like to direct my questions to Governor Weld. And I thank you both, Governor Dean and Governor Weld, for being here today.

Governor Weld, your program in your State in terms of the job training and eventually finding a job for many of these people who are on welfare, I understand, is reasonably successful. What is your success rate at this time and how many people do you have that are actually participating under the JOBS program at this particular time?

Governor WELD. We place about 8,000 a year and, in the Temp-Up program, our success rate is much higher. Of course that is pursuant to the 1988 Federal act for two-parent AFDC families and therefore we have everybody in the program. And 3,000 out of 7,000 families there are now off the rolls entirely because of their earnings in the private sector.

Mr. MATSUI. Do you know what the percentage is?

Governor WELD. It is 100 percent for Temp-Up.

Mr. MATSUI. I am talking about——

Governor WELD. People actually placed by jobs off welfare, it is 8,000. And my caseload is 100,000 if that is the percentage you are looking for.

Mr. MATSUI. So you are saying about 8 percent is your success rate?

Governor WELD. That includes a universe with the disabled and people caring for disabled who are not really candidates for this.

Mr. MATSUI. Assuming about a third of those 100,000 are disabled. I don't know——

Governor WELD. Fifty percent.

Mr. MATSUI. Fifteen?

Governor WELD. Fifty percent are disabled or caring for disabled.

Mr. MATSUI. The most successful program that has been studied, and there are many programs that have been studied since the 1988 Family Support Act was enacted, has been completed, has been in Riverside County. I am very familiar with it even though it is 200 miles away from my district, Riverside County, Calif., and the success rate is about 23 percent, and that means obviously the failure rate is about 77 percent.

And I am just wondering, you know, action given the fact that you do favor block grants, and I am assuming your program is not as successful as the Riverside County one, otherwise—if I am incorrect, could you correct me on that.

Governor WELD. Well 8 out of 50 would be a little bit below that.

Mr. MATSUI. Yes. That being the case, what do you do with the remainder of them, particularly if you have a period of low unemployment? How do you deal with them? Do you provide community service jobs?

Governor WELD. Well, our proposal, and it has not yet been passed in our legislature, Mr. Congressman, but our proposal is to have everybody go to work. And I can finance that by abolishing the cash grant. If I abolish the cash grant, that frees up so much money that I can offer everybody who is able bodied full-time day care and health care.

Mr. MATSUI. So what you would basically be doing is then to set up a situation where you would be providing community service jobs for these people; is that correct?

Governor WELD. For those who cannot be placed in the private sector.

Mr. MATSUI. You feel you can do, obviously, day care or you feel you can do transportation and you feel you can do health care for all these people for——

Governor WELD. I don't do transportation. I do day care and health care.

Mr. MATSUI. Somebody is going to have to get them to work and that is a cost these people incur.

Governor WELD. Our projection, 8,000 of the 55,000 covered in our able-bodied universe, 8,000 would get jobs through our welfare Massachusetts Jobs Department; 7,000 would be lifted off the rolls by increased child support enforcement; 7,000 would find jobs in a newly expanded day care industry which, obviously, with everyone getting day care benefits, is going to become much larger; and 5,500 would be subsidized community services.

Mr. MATSUI. If I could just ask one final question and you could answer this very quickly. If we block grant these programs, you would not have any problems, then, of us having participation rates, success rates. I think you answered Mr. Camp's question positively on that.

In other words, if we said by the year 2001 you had to have a 75 percent job placement success rate, you would not have any problems with that?

Governor WELD. I think output and result measures are appropriate.

Mr. MATSUI. You would agree with that?

Chairman ARCHER. The gentleman's time has expired.

Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman.

I, too, thank both Governors for being here today. I would like to revert to tax policy. We know Governor Weld that, under your leadership, you have cut taxes nine times while increasing State revenues and balancing the budget.

I would like to ask you which of your tax cuts you believe has generated the most economic growth and created the most jobs?

Governor WELD. So far, Mr. Congressman, it would be the research and development tax credit because that went through in 1992. We took California's tax cut, which was the most generous in the country, doubled it and enacted it. But over the long term, I think the most recent tax cut, a phaseout of the capital gains tax based on the holding period of the asset, is going to have the most impact on the economy.

People know if they hold an asset for 6 years, whether it is real estate or a share of stock, then they are not going to have to pay any tax. That is going to reward patient capital which is what we need for the high-tech industries of the future.

Mr. RAMSTAD. Have you also indexed capital gains?

Governor WELD. That is really an extreme form of indexing. Our capital gains is 6 percent, and I knock off 1 percent for every year you hold the asset. It is the Jack Kemp proposal.

Mr. RAMSTAD. I see. Exactly my thought.

Final question, Governor Weld. Which if any of your tax cuts were directed specifically at low-income working families?

Governor WELD. Well, we increased the head of household exemption. We have increased the exemption for dependents which is something that I commend in the Contract, and we have raised our no tax status threshold from 11,000 to 13,000, the point at which you pay no taxes whatsoever, and we have expanded the availability of our low-income tax credit.

Mr. RAMSTAD. With reference——

Governor WELD. Four of our nine are aimed at what could be called low-income wage earners. One is a general income tax and the other four are more targeted toward business and job creation.

Mr. RAMSTAD. Perhaps just a final question, Mr. Chairman. Perhaps it is too early to quantify the results but, thus far, have you been able to measure any improvements in the economic situation of this population group or correlate any?

Governor WELD. Our unemployment rate has gone down from the highest in the country, just under 10 percent my first year, to below the national average the last year. That is 100,000 more people working but that is not atypical, so it is kind of hard to say there is a direct cause and effect relationship although, as a committed supply sider, I of course think there is.

Mr. RAMSTAD. As a fellow supply sider, I thank you, Governor, for bringing your message to Washington. We need to hear it.

Chairman ARCHER. Mrs. Kennelly.

Mrs. KENNELLY. Thank you very much. And welcome, Governor Dean and Governor Weld. Governor Weld, I am from Connecticut so I follow your State. You were bold. You suggested 60 days and you are off. Then of course your legislature changed it dramatically and you vetoed it, and now you are back.

And I followed your program and commend you for it, but I do see that you have child care there and you do have a job provided, so I hope we can do that as well. But in the meantime, I welcome you, Governor Dean, because I came back here ready to look at the Contract and be involved in that exchange, and then the next thing I know, welcome to the block grant world. And at least you put your hand up and said, stop, let's think about this.

And I really thank you for that because I think you are saying to us, you and I know and everybody in this room knows, we are going to raise taxes or we have got to cut spending, and if you can't cut spending or raise taxes, well, take a block grant and send it to the State. And then you get back to the State and the State doesn't want to raise taxes, so they are going to have to cut spending. So this is going to have an effect in the cities. I am just glad you are giving us an opportunity to think about the block grant and the ramifications for the individual States. I know from the Northeast to the Sunbelt, it could be a big shift.

Could you expand a little bit more on that. Are you talking about welfare and AFDC being a national interest. I caught it quickly last night when you were on "Crossfire," and today I heard you, but I didn't quite get it completely. Would you review that?

Governor DEAN. Thank you. Let me respond by saying, with all due respect to my colleague from my southern border State, I find

it—I am the only Governor in the country who has a welfare program, statewide welfare program that requires work and that limits benefits. I wonder what is going to happen. And no one in the committee or Governors' Association has answered that for me.

What happens when there is a recession and there is no job available? We found it necessary to create public jobs in order to require people to work and that takes money to do that. And so I will reiterate my belief based on experience, that the kind of welfare reform that we are talking about here, which I fully support, is not possible when we are cutting large numbers like $40 billion.

I believe welfare is intended to be a safety net and I think it has gotten out of hand. I wouldn't push the clock back 50 years. I would probably do it 25 years. We need a safety net, particularly for children. We need to make people work. We need to have time-limited benefits.

What I would request of the committee and of the Congress as a whole is to do this in a reasonable, thoughtful, moderate way, keep what is good about this program. It was started for a reason and throw out what is bad about this program, as many of us have around the country.

Mrs. KENNELLY. So very quickly what you are saying is, with a block grant you get a certain amount of money, then those on welfare use up that money, then you have a recession and somebody who has been working and gets laid off and due to no fault of their own has to apply for welfare, the money might be gone?

Governor DEAN. That is right. Under the scenario of total block grant and no national minimum, we might have to take benefits from other people on the program and we might have to deny benefits to people who have been working all their lives and have not been on welfare because the benefits may have been used up by people already on the program.

This needs a lot of thought.

Mrs. KENNELLY. Thank you, Governor.

Chairman ARCHER. Mr. Zimmer.

Mr. ZIMMER. Thank you.

Governor Weld, before you arrived, Mr. Neal gave an opening statement in which he said he has been waiting for a phone call from any mayor or any Governor willing to give up some Federal support for welfare or other programs.

Governor——

Mr. NEAL. Would the gentleman yield for a moment. I don't think that is what I said at all.

Mr. ZIMMER. Could you put it in your own words.

Mr. NEAL. I said I have yet to receive a phone call from any Governor or any mayor who was willing to send back Federal dollars for projects.

Mr. ZIMMER. OK. I stand corrected. I thank the gentleman.

Governor Pataki responded by saying that he has a plan to cut Medicaid costs which would result in a savings to the Federal taxpayers of $2 billion. What is your response to that challenge by Mr. Neal as expressed in his words?

Governor WELD. Well, our proposal—and I have a waiver application pending with Secretary Shalala—our proposal to take over the management of the supplemental security income program

would free up $60 million which we could either grab or refund to the Federal taxpayers. I suspect it would be refunded to the Federal taxpayers, if the proposal that Governor Engler and Governor Thompson and I were working on were adopted. We proposed block grants with the Federal funds capped at current or recent levels for the next 5 years.

If that were adopted, I think the hit to Massachusetts in the first year would be $20 million. I would be willing to eat that and more than that. I have said publicly up in my State that I would be willing to absorb a $60 million hit in that area because I think that being able to manage the program translates not just to flexibility but to dollars at the State level.

Mr. ZIMMER. Thank you.

Governor Dean, do you share the view that flexibility equals dollars?

Governor DEAN. No. I support flexibility but not to the degree that Bill and Tommy and John do for the reasons I have stated. I think flexibility is important to make the program work better. You know, the total administration budget is about 12 or 15 percent in welfare. Even if we could somehow be twice as efficient as the Federal Government, we are going to save 6 percent. We are not talking big bucks. Furthermore, welfare is not a big program in the grand scheme of things in terms of Federal budget.

So I think we may be able to save a small amount of money but I think the flexibility is to get a better program targeting more and allowing States to get out ahead and push the envelope.

Mr. ZIMMER. I would like you to elaborate on a point that you made a while ago. You said, while you don't agree with the block grant approach, you would be willing to have Congress reduce the minimum amount of the entitlement for welfare.

Since it is our objective to get spending off of this steep trajectory, how would you propose that we accomplish the same result by reducing the minimum?

Governor DEAN. When I say I don't support a block grant, I don't support it in the way that my three Republican colleagues do. A partial block grant sounds terrific, and what I would propose, and this is again speaking as an individual Governor, I would propose that there be a minimum standard of grant throughout the country with an entitlement and that block grant over and above that and then go ahead and level fund that.

If we have to reduce benefits in the high benefit States, so be it. But at least every American and every child is guaranteed that they are going to be taken care of in bad times and maybe we can work out an approach together if there is that willingness to be bipartisan that will allow us to do that.

Mr. ZIMMER. Thank you.

Chairman ARCHER. The committee should be aware that Governor Dean has an engagement that is going to require his leaving I think at this time; is that correct?

Governor DEAN. In about 3 minutes, yes, Mr. Chairman.

Chairman ARCHER. About 3 minutes, all right. So we would be pleased to have you for another 3 minutes and, at that point, you certainly will be excused to attend whatever the event is you have to go to.

Ms. Dunn.

Ms. DUNN. Thank you, Mr. Chairman. And welcome Governors.

As a fairly new member of this committee, and having the opportunity to hear testimony for the first time in these past 3 days, I continue, Governor Dean, and I think I should tell you, to be startled by the degree of control you seem to be asking for by government over the life of the individual.

And I think what I would like you to do, if I may ask you please, is to contrast your views with the views of Governor Weld and what role you believe the Federal Government should hold as we design our welfare reform program, what role you believe the States should have and what should the individual who is involved in these programs be doing?

Governor DEAN. Thank you very much. It is a great question. I think that where Governor Weld and I differ in degree not in direction is that we both agree, and I think most Governors agree that the Federal Government should play a smaller role in our life, also, and in this program. I believe that the Federal Government, this is a Nation, that all 50 States are part of that Nation and there ought to be some minimum standards imposed by the Federal Government.

I believe that the States ought to have far greater flexibility, freedom from regulation, from the nitpicking kind of regulation that we have been subjected to and lots of other people have for a long period of time. Freedom to run these programs and administer them with a reasonable Federal oversight but not the nitpicking kind of auditing that we have had to do for many, many years but that we ought to be required, as Bill has said, to deal with some basic outcome and having to meet those kinds of standards because this is indeed a national program.

I believe the individual has a responsibility to do the best they can for themselves and their families, a responsibility to go along with any rights that they may have. And I believe that part of that responsibility is working to the best of your ability and contributing whatever it is you can contribute.

We are both moving in the same direction, as I suspect the Congress is, and the question again is one of degree. I do not want to see the Federal role eliminated. I do want to see more responsibility at the State level and at the individual level.

Ms. DUNN. And Governor Weld, could I ask you to respond to that question, please.

Governor WELD. I think Governor Dean and I do differ in degree. I think there is a certain amount of distrust of the States in Washington that perhaps had its origins in the civil rights struggles of the fifties and sixties. This distrust was carried over and applied to the economic area where it really didn't have a decent underpinning; I think it now deserves a burial. I think that you can afford to leave much more running room to the States.

I think a mechanism which you could all use—an assessment mechanism is entirely proper—is to make sure that you all aren't buying a pig in a poke. But obviously I prefer to move farther down that road than Governor Dean.

Ms. DUNN. Thank you.

Chairman ARCHER. Mr. Coyne. Mr. Coyne will inquire.

Mr. COYNE. Thank you, Mr. Chairman.

Governor Dean, in your testimony, you indicated that in our rush to do welfare reform here at the national level we might be surprised to find out that reforming welfare doesn't really reduce costs. In other words, you have found that in reforming welfare in Vermont, indeed it has cost some money to do it correctly. I wonder if you could elaborate on that.

Governor DEAN. If you are going to require people to work, they have to have certain supports. Most of the people on welfare are single mothers. Many of them have small children that are not able to go to school. In fact what we have said is if your children are small and not in school, we require a 20-hour work week and if they are in school, we require a 40-hour work week for just that reason.

We believe that middle-class women are not capable of working unless they have some kind of child care arrangement. Therefore, you have to supply that for women who are on welfare. Transportation is an issue in our State because we are a very rural State and there is not much public transit. But it is a significant expense, the creation of the public JOBS program.

I don't see how you can force people to work, which I fully support doing, unless there are jobs for them to work in. And if somebody can solve that dilemma for me, we had a recession not long ago when the national unemployment average was 7.5 percent or higher. There are a lot of people who wanted to work who couldn't find jobs.

What about the people who may not have worked for 8 years or longer? We are going to require them to work as we should. There has got to be some money there to put into jobs and if you don't have the money, and I am sitting here telling you that as the only Governor in a State that has a program like the one you are talking about creating.

Mr. COYNE. Thank you very much.

Governor Weld, in Pennsylvania, the State I represent here in Congress, if the balanced budget amendment was to be implemented, it would cost us about $3.1 billion or more each year. And if we were to look at some way to raise that additional revenue, it would mean that Pennsylvania taxpayers would have to be taxed by the equivalent of an additional 12 percent across the board. I am just wondering if that is the kind of message that Governors want to receive from Washington.

Governor WELD. Well, Mr. Congressman, if the antiunfunded mandates bill that is now before the Congress passes, I suspect that that $3.1 billion would be lower. But I do think that the results of all of these reforms is going to be, as Congresswoman Kennelly was indicating, that spending is going to be cut somewhere.

I happen to think that is a good thing because I think the combination of Federal, State, and local spending is too large—together, those add up to 45 cents on the dollar of every dollar anybody earns. So I think the overall thrust here is in the right direction.

If the States are left free to manage their own affairs, I also think there is going to be some savings that would further cut into that $3.1 billion figure. But if—you know, if that kind of program

went through that had that kind of impact on Pennsylvania, I have got to think that the Federal Government would be a whole lot less big and that would be saving Pennsylvania taxpayers Federal dollars.

Mr. COYNE. Thank you.

Chairman ARCHER. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. And thank you, Governor Weld, for being here.

My personal view of the Contract With America is that we are attempting to restore States rights, and to a great extent we will free people from the slavery of the Federal Government. I regret that Governor Dean had to leave because I wanted to refer to my State Governor, Governor Zell Miller who is a Democrat; and to give you a little indication of how Governor Miller and I have had occasions to get along in the last few years. I was told that Governor Miller made the comment that when the only thing worse than Mac Collins being elected to Congress is that if he had been reelected to the Georgia State Senate.

Now, having said that, just being in the company of Governor Miller about 1 month ago, he came up to me and said, Mac, as far as welfare is concerned, send me the money, even if you have to send me less, I will take care of welfare. And as a feather in his cap, he has done a great deal of work in that area.

We passed a requirement for work in Georgia. They are now implementing a new program, a program that will instruct caseworkers to figure out which welfare applicants need to avoid assistance rather than trying to figure out how much assistance they can obtain.

Also, the gentleman from New York, Mr. Rangel, made a very good comment about jobs. I personally think you must have a JOBS program to parallel welfare reform or welfare reform will not be successful. And that to me, again, is why the Contract has reductions or credits for families, it will help stimulate the cash flow of the private sector, it has incentives for people who want to invest and take that risk that results in creating jobs. I think both of those have to go together for us to have successful reform.

I would hope that we could include—it was referred to earlier about waivers for Medicaid so that we can revisit the institutionalization of seniors. Now Medicaid requires that many States without the waivers have to put those people into nursing homes rather than looking at other types of settings such as personal home care.

If you would, in the last closing seconds, comment on that Medicaid waiver. Thank you.

Governor WELD. Well, Mr. Congressman, I have had applications for waivers pending with the Department of Health and Human Services for well over 1 year now. We have not been able to implement our reforms in the absence of that waiver authority being granted from HCFA. It has been frustrating.

We think it is costing us money and that our population has not been well served. This is not a frustration that has been limited to Democratic administrations. It has something to do with the relationship between the Federal Government and the States, not with being a Republican or a Democrat. And generally our position as Governors has been not only that we want you to give us the waiv-

ers automatically, but that we don't want to have to ask. So we are talking about shared power as well as just shared responsibility.

Mr. COLLINS. Thank you very much for being here.

Thank you, Mr. Chairman.

Chairman ARCHER. Governor, we hear you.

Mr. Levin.

Mr. LEVIN. Thank you, Governor. I think your plea for boldness is attractive, striking while the iron is hot, but I think we have to ask ourselves what and who is going to get burned. So let me ask you about that as someone who is very much in favor of more State flexibility but has some concerns about the extent, I don't want to say extreme, to which you would carry us.

Do you favor block granting in nutrition, the food programs, the same way you state you would block grant welfare?

Governor WELD. I do, Mr. Congressman. I favor local State option in that area. I would mention that Massachusetts fully funds the WIC program and we are great believers in prevention spending in the human service area, so it probably wouldn't make any difference to us, we would be fully funding all those programs.

Mr. LEVIN. The nutrition programs, food stamps, for example, act as substantial economic stabilizers. And you say you are willing to forgo that. Do you have any idea if the block grant had been in place, say the last 7 or 8 years, both in welfare and in nutrition food programs, what would have been the lowered return to Massachusetts?

Governor WELD. I do not know the dollar figure, Mr. Congressman, but I think my answer would be the same as what my answer to Mrs. Kennelly's question would have been: What do you do when a recession comes? And my answer is that the States would adjust their spending to make sure that people were not left to starve on the grates.

Perhaps the money would come from highway programs, perhaps it would come from some other area, but no chief executive of a State is going to put up with breadlines in his or her State. So I don't know where the money would come from but I just—I assert it but I can't prove it, but I assert that Governors would manage to the situation and manage to the figure.

Mr. LEVIN. Let me send you the figures. We may have them tomorrow. I think you are talking about hundreds of millions of dollars for Massachusetts and I think in terms of Federal-State relationships, they have been shaped not only by the civil liberties issues of the sixties, but the economic issues that began to loom large in the thirties.

And we are going to have to act on this and I would like to send you the figures on what these programs have meant for Massachusetts the last decade in food programs, and in welfare. I would be interested to hear what you would cut in your State rather specifically if these programs were cut rather substantially.

Governor WELD. I would be very happy to respond to that, Mr. Chairman. Let me just say, we passed an education bill in 1993 that requires me to come up with a quarter of a billion dollars every year in additional K through 12 education spending. That is putting a lot of pressure elsewhere on the budget, but we are managing to it and if something happened that put a $200 million a

year pressure on my human services area, I am confident that we could manage to it.

Mr. LEVIN. Thank you.

Chairman ARCHER. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

Governor, welcome. I have been delighted at your candid testimony. And I wanted to follow through on a couple of the concepts we have been outlining here today. I think there are a lot of us that feel that one of the capstones of welfare reform at the local level is linking welfare rights to responsible behavior. That takes a number of different forms, perhaps a workfare provision that would require people who are able bodied to work for their benefits, a learnfare that would require school-age recipients to attend class, the possibility of some sort of drug testing and also some form of wedfare to discourage illegitimacy.

These have all been talked about at the State level and are now being contemplated at the Federal level, along with policies that reduce dependency, possibly more expanded or more targeted job training programs, or even an extension of health care benefits to recipients who leave welfare voluntarily and who take low-paying jobs without benefits.

With those perspectives in mind, are these the sorts of policies best implemented at the local level with block grants at the Federal level? And are these the sorts of things where States have a broad ability to develop innovative individual approaches targeted to the specific welfare problems in their States?

Governor WELD. I think the answer is yes, Mr. Congressman, conditions do differ from State to State. If you look at the work done by Governor Thompson in Wisconsin, it has been great for Wisconsin. He has been reducing his welfare rolls. It might not apply in some other State.

I am in favor of giving the States the ability to experiment here. I personally would jump all over the workfare and learnfare approaches. I think that is exactly the way to go. I might put a little bit less emphasis on job training programs than another Governor might because I happen to believe there is no substitute for work, not preparing for work. Not thinking about work, nothing except work itself.

And I think if you get somebody having the experience of leaving the house every day and going to work, even if it is 25 hours a week, then they get a supervisor who can give them a reference, they get work habits, I think that is more important than two or three training programs at the end of which you might not find the job you wanted.

Some other Governor might do it differently.

Mr. ENGLISH. That leads me to my followup question. Secretary Shalala was in the other day and was stressing the need to include job training at the front end as a part of any Federal welfare reform proposal. From your experience, how effective have the job training programs been at the grassroots level aimed at bringing people off of welfare.

Governor WELD. I am probably not a very good person to ask, Mr. Congressman, because, as I say, I am more of a believer of getting people into the work experience than putting an enormous

amount of money into job training. I would be paying someone for every hour they worked in that community service job whether it was lifting crates in a food pantry or working at a hospital or environmental organization. I think we could get a lot of good done there and I think that is a form of job training. I think a job is the best job training.

Mr. ENGLISH. Thank you, Governor.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

Governor Weld, you weren't here when we first talked about the differences. Some people are opposed to having the flexibility in the States because they say, for instance, like Wisconsin has a more generous provision that is more people move to Wisconsin to receive those benefits and some people are opposed to that because they say it is not right for people to be able—to move from State to State to receive those provisions.

I would like your comments on right now in your State, you are cutting taxes, you are doing some things to make it more friendly for businesses to move to your State. Why should it be OK or encouraged for States to have a more business-friendly climate to attract people because they want to do that and yet not have the freedom and the flexibility to design their publicly funded programs, you know, to the poor or disadvantaged to make their States either less or more attractive to those types of people.

Governor WELD. I agree with the premise of your question, Mr. Congressman. I think States absolutely should have the flexibility to set their own policies even if that means they wind up competing with each other. Besides it is already the case that States have different benefit levels.

I think if I had a completely free hand, I would probably try to steer my State in the direction of social policies more like New Hampshire which is a, relatively speaking, low service/low benefit State. Massachusetts, historically, has been a high service/high benefit State, and I am putting my shoulder against the wheel trying to reverse that a little bit. But I could never get it as far as New Hampshire and that is because States make cultural choices—that is part of the richness of our pluralism. So I think you can't really argue that the States should not have the freedom to compete with each other.

Mr. ENSIGN. The followup question is: We have also heard some talk and, as a matter of fact, Representative Gephardt was here the other day talking about he would like to see incentives built into the system. You mentioned incentives built into the system where if—on a results type of thing where, if States did better, they got more money, but he did not mention the same way in a marketplace where businesses have incentives, they make more money if they do things right but they also are penalized if they do the wrong things.

How do you feel the Governors, including yourself, would respond to penalties and less money in their block grant programs if they didn't meet the results?

Governor WELD. That is the real world. That would be just fine. The example I gave earlier, my hypothetical example of myself fail-

ing to put in an anti-illegitimacy policy and therefore losing money, that was a penalty. It contemplates penalties as well as incentives.

Mr. ENSIGN. Thank you.

And thank you, Mr. Chairman.

Chairman ARCHER. Dr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman. Governor Weld, could you tell me, do you budget on a 1-year basis or 2?

Governor WELD. One-year basis.

Mr. MCDERMOTT. So you were $13 billion when you came in and you are now 16?

Governor WELD. $16 and change, yes.

Mr. MCDERMOTT. So you are going up.

I had the experience in 1981 when we went through this block grant business once before, I was the Ways and Means chairman at the State level. We had a Republican Governor who was out in 4 years as a result of it. I want to ask you some questions about it.

If the proposal that is in the Human or the Personal Responsibility Act, which I guess you are signing off on today, you like what they have dropped in as the proposal for the Congress; is that correct?

Governor WELD. I support the Contract, yes.

Mr. MCDERMOTT. You do. You support the Personal Responsibility Act that has the welfare reform bill?

Governor WELD. Generally, yes, Mr. Congressman.

Mr. MCDERMOTT. Well, then, I will just tell you that in 1987, if you had had this act in place, today in 1993, you would have $111 million less in your welfare program. There would be a 30-percent reduction because they allow you to go up 3 percent a year, no matter what happens in the economy.

So now I know you are building your budget for this year and I want to hear you tell the Congress what you are building in as your assumption in your fiscal year 1996 budget that you are going to get from the Federal Government for welfare. Are you expecting the same amount or are you building in a 10-percent reduction or a 20-percent reduction?

What are you submitting to the Massachusetts Assembly?

Governor WELD. It is a slight reduction, Mr. Congressman. I think from about $820 million down to $785 million for the State's share, so that might be a couple of more million reduction.

Mr. MCDERMOTT. So that is about a 3-, 4-, 5-percent reduction?

Governor WELD. Oh, no. More——

Mr. MCDERMOTT. Ten percent.

Governor WELD. Between 5 and 10, closer to 5.

Mr. MCDERMOTT. So you are saying you are going to accept from us a 10-percent reduction at the Federal level?

Governor WELD. Yes. It is not because I am being generous, it is because I am projecting an impact on the caseload from all of these welfare reforms we are trying to get through.

Mr. MCDERMOTT. And you are sure that is all going to be coming out of the Congress, 10 percent, if we cut——

Governor WELD. The way the system is currently configured, I am a 50 percent State. I can look for 50 percent of what I have spent.

Mr. McDERMOTT. Now, if you went into a recession and you suddenly had a large increase in your caseload, how would you deal with that, raise taxes? Or cut benefits? Or what would be your proposal to your legislature since you are not going to have any kind of entitlement out of this place? You will get a capped amount, that is it, go down the road and fix it.

Governor WELD. In a program that was not an entitlement, I wouldn't rule out benefit cutting. I wouldn't rule out going to my highway spending for $100 million or some other part of the budget. I would manage to the figure and, you know, keep an eye on what is happening out there on the pavement. Are people suffering pain, like any Governor——

Mr. McDERMOTT. Would you tighten your qualifications and put people off the program.

Governor WELD. Oh, yes. When we abolished the State welfare program and imposed a screen, a million dollar screen for this program for the disabled, 20 percent of the people on the program did not bother to reapply. Our former program—these eligibilities are not cast in stone.

Our former program made all ex-convicts eligible for welfare. The theory was, you go back to a life of crime if the taxpayers don't support you. That is ludicrous. It made substance abusers eligible for welfare. It made me eligible for welfare.

Mr. McDERMOTT. How about children of women under 18? Do you agree with this proposal that says you can't use any Federal money for women under the age of 18 for their children?

Governor WELD. There are a couple of things there that I would like to think about and I would favor, personally, the State option.

Mr. McDERMOTT. Tell them they are going to write the bill very shortly.

Mr. SHAW. If the gentleman would yield, it does not say that.

Mr. McDERMOTT. I want to find out——

Governor WELD. Two of the provisions that have gotten a lot of discussion in the media, the legal aliens and the children—illegitimate children born to unwed mothers under 18, I would favor State option. I think in my State, I would pick up the legal aliens and I would get the money, somehow.

Mr. McDERMOTT. So you would pick up the legal aliens but not the children of women under 18.

Governor WELD. I am thinking about the second one. I have made a decision on the first one.

Mr. McDERMOTT. Have you any proposal for forcing these young women to go home, to make them go home so that the children have food to eat or are you expecting to pick them up in the CPS, the child protective services.

Governor WELD. My welfare proposal at the State level would require young mothers under 18 to live at home, to live at home at least until they finished high school unless there was an at-risk situation that they were in some physical danger. And in which case, I would not take the child and put them in an orphanage, but I would put the mother and child in a group setting, supervised.

Mr. CRANE [presiding]. The time of the gentleman has expired.

Mr. Christensen is next.

Mr. CHRISTENSEN. Thank you, Mr. Chairman. Thank you Governor Weld for your testimony today.

In Michigan, Governor Engler's plan cut property taxes and made up the revenue shortage by raising sales taxes by 2 cents. I did think it was from 4 to 6 cents. In a low population State like Nebraska, if we wanted to do that same thing, we would have to raise our sales tax, I think, up by 12.5 cents.

What recommendations might you have for low population States if they wanted to emulate what you have done in Massachusetts and what Governor Engler did in Michigan? What could we do to make up that revenue shortage if we didn't want to raise sales tax by that amount?

Governor WELD. Well, I can't talk about raising any taxes, Mr. Congressman, because I have taken a blood oath never to permit any tax to be raised in my State. So I have a hard time even wrapping my tiny mind around the concept of a tax increase.

Mr. CHRISTENSEN. Any suggestions as far as what Governor Engler did in Michigan and how low population States, though, because we only have 1.5 million, 1.6 million people, the percentage in sales tax would go up enormously in Nebraska. Are there any alternatives to that or not?

Governor WELD. I really don't think I am competent to answer the question.

Mr. CHRISTENSEN. OK. Thank you.

Chairman ARCHER. Next, Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Governor, I was interested in your comments on some proposed changes to the SSI program and I approached the two mayors unknowingly who are members of our next panel asking if they are members of your staff. They indicated they were not—I apologize to both you gentlemen, but I did find a person I think and I would appreciate if you could share with me a copy of your proposal on the SSI program.

Two short questions, Governor. You do support in your statement and verbally the three-fifths majority or supermajority to raising taxes as part of the constitutional amendment on a balanced budget? I am assuming that is correct.

Governor WELD. That is correct, Mr. Congressman.

Mr. KLECZKA. Do you have that provision in your State?

Governor WELD. We do not. I would love to have it.

Mr. KLECZKA. Have you proposed such to the legislature?

Governor WELD. Three years ago, yes.

Mr. KLECZKA. Second, as the balanced budget amendment moves forward, it does not contain a provision on mandates, on the Federal Government paying for mandates to State government.

Would you be supportive of that protective language in the constitutional amendment?

Governor WELD. Well, yes, I would, but my understanding that there might be a couple more votes for the balanced budget amendment in an adorned form, and I think the most important thing is to get the balanced budget amendment through, particularly if we can get that antiunfunded mandates language through in statutory form. That is enough protection for the short term, and we have been assured by leadership that there will be at least a vote on the

Hill on the antiunfunded mandates language in the context of a constitutional amendment at some point this year.

I think it might be better if you let the balanced budget amendment go through and then let a few months go by so that support for the antiunfunded mandates concept could bubble up to Washington from the State legislatures and then maybe you get them both which is the best long-term situation.

Mr. KLECZKA. But it has to bubble here first, but it bubbles up in the States if it is not the part of the proposition we send to the States——

Governor WELD. What I mean is if there is a delay, and this is conjecture on my part, but if there is a delay, then you might get the State legislatures calling up their Congressmen saying, hey, we think a yes vote on this antiunfunded mandates constitutional amendment would be a handy idea.

Mr. KLECZKA. Well, I think it is going to be a handy idea and I think that bubble up should start with the Governors who are supportive, generally, of the balanced budget amendment. As a State—former State legislator and most of the members of the panel are, I recall some years back on the CETA program and the State of the Wisconsin where I hail from did participate in the CETA program, and then finally at the end of the Federal funding portion, we read the fine print and we were under a moral obligation in Wisconsin to retain these folks. And we scrambled around and we finally did so but at the expense of some extreme budget pressure.

Let me say before my time expires that without this protection for the States in the balanced budget amendment itself, and with the pressures to cut over $1 trillion between now and 2002, don't think for a moment that block grants, be it for welfare or any other program, are going to be sacrosanct.

We are going to be looking at those in cuts so, in essence, what we are going to be doing in a Federal level, we are going to be very heroic at home but we are going to constitutionally shift the shaft to you, the Governors, and that 6 years down the pike we won't know whether or not I am correct as we sit here. Chances are you probably won't be in the Governor's seat anymore, but I pity your successor because, at that point, the pressures are going to be on the States which have clearly limited resources. And as Governor Dean said, they have to go right to the middle-income taxpayer if in fact those adjustments are made through tax increases.

One point that hasn't been brought up in the committee is another item in the Contract calling for a little checkoff box on the tax return. If you or I check that off, that means 10 percent of our tax payment to the District of Columbia would go for budget deficit reduction only and if every taxfiler in the country checked that box, that is 10 percent less revenue that we are going to have to send back to you to pay for the things that we are mandating—not mandating, that are left to you in your State.

Governor WELD. That would be wonderful. Drive down the cost of capital, we would be able to do better than the Germans and Japanese. That would be terrific.

Chairman ARCHER. The time of the gentleman has expired.

Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman.

You know, frankly, Governor Weld, I am very impressed with your testimony on this committee.

You know, we can talk about training people after they get out of school. We are talking about training people and finding them jobs. In my judgment, that starts way back, in fact it starts in the grade schools and kindergartens as we go along.

When I hear some of the things that are being said to me by the outstanding congressional students that come up to Washington, I ask them what they are being taught in public education. They are not being taught that you stand on your own two feet. They are being taught, well, the government is the answer.

Now, is there some way that we can, or should we or shouldn't we, start looking at what we are teaching our young people now about what has made this country great rather than waiting until they have been indoctrinated with the social welfare programs when they get out of school.

I would like to have your opinion on what we are teaching in the schools and public education now.

Governor WELD. I think, Mr. Congressman, probably we should move a little bit in the direction of the German apprenticeship program. We have introduced a bill in our State actually which has gone through to create a certificate of initial mastery in the 10th grade.

And, you know, in the past, our education system has been seemingly designed on the assumption everybody is going to go to Ivy League schools. That ain't true. Fifty percent of our people aren't going on to college at all. And I think we need more emphasis on vocational and technical education and realize the facts, that not everybody is going to go on to the liberal arts, bachelor's degree. And I think we would be doing everybody a favor if we moved in that direction.

Mr. HANCOCK. In other words, your opinion is that, let's teach them that even school itself is work; am I correct in that?

Governor WELD. That even?

Mr. HANCOCK. That even going to school itself is work, it isn't just fun and games.

Governor WELD. That is right.

Mr. HANCOCK. In other words, your position is that we need to get people interested in work of some type?

Governor WELD. That is right. I don't think we are doing enough specific preparation during school for vocational and technical education, and I think our school-to-work programs are nowhere near focused enough. We have got to go to the business community and say, what do you need in terms of people coming out of school, and let the businesses—the employers—design the school programs. You have got to get more business input into the curriculum in the schools.

Mr. HANCOCK. Real quickly, what is your opinion of "outcome-based education" that is being pushed so hard through the National Education Association?

Governor WELD. Well, I know that outcome basing has got a bad aroma in the education area. I use it in a lot of other areas measuring by results as opposed to measuring the process, so I think

maybe I don't really understand enough what outcome-based education means.

Mr. HANCOCK. Thank you, Mr. Chairman.

Mr. CRANE. The time of the gentleman has expired.

Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. And I thank Governor Weld for being here today. Good testimony.

I also want to thank you for being an active participant in the new partnership we have been trying to develop in the past couple of months between the legislative branch at the Federal level and the Governors.

I want to thank you on the unfunded mandates front. You have been very helpful, as have your staff, in putting together a good piece of legislation. As you know, the Governors helped write H.R. 5. It is expected to be on the House floor next week. My understanding is it may go to the Senate floor as soon as this afternoon.

I enjoyed your dialog with Mr. Kleczka. I am glad to hear he is interested in this issue, the unfunded mandates. I look forward to having him as cosponsor on the bill. It is a good strong first system on the unfunded mandates front and, again, it was not something that was done solely within the halls of this Congress, it is something where we reached out to the Governors and local officials. And, again, I want to thank you for helping us on that.

I think it will lead to a new partnership. I think it will give many of the State legislatures comfort as to the unfunded mandates part of a balanced budget amendment. If in fact it is necessary to go back later and do an unfunded mandates amendment, I am sure that you and others will be supportive of that. Our leadership has indicated there will be a vote on that.

During your testimony, I had one question with regard to Medicaid. I was struck by your success there in terms of managed care. I think in the New York Times today there was an article on managed care and Medicare, something this committee is extremely interested in.

I guess, if possible, I would like for you to elaborate a little more on what you see as the advantages to the managed care approach in Medicaid. And then if you could comment on what else we could do at the Federal level in terms of making your life easier on the Medicare front. This is an area that is not often talked about in the welfare context but obviously is one, if not the, biggest program.

Governor WELD. The proof of the pudding is in the eating, Mr. Congressman, and I think during the 4 years prior to your coming in in Massachusetts the annual growth in Medicaid was something like 18 to 52 percent a year. And now in the last 4 years, we have gotten the growth down to under 3 percent. When you factor in an increasing caseload, it is negative growth last year. So the managed care aspect there has been terribly, terribly important.

Mr. PORTMAN. You talk about the caseload having increased and yet you are seeing reductions in cost because of the cost efficiencies in managed care?

Governor WELD. Right. And another thing we have done is reform our hospital financing system at the State level in 1991 to permit managed competition and bulk purchases and having the

players in the health care industry use their purchasing power, their buying power to get volume discounts and drive down costs. I think that this has also had a big impact on costs in that area, letting the market work.

It is a good case study for introducing a market mechanism into the provision of the health care where it did not exist before and having the market drive costs down.

Mr. PORTMAN. With regard to Medicaid, just briefly, what else would you look for from the Federal Government? What other flexibility or what other Federal approaches on the Medicaid front could keep your costs down?

Governor WELD. Well, of course having to go to Washington to get permission for every amendment to the State plan slows us down a lot and I think deprives us of the flexibility to keep our costs down by just such initiatives as I mentioned. We needed that waiver for that hospital financing measure back in 1991. We got it, but I have got a bunch of others pending.

Mr. PORTMAN. Thank you.

Mr. CRANE. The time of the gentleman has expired.

Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman. And Governor Weld, welcome, and thank you very much for your testimony.

I want to spend my couple of minutes here talking a little bit about welfare reform and specifically the block grant proposal. Governor Dean said, on behalf of the National Governors' Association, that the Governors were in favor of the block grant proposal and said the NGA thought that there should be some kind of minimum standards that would be set in terms of the block grant funds.

Would you comment on what you think the minimum standards programs ought to be in terms of any kind of block grant funding?

Governor WELD. Well, I think Governors certainly agree with the idea, for example, of a work requirement and of time-limited benefits. The question becomes whether you are going to make that a requirement of the program or whether you are going to make it a goal of the program with the Federal Government performing an assessment to see how well the States are doing in reaching those goals would then either benefit or penalize depending on how well individual States were doing.

I think Governor Dean and some others would prefer that those principles be conditions to receipt of the money. I would prefer to have a single Federal audit every year, with an assessment based on that audit rather than on receipt of the funds because the latter could contribute to the sort of micromanagement that we have seen in the past. You might start out with 4 or 6 conditions, then pretty soon there would be 18 conditions and we would be back where we were before I acknowledge your duty to follow the money and make sure it is being spent on what it purports to be spent on.

Mr. PAYNE. Let's see if I understand. So you are saying, then, that there would be no minimum conditions but yet there would be certain parameters. What is it exactly you audit as you audit each year if there were no standards to which you audit?

Governor WELD. Well, you would have your goals that the States were to achieve and you could design the audit any way you want. But the example I gave earlier is, let's suppose that one of the Fed-

eral standards or goals or even conditions was measures to reduce teenage illegitimacy.

Let's say I did a lousy job in my State and that my teenage illegitimacy rate was triple what it was anywhere else. I would expect Uncle Sam might want to take some action based on that. That is what I call a tripwire, but I like to build those tripwires into the future rather than having them all be at the starting gate and have the States have to step over the tripwires in order to participate in the program.

Mr. PAYNE. OK. So you are saying then there ought to be goals such as reducing teenage illegitimacy but there should be no specific goals or no specific requirements in terms of how much needs to be done in order to meet them.

Governor WELD. I think you can build how much needs to be done into the future. I am a little hesitant about saying that Governors would like to sign up for these 12 conditions on the program as a condition of receiving any money to begin with because then I am afraid that could lead you to management by the bureaucracy, not even by the committees of Congress but by the administrative bureaucracy. And management by a bureaucracy too often turns into micromanagement, what we don't want.

Mr. PAYNE. It seems the audit processes lead or potentially could lead to even more management by bureaucracy.

Governor WELD. Well, except that an audit can be an audit on a test basis. I think you are more than entitled to that. I don't know of any Governor who would say, give us the money and don't audit how it is being spent.

Mr. PAYNE. Well, I am not suggesting we ought to do that. I am just asking about what the rate ought to be and what the minimum level ought to be. And I think what you have said is we should have goals, we should perhaps have minimum standards and then there should be some incentives and disincentives to encourage reaching those goals.

Governor WELD. Right. Goals and assessment mechanisms is how I would describe it, Mr. Congressman.

Mr. CRANE. The time of the gentleman has expired.

Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. I would like to follow up on what Mr. Payne was talking about because, Governor, we had this conversation about 1 week ago. I think it was pretty much the consensus that we could put in place a mechanism for a preapproved plan which would be voluntary on the State's part if the State believes it is getting into an area it is concerned about and feels that it should have some preapproved mechanism that would be available to the State.

But the audit would of course have to go forward and, it being Federal money, the Governors certainly recognize the need for that. I think what we would try to do is to set up a the basic framework, which would be just as simplistic as we can possibly make it and as direct as we can possibly make it and easily understood and difficult to manipulate by the bureaucrats, so that people will know where they are going. We should get the Governors to help us draw it.

I can tell you that Congress has really reached out to them, Democratic and Republican Governors. And I mentioned this to Governor Dean as he was leaving in order to give us your input on drawing this plan because we want it to work. We want to decrease the bureaucracy.

Governor Weld, I very much appreciate the tremendous help you have been in these meetings in keeping things on an even keel and recognizing the progress that we have been making in meeting with the Governors. You have certainly brought great pride upon your own administration, yourself and your State in taking a collapsed miracle, resurrecting it like a phoenix coming out of the ashes and you have done a wonderful job for Massachusetts. You put together just some good commonsense programs and some good commonsense tax structures which have brought your great State back.

And it is certainly recognized, I think, by us in Washington, and it is also a model, not only of what you have done with welfare, but also the tax policy that you have put in place. It just makes common sense what you have done and the results have been terrific.

I just have one question that I do want to ask you. Have you seen any of the welfare benefits being cut off? Have you seen this come into play in any of your crime statistics?

Governor WELD. Welfare benefits being cut off?

Mr. SHAW. Yes.

Governor WELD. Contributing to crime?

Mr. SHAW. Has there been any correlation between cutting the benefits and the crime rate within the State?

Governor WELD. Well, our crime rate is down a little bit over the last few years and that follows the time when we cut off a lot of the State welfare benefits specifically for ex-convicts. So that would suggest a lack of correlation.

Mr. SHAW. Good. Well that question has been raised on several occasions and I appreciate your being able to give us that information. Thank you very much for being with us today and the contributions that you continue to make toward welfare reform.

Governor WELD. Thank you, Mr. Chairman.

Mr. CRANE. Mr. Neal.

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

I want to welcome you my friend.

Governor WELD. Thank you, Congressman.

Mr. NEAL. You know I served as mayor and don't ever take credit in an executive capacity for crime standards going up or down because surely it is going to be reversed at some time and your opponent will remind you of the previous position that you took.

Governor WELD. With any luck, I will be one jump ahead of the posse, Mr. Congressman.

Mr. NEAL. I want to welcome Governor Weld, as you can see very affable and very likable. In a State that is overwhelmingly Democratic, he has enjoyed great success in the polls, great speculation about his national ambitions. He was over in Ireland recently trooping around. He is running and we do want to welcome him here in that spirit.

One of the things I am struck by, you said you cut taxes nine times and you said you needed a three-fifths majority in the State constitution to prevent that from happening.

Governor WELD. Oh, no. Only on the up side. I wouldn't apply the three-fifths to a tax decrease and I don't think the house provision does either.

Mr. NEAL. One of the esteemed sons of Massachusetts, Elliott Richardson, I think that you would say he should share that title, has suggested that one of the relics of the past that ought to be abandoned here in the Senate of the United States is the filibuster. Why would we move down the road of creating a majority here when 40 percent plus one of the elected Members of the Congress can hold up what may well be for whatever may be sound policy and strong principle?

Governor WELD. I think anybody that creates downward pressure on taxes is good, just like I am about to go into another committee and testify in favor of the line item veto which I like because it creates downward pressure on the budget.

Mr. NEAL. You have worked with a legislature that is overwhelmingly Democratic, the leadership on both sides. You haven't had to resort to that sort of a tactic.

Governor WELD. That is true, Mr. Congressman. But I think we have been lucky in that we were able to achieve more in a down market because everybody was scared of our State going into bankruptcy than we would have in more normal times.

Mr. NEAL. Let me just close on this note. Let me just ask you a question and it will be between you and me as they say here in Washington.

Governor WELD. OK.

Mr. NEAL. Do you have any plans to send back any of that $11 billion that is going to the Boston Harbor in the spirit of this tax cutting zeal?

Governor WELD. I think the Federal money is going to the artery tunnel project and we are in the middle of a stream there, so I don't think I want to change horses on that. I have said that I am not going to come looking for any more money on the strength of any change in the project. It is time to cap the Federal investment there.

Mr. NEAL. At $11 billion, there is no more to come back and get.

Governor WELD. Seven seven. Seven seven and change.

Mr. NEAL. Thank you, Governor. It is nice to have you here.

Mr. CRANE. Well, I want to express a profound appreciation to you, Mr. Governor, for more things than I can attempt to convey today, but you have performed a near miracle in what was known as Taxachusetts. And going back to that 1980 campaign traveling in your neighboring State now governed by Mr. Dean, I remember that I encountered many Massachusetts—former Massachusetts citizens who had jumped that line to get away from the excessive rates of taxation there, and it is really a distinguished record. And when you need help in Illinois, please let me know because I owe you one, Bill.

Thank you so much.

Governor WELD. Thank you, Mr. Congressman, and I wish you would run for President again.

Mr. CRANE. Mayor Goldsmith and Mayor Rendell, are they here? Please be seated, gentleman. And before we proceed, I have a unanimous consent request from our colleague who is unable to be with us at the moment, Mr. Jacobs from Indiana, welcoming Mayor Goldsmith to the committee, but we have also our distinguished colleague from Indiana, Danny Burton, who is here. And Danny will you please introduce the mayor.

Mr. BURTON. I thank you, Mr. Chairman. You never know about political aspirations but Mr. Chairman, we also have Congressman Buyer here from Indiana, the great new Congressman, second-term Congressman who will also share in introducing our great mayor from the city of Indianapolis.

Mayor Goldsmith was elected prosecutor many years ago and did an exemplary job as the prosecutor in dealing with the severe criminal problems we had in Indianapolis. And in 1991, he was elected mayor. He has been very, very active and a leader in downsizing government. He is making government much more responsive to the people of Indianapolis than has been the case in the past and he has done it while holding the line on taxes.

As a matter of fact, some of his accomplishments since he became mayor, he has reduced the city work force by one-third, by about 35 percent. Now bear in mind there has been no tax increases and he has reduced the work force by 35 percent. At the same time, he added 100 additional police officers to help in law enforcement. He achieved $100 million in savings by inserting competition into delivering city services and he has privatized many parts of the city government. I am very interested in golf, as many of my colleagues know, and he has privatized many of the city golf courses and they are much better than they were in the past because of that privatization effort.

We have had 6 years without a tax increase. Three years of record job growth. And he has invested $500 million in infrastructure improvement and all the time while holding the line on taxes. I think he is one of the great mayors of America and I am very proud he is my mayor and I am very proud to have been able to be a participant in introducing him here today.

Mr. CRANE. Thank you.

Congressman Buyer.

Mr. BUYER. Thank you, Mr. Chairman, I would like to commend Mayor Goldsmith for his effective leadership in regard to urban renewal in the city of Indianapolis. Mayor Goldsmith has taken a lead in the city of Indianapolis in terms of streamlining and reorganizing government, by using the practical methods of government that are efficient and cost effective.

Mayor Goldsmith has achieved these things again, exactly as my colleague said, without raising taxes. We here in the Congress should listen well to Mayor Goldsmith in his leadership in reforming government and his innovation, not only with his background with crime, but with welfare reform that we are talking about in giving flexibility to the States and its impact with the cities.

So I welcome Mayor Goldsmith here to the Congress and to this committee and thank you, Mr. Chairman.

Mr. CRANE. Thank you for your introductions. And now, honorable mayors, if you will proceed with your opening statements. And

we have some time constraints, so if you have a lengthier than 5-minute presentation initially, be assured that it will be a part of the record and proceed.

STATEMENT OF HON. STEPHEN GOLDSMITH, MAYOR, CITY OF INDIANAPOLIS, IND.

Mr. GOLDSMITH. Thank you. I don't have longer than a 5-minute presentation to begin with. Let me just say briefly I appreciate the Congressmen's introductions.

Indianapolis is the 12th largest city in the country. We have one of the best economies. We also have all the same problems that everyone else does. This Congress has obviously a historic opportunity and that is to face up to the fact that the previous Federal policies have aggravated the problems in cities. They haven't mitigated those problems. And there will be a temptation just to walk away from cities and say three decades or two decades of failed Federal policy, we will just eliminate those policies and ignore cities.

I would hope you would resist that temptation and look at cities as great places and how a renewed relationship between the Federal Government and city governments around the Contract With America can produce a better economy in our cities.

Let me just say very briefly that our marketplace has changed. All of us who are in urban corridors see a situation where if you look on the other side of the cityline, the crime is less, the schools often are better and the tax rates are less. And with the aggravation of the Federal mandates and the welfare system, we really are seeing structural disinvestment with dollars, private dollars kind of rolling out of cities. And the issue is how to use tax policies to encourage investment in our cities.

These ever-growing concentric circles of poverty threaten not only the people who are in them but they also threaten the suburbs as well. We have to find a way to have wealth increase so these increasing circles of hopelessness and poverty and crime can be reduced and I think we have a historic opportunity to do that.

Frankly, my city is succeeding despite Washington, not because of it. Washington's policies, dysfunctional welfare systems, ill-advised mandates, have made it more difficult for me to succeed.

My proposition here, Congressman, is three part and very simple and is consistent with the Contract With America. One, wherever you can, will you please use tax policy and not Federal grants to make it a good place to live and work in my community. Second, use the marketplace and not mandates to be a successful partner with cities. And third, use both of these to balance the budget. Very briefly let me mention each.

First, I would hope that you would consider tax policy, not spending, to solve the problems in my city. This Congress obviously appreciates the importance of tax policy. In the Contract With America are very powerful provisions to encourage family formation through credits for children. It encourages investment through capital gains cuts.

That is the same sort of thinking that you are addressing to family structures, using tax credit policy, I would hope that you would use that as an approach to cities. That is to say, stop giving us

grants with lots of strings attached which are very expensive and think about ways to use taxation to encourage private investment in job growth much more efficiently than through grants in urban corridors. You can reduce the Federal role in cities and in States by using tax policy and eliminating the way we do things now.

I would—we are not prepared here today to discuss details but if you have a flat tax, make your tax flatter. If you cut capital gains, cut them more aggressively in areas that are poor. If you have a possibility for payroll credits for people who have job locations in urban corridors, all of those are much more powerful and much more wealth producing than the failed welfare policies of the past.

Second, I would encourage you to use markets, not mandates. As we all know in the room today, Liberals and Conservatives, welfare pays more than work. You have destroyed the marketplace in my city by making sure if you don't work, you earn more than if you do work. You have destroyed the marketplace.

I would ask you to consider how to stop this particular addiction and, as we do that, let me just very briefly say that the—as a prosecutor, I collected child support for 12 years and my collections went from $900,000 a year to $38 million a year. The moms I represented were rational people. They knew what was in their best interests. It was not in their best interests to work because welfare paid more than work.

We can create a rational system and I would suggest that just taking the welfare system in toto, using Federal—taking Federal bureaucrats and moving them to State bureaucrats is not the answer. We need to use the marketplace to create jobs, not just to move the Federal welfare system to the State. And there are some ways to do that.

Finally, I would just ask that you free us from these mandates. And I could give a long list, but 6 seconds on several. The Fair Labor Standards Act took more police officers off the street than you put on the street last year with the crime bill. The 13(c) of the Mass Transit Act ensures that poor folks can't get to their jobs in an efficient and effective way.

The Davis-Bacon Act, as applied to community block development grant money, makes sure I can't hire urban poor. On and on and on. We have a Tax Code that says you will give me incentives if I have socialism rather than private service delivery and they are many of the areas of privatization that Mayor Rendell and I have done.

Just to conclude, my messages simply are you can balance the budget. You can cash out all your grants. Take all the bureaucrats at the State and Federal level, keep all the benefits, give me some opportunity to make my marketplace work and we will all be better. We reform the welfare system along the same direction.

So my message is please use tax policy. Our marketplace is not even today. The Federal Government has destroyed the marketplace in cities. It is very expensive to invest in our city. Please help us with tax policy, not grant policy, not bureaucracy, not welfare but tax policy to make our marketplace work. Remember that the marketplace works, mandates don't.

And if you could balance the budget around these principles, we will create, I am absolutely convinced and committed to creating, to creating opportunity for poor folks in my community and we can create opportunity through a conservative agenda if we pay attention to those principles and infuse hope and opportunity and jobs in urban corridors.

Thank you very much.

[The prepared statement follows:]

Testimony to the House Ways and Means Committee
Mayor Stephen Goldsmith
January 12, 1995

Mr. Chairman:

Thank you for the opportunity to testify on the Contract with America and think through with you what a new urban agenda for the federal government might look like.

The Republican victory on November 8th was a clear signal that the American people no longer trust big government, particularly a big federal government, to solve their problems.

Many observers expect the 104th Congress to ignore cities; or, worse, to carry out the voters' call for smaller government in ways destructive to urban areas. It would be easy to leave the cities for dead, figuring it is the price they pay for decades of failures by big-government mayors. But as the leaders of this historic Republican Congress, you have the opportunity to do the completely unexpected. You can -- you must -- fashion a positive Republican agenda for America's cities.

The first thing Congress should do is recognize that the marketplace in which cities operate has changed. No longer do major cities compete against each other for businesses and home owners. We compete against our suburbs, and we start out at a substantial disadvantage. Suburbs have lower taxes, lower crime, and better schools. As a result, wealth and jobs are rapidly flowing out of our cities, leaving pockets of poverty behind. Not only has the federal government failed to address this fundamental imbalance, it has actively increased the centrifugal forces pushing wealth out of the cities.

The good news is that there is a new generation of mayors already at work in our cities. The same small government sentiment that drove this year's election has already been making big-city, big-government mayors an endangered species. Taking their place are mayors of both parties who are adopting more conservative approaches. We are holding the line on taxes, reducing the size of our governments, and becoming more responsive to our customers.

Yes, cities are surviving; and some of us are even thriving. In my city, Indianapolis, we have added 15,000 jobs to our economy over the last three years; and the most recent unemployment statistics show us at 3.9% -- as close to full employment as a major city can get.

If the most feared words outside Washington are, "Hi, I'm from the federal government and I'm here to help you," then the most annoying words inside Washington may well be, "Hi, I'm a big-city mayor and I'm here to ask for more money."

You won't hear us asking you for bigger federal checks. For too long, big-city mayors have come to Washington with tin cups out, painting bleak pictures of the despair and hopelessness of their cities, and beseeching you for bigger federal checks to address all the awful problems of life in America's cities.

This "pity strategy" of urban aid must end, today.

Our cities are surviving not because of the federal government, but in spite of it. Federal action, from the Interstate Highway Act to the completely disfunctional welfare system, acts to inhibit the operation of the free marketplace in cities. Yet most cities prosper nonetheless.

Don't misunderstand -- ultimately, cities cannot succeed without your help. But frankly, Washington has been our problem much more often than it's been our partner in attacking urban problems.

The Contract with America is an excellent start. Balancing the budget, reforming welfare, cutting taxes, and reducing the capital gains tax will be helpful to all Americans, including residents of cities.

Here's how to fashion an urban agenda that helps cities, sticks to the principles of the Contract with America, and acts in accordance with the clear will of the people for smaller government:

First, we need you to end federal policies that drive families and businesses out of America's cities. Congress must reform welfare and job training, provide incentives for urban environmental clean-up, remove federal barriers to competing out municipal services, address unfunded mandates, and dismantle the federal grant bureaucracy.

Second, we need some small remedial actions from the federal government to help us overcome 30 years of failed policy. Congress should create a federal tax advantage for families and businesses to invest and locate in cities.

Use tax policy, not grants, to help cities

The Contract with America, with its tax credits for children and its capital gains tax cuts, displays a clear appreciation that tax policy is preferable to federal spending as a tool for helping people. This philosophy extends to cities as well. A series of thoughtful tax incentives could apply a tourniquet to the flow of businesses and families leaving cities, and give cities the time and tax base to address their underlying problems.

If the federal government were to create a federal tax advantage for businesses and families that locate in cities, you would immediately begin to reverse the centrifugal federal policies of the past that forced wealth and jobs out of cities. This tax advantage, if significant enough, would be so valuable to cities that you could eliminate virtually every urban grant program and cities would still come out ahead.

This tax advantage could be structured in any number of ways. Most dramatic would be reducing the federal tax rate by some small amount for residents of cities. This would be particularly simple to accomplish if a flat tax is established.

As the well-respected business journal in my city recently editorialized,

> "[A federal tax break for residents of cities] is an idea that could reduce the cost of assisting cities by reducing the federal bureaucracy, while at the same time giving businesses and families incentives to return to the cities' cores. More people and more commerce would mean more tax revenue, thus offsetting the lost grant money. And, perhaps more importantly, such boosts in population and activity could help stem suburban flight and the risk that cities become cores of poverty ringed by affluent suburbs. It would mean restoring the financial health of cities."

If an across-the-board tax advantage is too ambitious, consider a bonus provision for the planned capital gains tax reduction to reward investment in cities. Or, even better, reduce the payroll tax for companies that locate in urban areas.

Using tax policy instead of grants to allocate assistance to cities would eliminate the overhead of federal and state bureaucracies, and target revenues directly to the areas they are needed most. If you are serious about reducing the size of the federal government, that's one guaranteed way to do it.

If you must use grants, reduce their amounts but increase their flexibility

The bizarre process of navigating the federal bureaucracy for grant money creates crazy side effects. First, federal dollars end up going to the cities with the most clever grant writers, not the cities with the most pressing needs.

Second, federal assistance drives local strategies, as local governments tailor their solutions and even their view of the problems to maximize their ability to obtain grants. If drug treatment is what pays from

Washington this year, you can bet that the need for more drug treatment programs is the need cities will start exhibiting. Disjointed (and sometimes even contradictory) federal programs lead to disjointed, ineffective local strategies, as cities try to mix and match from hundreds of federal programs.

If the federal government were to cut grant funding by, for example, 20% -- but consolidate the grants into only a few general categories, cities will actually receive more dollars because you will cut the overhead rate. Bob Woodson, president of the National Center for Neighborhood Enterprise, estimates that by the time one of the dollars you allocate for antipoverty programs trickles down through federal, state,and local bureaucracies and actually gets into the hands of a real person, only about 33 cents is left.

So reduce the amount you spend on cities by 20%. Consolidate the estimated 600 federal grant programs into just a handful of areas that eliminate federal and state middlemen and give broad discretion to local governments. Clear out some of the thousands of bureaucrats that currently administer these programs. Apply the savings to deficit reduction or other pressing national needs. And the nation's cities will still come out ahead.

Help rebuild the free market in urban neighborhoods

The free market does not exist in the inner cities of America, period. Any attempt to revitalize our cities must begin with this understanding, or it is destined to fail. When welfare pays more than work, when public schools graduate kids that can't read, when crack use creates criminals so irrational that traditional sanctions don't apply, when high taxes and crumbling infrastructure keep businesses away, we cannot delude ourselves that the free market works.

The first order of business if Congress wants to rebuild inner cities, therefore, is to help rebuild the free market. Start by reforming welfare. The welfare system as it has existed for the past two decades has failed. There are all sorts of awful side effects of the welfare system as it currently operates. Pay immediate attention to changing the rules that cause welfare to pay more than work. Folks on welfare, acting very rationally in the best interests of their families, recognize that they will lose money if they enter the workforce. Our local efforts to create markets cannot succeed as long as this is the case.

Any legislation that frees welfare policy from the failed federal bureaucracy would be welcomed by the nation's mayors.

However, with all due respect to some of the extraordinary governors at work in America today, state welfare bureaucracies are only marginally less bad than the federal bureaucracy. A critical ingredient of successful welfare reform is breaking up the existing government monopoly on the delivery of welfare services. No matter what reforms are ultimately enacted, they must be accompanied by reform of the delivery system. We need a competitive, performance-based system, with many different providers. They should be paid based on how many people they get out of the welfare system, not how many people they keep in it.

A useful model is school reform -- government could "charter" local welfare offices, with pay based on performance. This would allow innovative private providers of welfare to exist, take advantage of existing neighborhood-level institutions, and cause existing government welfare offices to produce results or go out of business. A chartered welfare system would allow government to take advantage of churches, not-for-profits, and other neighborhood organizations that are some of the strongest forces for good in urban neighborhoods.

Help level the playing field to attract private investment

Major cities no longer compete against each other for businesses and home owners. We compete against our suburbs, and are losing badly. Suburbs have lower taxes, lower crime, and better schools. As a result, cities are bleeding wealth, population, and jobs. We would much rather have private dollars in the form of

new businesses and new middle-class home owners than more taxpayers dollars from you. Help us get them.

First, no federal agency gives less thought to the unintended side effects of its actions than does the Environmental Protection Agency. When the EPA imposes draconian clean-up standards, it effectively quarantines urban sites. No company will build and no bank will lend on a property with even a hint of contamination -- not for fear of the environmental hazard, but for fear of EPA lawyers. Rather than invest in clean-up, businesses and investment find it much easier to leave our cities. Our tax base shrinks, the urban sites never get cleaned up, and the urban poor lose access to good jobs. Everyone loses.

Use Superfund to pay for environmental clean-up, not for lawyers. Use tax policy and government guarantees to encourage companies to clean up and reuse urban sites. You will show that conservatives can have a working approach to urban environmental problems, and as a nice side benefit you will create hundreds of thousands of jobs in cities at the same time.

Free us to spend more money protecting our citizens

Increasingly, the federal government tells cities not only how to spend the federal money we receive, but also how to spend our own local tax dollars. Every time Congress passes a new mandate, it constricts our ability to deal with our own problems and inhibits the functioning of local democracy.

Every day, elected officials make trade-offs between important public goods and referee arguments between interest groups. As citizens of my basketball-savvy state will tell you, the official closest to the action is usually in the best position to make the call. Mandates prevent us from "making the call" on local priorities. We mayors respect the role of Congress in setting a national agenda for America. But give us the authority to pursue that agenda in a way that makes sense for the individual needs of our cities.

The real world effect of ever-increasing federal mandates is that cities have less money to spend on public safety, which for most of us is our number one priority. While the much-vaunted crime bill may have added some number of police officers around the country (Indianapolis got about 29, an increase in our police force of about 2.5 percent), the combined effects of the Clean Water Act, the Clean Air Act, the Americans with Disabilities Act, the Fair Labor Standards Act, and a dozen other major mandates have reduced the number of police officers we can afford by probably ten times that amount. If you really want to fight crime, you don't need to give us more money; just free us to spend more of our own.

Encourage "reinventing government" at the local level

"Reinventing" got its start at the local level because financially-strapped cities knew they could not raise taxes and had no choice but to scour their budgets for savings. Cities discovered that if they allowed private sector companies to compete against government workers for contracts to provide services, the market would create efficiencies and improve service.

Here in Indianapolis, competition helped us save $100 million, reduce the non-public-safety city workforce (everybody but police officers and firefighters) by 30%, and fund a massive $500 million infrastructure improvement program without raising taxes. Not coincidentally, the last three years have been the best in the city's history for job creation. As Indianapolis and scores of other cities have demonstrated, competition works.

There are scores of ways the federal government could help us in these efforts. Let me cite two.

Indianapolis could dramatically improve mass transit by allowing private sector providers to compete against the government-run public transit monopoly. We could improve service, cut costs, and create opportunities for the creation of small- and minority-owned businesses. However, the federal government stipulates that any mass transit worker "negatively impacted" by competition is entitled to six years full salary and benefits as compensation. Michael Jordan didn't have a contract that good. Cut funding for mass transit; but let us

break up the mass transit monopoly and purchase transportation from the low-cost provider.

The second example is a remarkable irony. If a city asset such as a building, wastewater treatment plant, or golf course is constructed or improved through proceeds from municipal bonds (as most are), the federal tax code actually punishes us if we allow a private sector company to manage or purchase that asset -- even if the private sector company could manage it better and cheaper for the benefit of taxpayers. In other words, the federal tax code encourages socialism and public ownership over capitalism and public benefit. It should be changed.

A smaller and more conservative federal government can produce a positive agenda for addressing the problems of poverty and hopelessness in America's cities. The new Republican Congress under your leadership has the ability to prove it. Give us more flexibility in how we use federal assistance. Release us from micromanagement through mandates. Level the playing field for private investment. Remember that the marketplace does not work in our inner cities, and help us empower everyone to participate in the mainstream economy that provides most Americans with health, hope, and security. And cities will create their own success without asking you for more federal dollars.

It's a deal Washington can't afford to refuse. Thank you.

Mr. CRANE. Thank you, Mayor Goldsmith.
Mayor Rendell.

STATEMENT OF HON. EDWARD G. RENDELL, MAYOR, CITY OF PHILADELPHIA, PA.

Mr. RENDELL. Thank you, Mr. Chairman. We were told by your staff that pursuant to Speaker Gingrich talking about the cost saving that we have done in Indianapolis and Philadelphia, to relate some of these and how they would possibly be applicable to the Federal Government.

I did that in my written testimony and I am not going to miss the chance of telling the Ways and Means Committee what I think about certain parts of the Contract With America and certain things that I did think are essential to the Federal Government helping cities. And I think Mayor Goldsmith was right on all of those points.

The Contract With America, I think, can be something very positive for cities and for the residents of the cities. There are parts of it that I am extraordinarily enthusiastic about. As you know, all mayors support the portion of the Contract that talks about the elimination of unfunded mandates. I would love to see the waivers that is in the current bill, S. 1, and the bill in the House that extended from a 50-percent vote to waive to the same 60 percent that you are going to require for tax increases. I think it would sort of be fair play to do, but whatever you give us will be a substantial help going forward. And that is one of the very best things in the Contract. It is excellent.

Second, in the Take Back the Streets Act, I am a believer in prevention, but I don't think there is enough prevention money in the act to make a difference and I am not disinclined to go along with the Take Back the Streets Act in moving the prevention money around, but rather than to give $2.5 billion to prison construction, and the crime bill already has plenty of money for prison construction, 4,500 new cells in Pennsylvania. Rather than give it to us for prison construction, give it to us for police.

Because under the Take Back the Streets Act formula, Philadelphia can get 367 police fully funded and that is great as opposed to the 1,000 police under the crime bill where we have to share a part of the burden, where we have to come up with a local match but we need more than the 367 police. Police on the streets are going to be more valuable to us than more prisons in addition to the prisons already created. So I think that is a change that I would like to recommend to you very seriously.

On the AFDC question, I share with my fellow Democrats some trepidation about what the Contract would do to AFDC. I have to be honest with you, and the reason I share the trepidation is I am not sure that work programs are available. My State in June of last year cut off welfare for single males and females from the ages of 45 to 65. Produce some job training money and said no problem, we will all get jobs.

In my city alone, there were 5,500 people in that group that were impacted. So far in a half year, the State has managed to produce 361 jobs for the entire State, not just for Philadelphia, and to say that there will be public service jobs as I heard Governor Weld say

in some discourse with some of the members of the committee, I don't think that—number one, public service jobs cost a lot of money. There is not going to be a public service job for less than $9,000 or $10,000 and that is probably more than we give to most AFDC families right now, substantially more. And second, as I read the Contract, within 5 years, you can no longer have subsidized work programs for those families.

I just don't believe from the type of people who are on AFDC and their level of training and skills that there are jobs available. And what will happen is what some of the Congressmen have alluded to: The problems will be passed down to us. So I think that is an important thing to look at.

I share my fellow mayor's belief that one of the things you can do for us, and the Contract does it in part, is use tax policy to help investment to build jobs. I am a Democrat. I am for capital gains reduction and in fact I am for exemptions in certain circumstances but not for everyone. Not for people who want to take capital gains for buying art. Not for people who want to take capital gains for Krugerrands, for buying Krugerrands.

Aim for capital gains reductions for those things that will produce jobs. And if you target it, as Mayor Goldsmith said, to low-income areas, let's have the enterprise zones and the empowerment zones together, let's have capital gains exemptions for investment in those zones that produce jobs.

So there are wonderful things for us in the Contract With America. We hope as you draw the line, you draw it appropriately.

And on the balanced budget amendment, I am willing to give this Congress the benefit of the doubt, but before we sign on as mayors, I think it is important that we see where the cuts come from. And I am willing to wait to see what happens because we have to gauge the effect of those cuts on our cities and our residents. So I think the Contract With America has a lot of good in it.

I would love to see a tax policy that Mayor Goldsmith and I have outlined. Congressman Coyne has put in a bill which is so vitally important to cities, the restoration of the historic rehabilitation tax credit. I know that was in the last Congress. I don't know if he has reintroduced it. That is a bill that would cost the Federal Treasury hardly anything when you balance the setoffs and we need it now.

In less than a decade, it produced 27,000 jobs in Philadelphia and put 35 major buildings that were moribund back on the tax rolls. So there is a lot that this Congress can do. We ought to work together as Republicans and Democrats, fashion the things we believe in in a way we can agree and let's get this country moving again.

[The submission is being held in the committee files.]

Mr. CRANE. Thank you very much.

And first to question the witnesses, Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

I thank both of you gentlemen for joining us today and sharing with us your ideas of how we can help the city.

And, Mayor Rendell, thank you for your comments on the Contract With America. All input is appreciated, even if it is contrary to what we want to have in the Contract. As the Speaker has said,

and I reiterate, the Contract is not written in stone. So we do truly appreciate all input that we are receiving, and we are getting a lot of it.

I was particularly impressed with both of your comments on the Tax Code and how we can use the Tax Code to stimulate growth, economic growth, in our urban areas. And you mentioned a couple of things, targeting capital gains, either exemptions or reductions to urban areas, perhaps even income tax. I heard Mayor Goldsmith say giving more favorable income tax rates to people to live in urban areas. I wonder if you might flesh out that list for us while you are here with any other Tax Code changes that you think would improve the prospects for rebuilding cities.

Mr. GOLDSMITH. Yes, sir. Actually, there are a range of them, and let me just quickly reiterate the principle. I think we all are interested in wealth increasing rather than wealth redistribution. And I represent both a suburban and urban area, and in my area if we can keep those rings of poverty from growing—

But the problem—and I spend half of my time on economic development, is businesses because the Federal Government has written off a lot of my lands as environmentally unacceptable, because crime rate is high, schools are bad. It is difficult. So I am trying to equalize the marketplace and then get out of the welfare grant system.

You could do something really dramatic which is take back all the money and all your welfare programs and give me *x* percent less flat tax rate.

Or you could say we will take the most impoverished areas of the core cities and cut their capital gains by half as much again as you do in the suburbs.

Or you could say, all right, you can use Tax Code policy more targeted. We can have a tax credit—you would do a lot better to get away with your job training money and give more ambitious tax credits and let me hire somebody who is on unemployment. Or a historical tax credit to take an old building and put it back on the marketplace.

You passed in the last Congress—reauthorized the LIFT program for low-income housing tax credits. I think there is a range of areas where reasonable people can agree or disagree.

But the point is if we can equalize the market it does—just in conclusion—it has a couple of other effects. It wipes out all the bureaucracy. Because it is a tax credit, we don't need people passing the dollars through. It makes the dollars used more widely because someone still has to invest private capital, which is a sanity check on the program itself, and it uses wealth creation strategy.

I appreciate the question. I would just say take away all the grants and eliminate all of them and make our flat tax flatter than the others. Or, in the alternative, if we are not prepared to do that, let's target some tax credit strategies around buildings and low-income jobs.

Mr. RENDELL. And I don't think the Congress is probably prepared to do the first part of Mayor Goldsmith's suggestion, but I do think that targeting and incentivizing aid to cities works. And the impact on it doesn't have to be enormous, Congressman, in terms the Federal Treasury.

Take the historic rehabilitation tax credit. I know that the CBO estimated that it would cost about $4 billion over a 5-year period if we restored that in income that would be sheltered from taxation that IRS is getting now.

That is correct, but the CBO never gives you the upside. It is so frustrating to us. The upside is for every $1 million invested in the historic rehabilitation tax credit, $217,000 gets sheltered that the IRS doesn't get. But it produces $787,000 of income on wages that is spent on wages out of every $1 million. Taxed at the lower rate, it produces $280,000 of Federal income tax, not counting the State real estate tax, the State income tax, the city wage tax that we would get from that. So it is a revenue-neutral or maybe slightly positive idea for you, and it is wonderful for us.

You have got all sorts of restrictions on tax-exempt financing, arbitrage rules, State volume caps. Get rid of those. Bring back the IDBs and, most of all, capital gains. I was the great supporter of Secretary Kemp's enterprise bill because it had capital gains incentives in it.

I thought the President's bill was terrific. The empowerment zone concept was great, and we won one of the zones. Everything was great about it, except it didn't have capital gains reductions or exemptions.

Those are the types of things that fit your philosophy and help cities just as well. It is good philosophy because we want to put people back to work. Do you want to sit there and give someone capital gains reductions for buying and selling art? I don't think so.

Mr. MCCRERY. Thank you for your testimony, Mayor Rendell. I may have heard you wrong. You did say that you are a Democrat.

Mr. RENDELL. I am a good Democrat, but I think we should take the best ideas of both parties—and we have got a terrific opportunity to do that now—the best ideas of both parties and merge them together. Capital gains relief is a Republican principle, a supply sider principle. Target it to investment and help poor rural and urban areas. It is a dynamite idea. It is a home run when you take the best of both of our philosophies.

And on some things we are going to disagree. And I probably disagree with you. Until I see the list I disagree with you on the balanced budget. I disagree with you on AFDC for the reasons that I expressed. But for some things this is music to our ears in cities.

Mr. MCCRERY. Thank you for your comments on dynamic scoring. We have been talking about that on this side of the aisle for a long time. I appreciate your comments.

Mr. CRANE. Mr. Ford.

Mr. FORD. Thank you, Mr. Chairman.

Let me welcome the two mayors to the committee.

You know, the Contract With America changes tax laws and Federal regulations with the notion that cutting taxes on investments and eliminating costly Federal regulations will pump enough money into the economy to create those new jobs. Mayor Goldsmith, I think you talked about those regulatory changes and all of the tax cuts that will pump it up. But didn't we hear this in the eighties with the Reaganomics? Didn't we have similar tax cuts and changes in Federal regulations in the early eighties under the Reagan administration? I know you were not yet mayor of your city

at that time, but did all of these problems go away in your area during the eighties?

Mr. GOLDSMITH. I think the proposition for which I stand, Congressman, is that you, the Congress, imposes on urban cities, and particularly on its poor, more costs through mandates than the benefits of the grants. And every one of these mandates has a cost.

For example, the environmental mandates make sure that we have quarantined urban land near the poorest areas and we can't invest or build or loan or develop. And Ed has his own examples. So a more rational cost benefit approach to those mandates would essentially cause investment to flow and jobs to be contributed.

Mr. RENDELL. And on the question of taxes, I agree with you that just generally believing that by giving tax incentives things are going to happen. That that may or may not work. I don't think there is any conclusive evidence. But if you target it to specific investment programs that are job creating, that is different.

Again, I don't want to see some rich guy invest in Krugerrands and then sell Krugerrands and get a capital gains reduction. I don't want to see that, and I don't think you do either, Congressman.

But I do want to see that same rich guy shelter some income by investing in a moribund historic building in the city of Philadelphia or Indianapolis or Chicago or St. Louis and—because by sheltering that investment someone can raise enough money to rehabilitate that building and put people to work constructing it and put people to work working in it once it is finished and put it back on the tax rolls, yes, that does work.

The historic rehabilitation tax credit was a smash success for cities in the eighties. And, in our own experience, we put in a real estate tax abatement for 3 years for new construction over for rehabilitation, the city of Philadelphia did, and our new construction on rehabs went through the roof, absolutely went through the roof.

So, yes, I believe properly targeted tax incentives, using whether it is our code in Philadelphia or your code in the Federal Government, do produce jobs. There is no question about it. Do create investment.

Right now, the biggest problem in Philadelphia—it may not be in Indianapolis, but it is in Detroit and Cleveland and Newark and L.A.——

Mr. FORD. Would it be a part of the Tax Code they are using in suburban areas or my area and your area?

Mr. RENDELL. They don't need it. We do. Remember what Mayor Goldsmith said. We need you to level the playingfield. We are losing everybody to the suburbs.

Mr. FORD. What section of the Tax Code are these businesses?

Mr. RENDELL. They don't need it because their local taxes are nil compared to ours. And the reason our taxes are so high is because we have in our metropolitan areas 80 percent of the poor people who need services. And we should give them services. But we pay for the services that they don't have to pay for. And, as a result, our taxes are high. Their taxes are low. Everybody is forced to cross the border leaving us with less revenue to deal with the people who need services. It is a vicious circle.

Mr. FORD. One final question to Mayor Goldsmith.

You were talking I guess about the public assistance programs earlier when you talked about welfare recipients receiving welfare wages. The benefits are higher than what the wages would be on many minimum wage jobs. And, you indicated that it is so attractive that people do not want to seek employment in the private sector, but would prefer staying on the public assistance rolls.

Evidence shows that about 70 percent of all AFDC recipients come off of AFDC within the first 15 months and signals that people don't want to be on the assistance rolls and want to be self-sufficient of the government itself.

Mr. GOLDSMITH. Congressman, that is absolutely true. There are some people——

Mr. FORD. Seventy percent.

Mr. GOLDSMITH [continuing]. Who find their way to the workplace despite all the obstacles of the welfare system. We are succeeding despite all the rules of the game.

And just to add that question and the last to Mayor Rendell's, in the old pre-Ed Rendell days in other big cities we taxed our people who had money in order to redistribute it to people who were poor, and suddenly people who had money said I am going to move. And as they moved we kept taxing the smaller and smaller base. And we see now that won't work.

We are saying—if the numerator is poverty and the denominator is wealth, poverty is growing faster than wealth. And we want wealth to grow faster than poverty. And I am suggesting that the welfare system needs to be restructured to provide more encouragement for people to find jobs.

Mr. CRANE. Next is Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. And thank you, mayors.

And, Mr. Rendell, I appreciate the fact that you identified yourself as a Democrat. I couldn't look at either one of you and tell. Neither one of you wear uniforms, but I do like your comments, especially in the area of capital gains.

I believe the capital gains tax reduction will create jobs. I would like to see us, in some way, target inner cities, enterprise zones or empowerment zones in other ways in the Tax Codes because I look at capital gains as a tool for new investment.

And I can respect the fact that the historical projects that you would like to work, but I see those as limited times for maybe 1- or 2-year jobs. I would rather see us concentrate on manufacturing jobs in some of those inner-city areas, and I would like to see us concentrate on the area of industry that we may be losing offshore today because of low wages in other countries.

But I don't think low wages in other countries is the only thing that is drawing our business and industry to those countries. I think a lot of it has to do with the burden that the Federal Government places on businesses through regulation and taxation.

What would you think about some other type of tax incentives that we could offer for industry that we are losing today? Because if we offer tax breaks to industry that we are losing, we haven't lost anything because we have already lost the industry. It would lure them to the inner cities.

Mr. RENDELL. That is really a terrifically complex question. In the general sense, you know, I believe—and you know in the GATT

agreement we have eliminated subsidies prospectively in that agreement. And foreign countries are going to have to live with that agreement as well. So there won't be any more subsidized shipbuilding if they live up to that agreement in other countries so we can compete here.

And, by the way, just what Congress did in GATT by eliminating those subsidies, we now have at the Philadelphia Naval Shipyard, which is one of the shipyards that is being closed, we have interest by Danish and German shipbuilders, some of the best in the world, in coming to the Philadelphia Naval Shipyard to set up because they know that there aren't going to be subsidies anymore so America has now got a better level playingfield. I think anything where we can use our influence to either eliminate subsidies worldwide or fight back I would be in favor of.

For cities particularly, though, for cities particularly, I have an idea that I think would help the country and help cities. You know, in foreign aid—and we give out significant foreign aid, not as much as we used to but significant foreign aid.

You know, of course, Congressman, that the Japanese when they give foreign aid they tell the country, fine, you tell us what you need, and you have got a credit. You come and buy it from a Japanese company. You don't get Japanese yen to spend in Africa, if you are an African country, or in Asia, if you are an Asian country, you get a credit.

France is now doing it. I think Italy is considering it. I believe we ought to do it and take a portion of that productivity and mandate that it comes or direct that it comes from urban areas. Ten percent, 15 percent must only come from companies located within distressed urban or rural areas, distressed areas—there are 101 enterprise zones now, some rural and some urban. Those would be the target for that.

We have got to fight back. That would keep our foreign aid helping Americans as well as those foreign companies.

Mr. GOLDSMITH. One brief comment. Congressman, your question is helpful because it raises two issues: One is the reuse of urban land through capital investment which is one issue. The second is how to keep people and their dollar bills from moving—that is part of the first. The second is how to create jobs for people who don't have jobs.

If you would focus on the second, which I think is the thrust of your question, a payroll reduction—a payroll tax reduction for a person who creates a job where they are employing somebody who was on welfare is more powerful than a job training dollar we pass through the system.

We know the job training dollars are relatively ineffective. So you could target tax credits for unemployed—for people who have been taken off of unemployment and put into the regular work force.

So we could either target capital investment, which has dollars move to our city cores, or target credits for people—for companies who employ people who are unemployed. And I think the latter would be a very effective incentive.

Mr. COLLINS. Thank you. Thank you, Mr. Chairman.

Mr. CRANE. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

It is an honor to have Mayor Rendell here, not merely as the chief executive of the largest city in my State but also as an executive who inherited a city in deep financial crisis and who developed an innovative financial approach to bringing the city back, reassuring bond markets, downsizing city government in a very dramatic way, and also, in my view, restoring a real sense of community in Philadelphia. And I would like to congratulate you for that and thank you for bringing your expertise to this panel.

For both mayors, I wanted to thank you not only for your testimony but also with regard to Federal mandates. Both of you specifically have, in a big way, reorganized your forms of service delivery locally. Can you outline for us some examples of how Federal mandates have gotten away—in the way of your process of reinventing local government?

Mr. RENDELL. Well, the worst thing about—and, Congressman, thank you very, very much for your kind remarks. And I know you are filling big shoes in our new Governor's congressional seat, but I know you will do very, very well, and good luck to you as well.

In the very realest sense what mandates do is rob us of our ability to prioritize our dollars to the needs of our constituents. And we know better, obviously, what the needs of our constituents are than a Congressman from California. Obviously, we do—or a Senator from California—because we hear about it every day.

There is one thing about being mayor. You hear from the public. They are outside my office every day. In fact, a friend of mine from a community group said if you don't do this, Mayor, we are going to come down and picket outside your office. And I said, Fred, do me a favor. You are a friend of mine. Call me before you come so I can make sure you can get space out there so there aren't other groups picketing in front of you.

So we hear from our public, very much so. And what mandates do is rob us of the ability to make our own decisions.

For example, the Americans With Disabilities Act, which I know is exempted from S. 1 and may be exempted from whatever the final bill will be—but under the Americans With Disabilities Act a Federal court determined that any time we did street repaving that that triggered the part of the ADA that said that whenever there was major street reconstruction we had to put in curb cuts.

So every time—we have a $15 million capital budget for street resurfacing in the city of Philadelphia. Now every time we have to resurface a street we have to put in a curb cut. It costs us about $3.5 million to put in those curb cuts so it has reduced our resurfacing budget by over 22 percent, and with that $15 million we are not coming close to the streets that ought to be surfaced. And, worse, sometimes we are putting in curb cuts on streets that have no sidewalks because they are in wooded areas of the city, but we have to put in curb cuts. It makes no sense, and it robs us of our ability to make the decisions of what is more important for our taxpayer as we do in everything else.

Mr. GOLDSMITH. I agree—I will give you two examples on the other half of your question.

Mass transit around this country doesn't work very well. The Congress of the United States has told me, as a mayor, that despite the fact that I have competed and privatized a whole series of city

services and every time I have done that I have saved money and enhanced the delivery service, you have told me that I cannot effectively compete mass transit. It is a congressionally guaranteed monopoly.

If I compete it out, you require me to give every existing employee and driver 6 years of full benefits—6 years, even if I compete it out. Poor people in my community have worse service. Minority businessmen and women cannot bid on their own service. Poor folks can't get to their jobs. But the Congress prevents me from breaking up that monopoly.

There are—the Tax Reform Act says that—the Congress of the United States and the Tax Reform Act has said we prefer socialism to capitalism. I cannot sell my wastewater treatment plant because of the Tax Code of the United States.

So the Tax Code itself, in various little mandate provisions, creates monopolies which cause inefficiency. Then you give us more grant money to be more inefficient. We would be delighted to respond with a long list of ways that you have inhibited the privatization process.

Mr. ENGLISH. Thank you, Mr. Chairman. And thank you, Mr. Chairman.

Mr. CRANE. Dr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

If each of you would tell me how much you get in community development block grants.

Mayor Rendell.

Mr. RENDELL. CDBG, $62 million.

Mr. MCDERMOTT. $62 million.

Mayor Goldsmith.

Mr. GOLDSMITH. $12.

Mr. MCDERMOTT. $12.

What is the difference in your two cities? Are they a lot bigger than you?

Mr. GOLDSMITH. He was a more effective lobbyer.

Mr. RENDELL. It is a formula. We are 1.6 million and, unfortunately, have a 25-percent poverty level.

Mr. MCDERMOTT. So you are building your fiscal year 1996 budget. What have you put in your budget for Federal grants? Have you put in the money you have had this year and run it forward with inflation or reduced it by 10 or 20 or 30 percent? What have you done?

Mr. RENDELL. CDBG funds don't go into our operating budget. The beauty of CDBG funds is that they are probably the most unrestricted Federal funds that we get. It was a program that was started by President Nixon. I think it is the best program because it has the least strings.

What we do with CDBG funds is basically pass them through to either community development corporations, private developers, people who are building subsidized housing for low—middle- and low-income people.

Mr. MCDERMOTT. Are you using them for the police force or the fire department?

Mr. RENDELL. No.

Mr. MCDERMOTT. No money is going in in any way?

Mr. RENDELL. It is about 85 percent housing and 15 percent commercial economic development. But that has to be in CDBG-eligible areas. So that doesn't come into our general fund.

You are thinking of the old revenue sharing days, and none of us want to go back to those days, where we could use the money for anything we want.

Mr. MCDERMOTT. How about in Indianapolis?

Mr. GOLDSMITH. Our cities are very similar in that regard. We keep none of the CDBG. We pass it all through to community groups on the condition that they leverage it against private dollars for basically low-income housing.

Mr. MCDERMOTT. And you are not expecting any loss in that money? You don't budget it, but you—there will be no impact if this Congress cuts that money?

Mr. RENDELL. We do expect a little bit of a loss, regardless of what the Congress will do. But what the President and Secretary Cisneros has said is that they are taking $700 million out of the program. And that $700 million is not a great deal extrapolated out over the cities.

But let's assume our allotment fell to $59 million next year. We would just approve less projects by CDCs or——

Mr. MCDERMOTT. What money do you get directly from the Federal Government that goes into your budget?

Mr. RENDELL. That goes into directly? Well, for example, the crime bill money will now go directly into the police department budget.

Mr. MCDERMOTT. Anything else?

Mr. RENDELL. I guess there are a number. Transportation money goes into our—we get capital money for transportation from the Federal Government. We get very little operating money directly from the Federal Government. We do get money for children and youth, foster care, for abused children. That comes from the State, but it is essentially Federal money that is passed through from the State.

And if we—if that was reduced by 10 percent, for example, on our children and youth budget, that would have a dramatic effect.

Mr. MCDERMOTT. And have you built in the amount this year for next year or are you expecting a cut there?

Mr. RENDELL. In our budget for next year we have built in no increase but no decrease.

Mr. MCDERMOTT. You think they are going to leave you alone? They are going to leave you whole in the appropriations process here in the Congress?

Mr. RENDELL. I think because of the different fiscal years that the State and the Federal Government go under, I think we are probably OK for this year.

Mr. MCDERMOTT. For 1 year. But you will be in big trouble the second year.

Mayor Goldsmith, you are shaking your head.

Mr. GOLDSMITH. The question is a legitimate question, Congressman. I am only shaking my head because I don't want to be Pollyannaish about this. Federal policy has, in part, destroyed cities, and now you can't just dial back 30 years and instantly recreate the market.

So if on one hand you take out all the grant money and don't readjust tax policy or anything else it will be very difficult for us to succeed. If you add the other half of the Contract With America, which is you want to balance the budget and take our grant money but you are willing to think of new, flexible ways for cities to create wealth, then we can do it.

But we can't be left in this funny situation where you spend a lot of money on welfare subverting the marketplace and at the same time take away the grant money. If we radically changed our relationship——

Mr. MCDERMOTT. Could I ask you one question? My time is about up.

Mayor Rendell, you said you support the 60 percent. Do you have a 60-percent requirement on your municipal bonds?

Mr. RENDELL. No, nobody asked me about the 60 percent for taxes. What I said is, since the House has passed the 60 percent for taxes, I would like to see the same 60 percent for passing an unfunded mandate which in the bill is now 50 percent. I think—I am a lawyer, and I am not even sure that the 60 percent is constitutional.

Mr. MCDERMOTT. That is good I clarified this. You are not advocating as mayor that it require 60 percent to pass a municipal bond issue?

Mr. RENDELL. No, I think 50 percent is sufficient. I don't think we should create artificial structures to force us—what we ought to have the guts to do if we have the political will to do it.

Mr. MCDERMOTT. Where are you on that, Mayor Goldsmith? Do you think it should require more than a supermajority to pass an issue here?

Mr. GOLDSMITH. That is not my issue, Congressman. I just want to be liberated at the local level, and however you do that is fine with me.

Mr. MCDERMOTT. You mean you would like to stay out of the fight. And you certainly wouldn't want to be limited by that kind of thing in raising your taxes in Indianapolis, would you?

Mr. GOLDSMITH. I can't afford to raise my taxes because it destroys wealth generation.

Mr. MCDERMOTT. I understand. You are never going to do it, of course.

Mr. GOLDSMITH. I think a plebiscite of the people or a supermajority of my local legislature would be appropriate to restrict me from raising taxes.

Mr. CRANE. The time of the gentleman has expired.

Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman.

I would like to go on record real quick that I am very much in favor of a supermajority for raising anybody's taxes.

I have a quick question, and I think probably I would really need ask, if you can, to submit this—the answer, later.

Currently, Congress is considering legislation to find ways to relieve State and local governments of the cost of Federal laws and programs. Do you agree or disagree that tax-exempt financing is a useful tool in leveraging your resources in order to finance not only

Federal mandated infrastructure but other needs as well? Is it a useful tool?

Mr. RENDELL. Absolutely. And, as I said in my answer to I forgot whose question, I think it was Congressman Collins, that is an area where we would like to see a lot of restrictions lifted dramatically—the State volume cap, the arbitrage limitation, things like those. So, yes, we think it is a very valuable tool.

Mr. HANCOCK. The next one, as part of this, you do have suggestions for the committee, and I have not had a chance to read your testimony. But, if you would, we would appreciate any detailed suggestions that you might have that you can submit to the committee which could be made a part of this hearing at a later date.

Mr. RENDELL. I will.

Mr. HANCOCK. And we will appreciate any information you might have.

[The following was subsequently received:]

Issue #1

Description of Issue--**Municipalities which undertake purely governmental projects should not be required to rebate to the federal government earnings made on the investment of bond proceeds that have been borrowed to undertake such projects.** The governmental projects referred to in the preceding sentence are intended to include, but are not limited to, projects such as road construction, sewer and water main construction, and municipal building construction projects; and do not include projects, the principal beneficiaries of which are non-governmental entities, such as corporations or private business partnerships.

Since the effective date of the 1986 Tax Act, local governments have been required to rebate to the federal government certain investment earnings on borrowed moneys. Prior to the adoption of the 1986 Act, this requirement had been applicable only to bond proceeds which were borrowed for the benefit of private (i.e., non-governmental) parties, such as developers, and had not been applicable to local governments borrowing money to undertake purely public projects.

The federal government requires that any investment earnings which are in excess of the interest paid on the bonds must be rebated to the federal government. By requiring the rebate of these amounts, the federal government has effectively increased the borrowing costs of the municipality for its capital projects. The municipality is prevented from "re-investing" the rebated earnings in the public projects, thereby increasing, incrementally, the amount which must be borrowed for the projects, as well as the amount which the municipality must budget for debt service to repay the increased borrowing.

Rationale for Issue--A significant factor in the amount of any investment is the cost of capital. The ability of governmental entities, including municipalities like Philadelphia, to invest in infrastructure projects is directly related to the amount and cost of the capital needed to finance the particular projects. Traditionally, municipalities had been

able to minimize their capital costs by borrowing money at tax-exempt rates and re-investing all earnings in the projects for which the money had been borrowed. This permitted the municipalities to "net fund" these projects, i.e., take into account all investment earnings and apply them to the costs of the projects, thereby borrowing less money to finance the construction of the projects. Obviously, amounts required to be rebated to the federal government are unavailable for investment and the real costs to the municipalities of completing their projects are increased.

Impact on Philadelphia and other Cities--Since the imposition by the 1986 Tax Act of the rebate requirement with respect to proceeds used to construct purely governmental projects, municipalities like Philadelphia, have paid the price of rebate in two respects: (1) the amounts which have been transferred to the federal government to make rebate payments; and (2) the commitment of the scarce resources of the municipalities (i.e., time, personnel, contracting with outside firms to calculate and advise with respect to the rebate requirement) to ensure compliance with the requirement

Generally, municipalities are required to rebate excess earnings to the federal government every five years. The effective date of the rebate requirement as applied to bonds issued by governmental entities undertaking purely public projects was generally August 19, 1986. Therefore, 1992 was the first full year in which significant revenues were transferred to the federal government in order to comply with the rebate requirement.

As of the date hereof, the City has rebated $2,442,400 to the federal government in order to comply with the rebate requirement and the City expects to rebate an additional $2,027,000 before the end of this calendar year.

In 1993, ***The Bond Buyer*** (November 18) reported that state and local tax-exempt bond issuers "are expected to rebate $305 million in arbitrage profits to the federal government [in 1993]- about 5% more than [1992]". ***The Bond Buyer*** went on to report that

> [b]efore 1992, issuers' arbitrage payments to the IRS had risen steadily each year, but still remained below $100 million. The IRS collected $72 million in 1990, $22 million in 1989, $16 million in 1988, and $17 million in 1987.

The significant increases in 1992 and 1993 over prior years in amounts rebated to the federal government are attributable primarily to the expansion of the rebate requirement by the 1986 Tax Act to the proceeds of bonds issued for purely public projects.

Related Existing and/or Potential Federal Legislative Vehicles--The only current legislative vehicle, to my knowledge, which attempts to address the problem of rebate is the Public Finance and Infrastructure Investment Act of 1993 introduced by Representative William J. Coyne. Unfortunately, for Philadelphia and other large urban municipalities like it, this Bill does not go nearly far enough. The Bill contains two provisions which are intended to ameliorate to some extent the negative effects of the rebate requirement: (1) one provision would expand the universe of issuers not required to rebate to the federal government by merely increasing from $5 million to $10 million the limit on the amount of bonds which

such an issuer may issue in a calendar and continue to qualify for the "small issuer rebate exception"; and (2) the other provision would increase another "small issuer exception", this one is referred to as the "bank qualified exception" and would redefine a small issuer for these purposes as an issuer of $25 million (increased from $10 million) or less of tax-exempt bonds in a calendar year.

Before the 1986 Tax Act commercial banks were significant investors in tax-exempt municipal bonds (holdings at of the end of 1985 were $231 billion of all bonds outstanding or 35%) because they were allowed to deduct 80% of their interests costs associated with holding tax-exempt bonds. This deduction has been limited in its application since the adoption of the 1986 Tax Act generally to banks which purchase the bonds of issuers which issue no more than $10 million of tax-exempt bonds in a calendar year (holdings as of the 2nd quarter of 1993 were $97 billion). By reducing the universe of investors, this imposes an additional cost on issuers by increasing the yields which must be offered to their remaining investor pool.

Large cities, such as Philadelphia would not directly benefit from either of the aforementioned provisions in the Coyne Bill because they will never be defined as "small issuers". A more plausible approach for such cities might be an exception to the rebate requirement should the issuer spend at least 85% of the proceeds of the bond issue within a three year period (often referred to as the "temporary period" in bond parlance). This is a certification which nearly every issuer makes today in order to ensure the tax-exempt treatment of its bonds, therefore it should not impose additional burdens on issuers.

Revenue Impact on Federal and Local Level--The federal government has collected more than $611 million in rebate payments over the last six years, however that may not represent all of the costs. In a June 4, 1993 article in ***The Bond Buyer*** it was reported that

> State and local officials were not happy about the millions of arbitrage dollars going into federal coffers
>
> "We could build a lot of infrastructure with that money," said Catherine Spain, director of the Government Finance Officers Association's federal liaison center.
>
> Spain said the arbitrage rebate payments "are only a fraction of the costs" of the tax laws rebate requirements. State and local issuers must also spend millions of dollars tracking expenditures and investments of bond proceeds, doing rebate calculations, and taking other steps to comply with the requirements, she said.
>
> "It's a high price to pay at the state and local level and it's probably not significant at the federal level," Cross said. "At this difficult time of balancing budgets, there's not a state or

local government that couldn't put these funds to better use."

Amy Dunbar, Director of governmental affairs for the National Association of Bond Lawyers, said arbitrage rebate "is a revenue-sharing program for the federal government, paid for by state and local governments."

When issuers rebate arbitrage on bonds used to finance infrastructure, Dunbar said, "some of the benefits of infrastructure investments are not staying at the local level" because the federal government uses the rebated money for other purposes.

Issue #2

Description of Issue--**The federal government should assist the economic development efforts of urban cities by reauthorizing the issuance of tax-exempt private activity bonds for commercial purposes.** The 1986 Act contained a number of provisions which, from the perspective of the federal government, properly withdrew the federal government's subsidy of "private activities". These provisions include the sunset of the provisions which authorized the issuance of tax-exempt private activity bonds for (i) commercial enterprises (to be distinguished from manufacturing facilities which may continue to be financed on a tax-exempt basis); (ii) sports facilities (if this provision had not expired the financing of Spectrum II would have been permitted); (iii) convention and trade show facilities; (iv) industrial parks; (v) air/water pollution facilities owned or operated by the private sector; and (vi) free standing parking facilities owned and operated by the private sector. In addition to expanding the types of private activity bonds which may be issued, the small issue exemption which is currently at $10 million should be increased significantly (possibly up to $50 million) to reflect the significant level of economic activity which is needed in today's urban centers.

Rationale for Issue--Philadelphia's economy, like the economies of many other northern industrial centers, has changed from a primarily manufacturing based economy to a more service based economy. The changes in the 1986 Tax Act, which allowed the authorization of manufacturing industrial development bonds to continue while permitting the authorization for commercial industrial development bonds to expire, has had a significant adverse effect on the investment in businesses and jobs in Philadelphia. Cities such as Philadelphia which are being transformed from manufacturing based economies to service based economies should be permitted to give incentives to those businesses and commercial enterprises which make up the fastest growing component of their economies by issuing tax-exempt bonds on their behalf.

Impact on Philadelphia--Attached hereto as Appendix I is a chart prepared by PIDC which tends to reflect the dramatic adverse impact of the 1986 Tax Reform Act on the investment by businesses in Philadelphia. In one year from 1986 (the last year tax-exempt commercial industrial development bonds were permitted) to 1987 the total number of

projects were reduced by more than half. It would appear from the Appendix I that the number of projects being financed by PIDC/PAID is approximately 25% of the normal pre-1986 volume. Similar trends are evident with respect to the employment statistics as well, and although one should heed the cautionary note contained in the Appendix regarding their worth, I am not sure I would conclude that these numbers are worthless. The "total project cost" is not intended to reflect how much is financed by tax-exempt bonds, but is intended to indicate the total costs of all projects for which PIDC received applications during the relevant year (there are probably included in these figures taxable financings as well) Also, the "new" employment statistics contained in the Appendix reflect the estimates made by applicants to PIDC for assistance. Nonetheless, the significance of the 1986 Tax Act is not lost upon examining Appendix I. Web Christman of PIDC provided me with the table included in Appendix I and may be called upon to give additional interpretations regarding the data included therein.

Related Existing and/or Potential Federal Legislative Vehicles--The Coyne Bill referred to above includes provisions which permit the issuance of manufacturing and commercial industrial development bonds, provided the proceeds of such bonds are used in an area designated as a "distressed community" within the meaning of the Bill. Philadelphia would probably qualify as a distressed community under the Bill because one of the determinants of a municipality's status is whether "there has been a military base closing within its boundaries within the last 2 years which has resulted, or will result, in the loss of not less than 500 jobs".

Revenue Impact on Federal and Local Level--I have not been able to obtain any statistics which indicate the impact of revenues at the federal and local level. However, the magnitude of the problem is reflected somewhat in the figures set forth in Appendix I showing the sharp reduction in projects completed by PIDC/PAID after the effective date of the 1986 Tax Act.

I hope the foregoing is satisfactory for your purposes. If you should need additional information, please do not hesitate to contact me.

C.D.A.

cc: Ben Hayllar
Thomas Queenan

Mr. HANCOCK. We know what has happened in Michigan and some other States. The question that Mr. Christensen asked, how we get away more and more from the property tax? In other words, trying to come up with either a sales tax or some other choice.

I understand that a few years ago the city of Philadelphia started experimenting with what is called land value taxation, am I correct in that?

Mr. RENDELL. The city of Pittsburgh. The city of Pittsburgh experimented with land value taxation where there is a higher tax rate for unused land than there is for land that is used as a way of taking people—in those days—it was the eighties. It was the eighties when people had money to burn, and everybody was investing money. And a lot of people would just buy up land and sit on it for the right investment opportunity, and that was causing a lot of the land in Pittsburgh to go undeveloped.

So they wanted to prod development and sort of penalize you for buying land and land-banking it as sometimes the government does, so they instrumented with a land value tax.

In some areas I think it can be successful. In our area it wouldn't be successful.

Our problem is not in people buying land, sitting on it for investment opportunities. Our problem, Congressman, is what Mayor Goldsmith alluded to. A lot of our land has been rendered valueless, some of it by Superfund and environment legislation which says if it is former industrial land, which says, hey, if you don't clean this up 100 percent and assume liability for anything we find later on then you can't, you know, take over the land. So, as a result, we can't get anybody to come in and look at that land.

So our problem is the other end of that spectrum in Philadelphia. We have land because of legal limitations and because of crime and things like that that nobody wants to invest. Nobody is buying to land-bank on it anyway.

Mr. HANCOCK. I am assuming the same situation in your area in Indianapolis.

Mr. GOLDSMITH. Yes, sir.

Mr. HANCOCK. You mentioned the problems with the Americans with Disabilities Act. You mentioned the problems that when you pave the street that just because you are repaving that you have got to put these curb cuts in. Is that the only problem you have had as the mayor of a city with the Americans with Disabilities Act?

Mr. RENDELL. Oh, no, no, no. Our biggest problem is that unless we are successful in getting a waiver from the Justice Department, who seems as confused over some of the provisions of ADA as we are, we are going to be required by the end of 1995 to put curb cuts on every one of our streets, which would cost us $150 million, and our total capital budget for any year is $120 million. I can't figure out how we are going to do that.

Mr. HANCOCK. Curb cuts is just part of the problem.

Mr. RENDELL. Yes. And there are access ramps. There are a whole lot of things. I hate to speak about that because somebody says you are against access for the disabled. Absolutely not. We are not. We want it done in a reasonable way.

Mr. HANCOCK. Have you had anybody sue you yet because they slipped and fell on a curb cut?

Mr. RENDELL. No, but it is interesting because the visually impaired disabled do not like curb cuts and tried to stop them. The blind do not like curb cuts and tried to stop them.

Mr. HANCOCK. I wonder if there has been a case where a city has been sued because of somebody slipping and falling on a curb cut. The reason I was asking is because my wife seriously injured herself with a curb cut not too long ago.

Mr. RENDELL. Not yet.

Mr. HANCOCK. Well, it is coming. Thank you.

Mr. CRANE. Mr. Camp.

Mr. CAMP. No questions.

Mr. CRANE. Mr. Kleczka.

Mr. KLECZKA. Based on the question from Mr. Hancock the further question is, is your wife suing?

Mr. HANCOCK. Not yet.

Mr. KLECZKA. Let me take Dr. McDermott's point one step further since he did steal one of the things I wanted to discuss. Let's say in 2 years the community development block grants are totally eliminated. And let's also say that low-income energy assistance is totally eliminated. Will that provide a hardship to your cities?

Mr. RENDELL. A tremendous hardship. And that is why I don't even want to be asked to sign on to a balanced budget amendment until I see what is going to be cut.

If you cut LIHEAP, unless somebody steps forward, and the State of Pennsylvania doesn't have enough money—and, Lord knows, we don't—you are going to have people who are looking for work, can't find work and have kids, and those people are going to run the risk of freezing to death or they are going to turn on their stoves and run the risk of those apartments going up in flames.

Mr. GOLDSMITH. Well, I am tempted to agree with that on most subjects. The answer is, obviously, yes, unless you change your approach to cities in toto. Which is to say, yes, CDBG is very effective money, and we use it well, and the other programs we try to do as well.

But every one of those programs you have a Federal bureaucrat tell a State bureaucrat tell a local bureaucrat tell a neighborhood person how to spend their money. If you replace those programs with sufficient tax credit so that is an advantage for people who live in urban cores, then we could do it. If you keep the tax situation the way it is now, take away the help for the folks who are poor, you will leave the cities with a foot in each world.

Mr. KLECZKA. You have mentioned that on a couple of occasions this morning. You have read the Contract as well as all of us. That is not part of the Contract. Those specific types of breaks are not there. So know full well you are not going to get the things, as I see it, which are the most beneficial because of the broadness of the way the tax cuts are written, but some of the downfalls that are coming—are coming, come hell or high water.

I have to assume that we are going to pass the balanced budget amendment.

And then the question I asked or in the statement I posed to Governor Weld, I think what we are doing here, my friends, is

shifting the shaft. And as a former State legislator we did it to the cities and the counties. Now, as a Federal legislator, I am going to be mandated to do it.

And the downfall for me is to become popular at home because I have cut the Federal deficit and cut taxes. And so, my friends, I—in a couple of years, if I am still around, I will be the hero. And the State legislators and Governors of the country and mayors such as you are going to be the villains.

And I see no protection for you. Because at the end of the day, at the end of this entire period, my friends, the people still live in Indianapolis, they still live in Philadelphia, and they still will be living in Milwaukee. They are not going to traipse out here to make their case. They are going to go to city hall with their signs.

If, in fact, the proposals did the things—and as a strong proponent of empowerment zones and enterprise zones, if the proposals were specific in that area, you are right, and these things will happen. But that is not the way it is geared.

Mr. RENDELL. Well, let me say, number one, I agree with you. If the balanced budget amendment requires the cuts that you are talking about, then it will be——

Mr. KLECZKA. By the year 2002 it is 1.73.

Mr. RENDELL [continuing]. Then it would be the greatest unfunded mandate of them all, the mother of all unfunded mandates. There is no question. But, as I think Congressman McCrery said, the Contract is not written in stone.

We are very hopeful—we are going to send you all of our tax incentive ideas, and we are hopeful that we will get that in, and we are hopeful that when you go through it you will go through it with an application of common sense and that the Democrats and the Republicans can get together and do some significant things.

Like I saw in the Contract—and we didn't go too far on this because the reinstitution of Star Wars which would rob us of money for the programs we need—I heard the testimony on Star Wars, that it would destroy 95 percent of the missiles launched on American targets. If 100 missiles were launched on Philadelphia it would destroy 95 of them, which means 5 would get through. Which would mean that I, sitting in city hall, you could put me in a thimble. I don't think I want to spend money on that when people I represent don't have money for heat.

Mr. KLECZKA. Mayors—and I am talking to both mayors—great job. And we appreciate you coming down today. Thank you, Mr. Chairman.

Mr. CRANE. Well, I want to express appreciation to both of you for your testimony and participation today.

One final question, though, if I may.

Mayor Rendell, when you first took office, my understanding is Philadelphia was in a kind of critical financial state. And I am curious what you did to restore the community's confidence in the business community and others in Philadelphia immediately after taking office.

Mr. RENDELL. Well, I think the first thing I did, even before taking office, during the campaign, is I told people the truth. I told them that we were in worse than critical shape, that we had one and five-sixths foot in the grave, and unless we were willing to do

very difficult things to reform the way we operated that we were done for.

And then we set out. We renegotiated contracts—didn't renegotiate, the contracts came up. We had some very bitter fights with our unions, and they were unfortunate, but we did render tremendous concessions in the benefit package that saved us almost $0.5 billion over a 4-year period. We got tremendous concessions in noneconomic things that enabled us to manage the government more effectively. And then we went out and examined everything that we did as a government, just like Mayor Goldsmith has done, and he has been the leader in America.

We did competitive contracts or privatized 23 services, saving $32 million a year. We went out and hellbent for leather decided we were going to collect every dollar of taxes out there not being paid. We didn't raise taxes, but we went out there, and we now collect $70 million more a year than we did before.

And we have reviewed everything we did as a government—downsize, rightsize. We have about 1,200 less employees out of 25,000 than we did. And all of that amounted to in 18 months we took a budget deficit of $450 million and turned it into an itsy-bitsy $3 million surplus. And last year we had a $16 million surplus.

But it wasn't easy. And people were ready for it because we told them the truth, and we told them what we had to do, and we told them what the payoff was at the end.

Mr. CRANE. I salute you both for distinguished performance. Mayor Goldsmith.

Mr. GOLDSMITH. I think, just to punctuate Mayor Rendell's comment, is something that I feel is at least helpful to point out. Budget reductions don't mean service reductions. And competition and private enterprise will cause better, higher quality and more services to be delivered.

Our budget is down in real dollars. Our employee force is down 35 percent, and our services are up. And to allow the dialog to be if you cut a budget you will cut a service is not true. And I think that these cities show that this Congress can dramatically make a change without incurring great loss in services to the people of America.

Mr. RENDELL. And the two of us are not alone. I think mayors all over the country, Republicans and Democrats alike, are doing similar things. And it can be done. I mean, one of the biggest problems we faced is I was a city that had strong labor contracts and civil service system. We have created an incentiveless system for our work force. And I think that is probably true to a great degree with the Federal work force. How do you get incentives back in? How do you get that free enterprise system to work for your workers and motivate them?

Privatization has helped because the workers who haven't been privatized—and they are the vast majority—they are scratching their heads and saying we better get together with our managers and cut costs or both workers and managers are going to be privatized out of a job.

And we tried to put in incentives for productivity. And I didn't get it in my last union contract, but if I am around for the next

one I want to get the ability to give bonuses for good performance and employee suggestions that save us money.

You remember that lady in Massachusetts who came up with a suggestion that saved them $189 million? I think she got a couple of days off and a letter from the Governor. And that is great.

But can you imagine if for the first year of any cost-saving suggestion that came from a Federal employee—for the first year of that cost savings that Federal employee got 10 percent of the savings rendered with say a cap of $50,000? Can you imagine the ideas that would come from your Federal work force for how you could save money?

Mr. CRANE. Well, I would remind you a former resident of your city, Mayor Rendell, Benjamin Franklin said a good example is the best sermon. And you are both shining examples, and I thank you for your testimony today.

Our next panel is Eloise Anderson, Perry Moy, Dale Kettler, and Robyn Klapperich.

Well, as we prepare to commence here, let me acknowledge one of our guests is a former constituent of mine, Mr. Moy. Mr. Moy is a living example of what opportunity, hard work, and commitment can do in the way of guaranteeing success. And I want to welcome you, Mr. Moy, even though I lost you as a constituent with reapportionment.

Mr. MOY. We miss you, Congressman.

Mr. CRANE. I look forward to visiting your restaurant in the very near future.

And I would like to yield to Mr. Camp to welcome also another one of our guests.

Mr. CAMP. Thank you. I want to welcome Dale Kettler, who operates a family farm in Chesaning, Mich., right in the heart of the Saginaw Valley in Michigan. His farm was started by his great, great grandfather, a Civil War veteran in 1878, and is about 500 acres of cash grains—corn, soybeans and wheat.

I have known Dale for some time. He is active in local agriculture as well as serving on various State agriculture committees. He has driven here all the way from Michigan. I know his wife Nancy is here, and two of his children came to hear his important message.

Dale is a farmer in middle America who knows what it is like to work hard, make ends meet and keep the family tradition alive. He is one of the real people that government must hear from in order to appreciate how high taxes are, how out of control spending is and how bureaucratic overregulation can harm a very important industry to all of us, the agricultural industry.

Thank you, Mr. Chairman.

Mr. CRANE. Thank you.

And now we will start with Ms. Anderson and then work to the right from your perspective.

STATEMENT OF ELOISE ANDERSON, DIRECTOR, CALIFORNIA DEPARTMENT OF SOCIAL SERVICES, SACRAMENTO, CALIF.

Ms. ANDERSON. Thank you, Mr. Chairman and members of the committee, for inviting me here to talk about the Contract With America.

I am Eloise Anderson, the director of the California Department of Social Services, and I am responsible for AFDC, child welfare, Social Security programs, disability evaluation and in-home supportive service. My experiences go back to the fact that at one point in time, 30 years ago, I was a socialworker in a community organization.

I would like to summarize my remarks and have my written testimony that you have be put into the record so that I can keep within your time limit here.

When I look at the Contract With America what I see is accountability. And I have been in this field for about 30 years, and I will say to you that accountability is surely lacking, especially in social services programs. So I am very excited about the fact that we are talking about accountability.

I also—in the past 30 years, I have begun to believe that the private sector can do much of what the public sector does now. And I come from the position that if people didn't want to buy our services maybe we shouldn't be providing them. And that at one point in time most of the social services that we provide now were done by the private sector.

I also, over 30 years, have begun to look at AFDC and other social service programs as injuring family stability and family formation. And the programs that we have put in place have ignored the importance of fathers, discouraged personal responsibility, and they take too much from family income to finance the good intentions of government.

I am not a tax expert. I am not a defense expert. And I am not an academician, but I think I have practical experience and some administrative experiences in this field.

Please—and I underline please—fulfill the promise to restore flexibility to the States, to develop innovative, effective and affordable solutions to our many service problems.

I have now worked for two Governors, one, Tommy Thompson of Wisconsin and the other, Pete Wilson, presently. What I have seen with these two Governors is that the waiver process that we must put our States through has been incredible. And even after we get the waivers and we do good with those waivers, one thing is for certain that they are not permanent. So no matter how good they are we may need to revert back to our old ways of doing things.

We in the State understand that when you give us taxpayers dollars you need to hold us accountable. We are not asking not to be held accountable, but we are not asking to be held accountable for a process. We need to agree on outcomes.

We look forward to a block grant. We need flexibility, designed programs that meet the needs of our residents. The current system, the relationship that we have between the Federal Government, State government, seems to be one devoid of trust. It seems to us that you don't trust us to do what is best for our citizens.

I guess the next question one would ask is what we would do with flexibility? Well, having now worked in two States, I will tell you that States are different. They are not only different geographically, they are different demographically. They have different economic bases, but they are also institutionally different, culturally

different and politically different. So I suspect that many of the States would do very different things.

But I also think that one size does not fit all, and we need to try to quit making programs that fit all people.

But I think that there would be lots of things that we would do similar. Especially when I look out and see the programs that are across the States in terms of their waivers we have a lot of things that are similar.

But I think there is one thing that we would all do and that is that we would not assume that people on AFDC are helpless. We would stop treating AFDC recipients as if they were victims that need to be taken care of. We would stop having the State play the role of husband or father or parent. The attitude is demeaning, and the attitude fosters dependency.

We believe that we need to create better incentives and different modeled programs to help people get out of the cycle, programs and policies that give incentives to do a couple of things. The importance of fathers—what this program has done, and I have watched it over 30 years, is marginalize poor men. It makes men at the low-income level redundant.

One of the things that I think States would do is that they would redesign the child protection system. They would make their child protection programs child centered and family focused. So as you are looking at this block grant we suggest that you also put child welfare funds into the block grant.

When we look at teen parents I believe that the States would come to that to try to deal with the issues, but I don't believe that the issues of teen parents is an income transfer problem. I believe it is a child protection problem. I believe for the past 30 years that government has sponsored child abuse in how we treat teen parents.

Give us flexibility in the funding to address these issues, and we will do it. We are up to the challenge.

Thank you.

[The prepared statement follows:]

TESTIMONY OF ELOISE ANDERSON
DIRECTOR OF THE CALIFORNIA DEPARTMENT OF
SOCIAL SERVICES
BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
JANUARY 12, 1995

Thank you Mr. Chairman and Members of the Committee for inviting me here today to talk about the "Contract with America." I am Eloise Anderson. I am currently the Director of the California Department of Social Services. This Department administers the AFDC, Child Welfare, Foster Care Systems, SSI/SSP, and In-Home Supportive Service programs in the State of California. In addition to my policy and administrative experiences, I also have hands-on experience as a social worker in a community agency.

First, let me say that I am thrilled to be able to talk with you about the Contract because I believe that the Contract heralds a new approach to government, one that I have waited for since I became of voting age in 1963. We, the people, will be served well by the direction that the Contract outlines. The approach of the Contract will put us in a position to face the challenges of the next century, hopefully as a united people where all who put forth the effort can benefit. I think the Contract is about government accountability, especially federal government accountability. We must increase accountability in all programs including welfare. I also agree that we should shrink the size of government at all levels; too many of our problems have grown beyond our ability to support them. The Contract is also about families, and for over thirty years I have witnessed the disparagement of families by government programs that ignore the importance of fathers, discourage personal responsibility, and take too much of the family's income to finance its good intentions.

I am not a tax expert, I am not a defense expert, and I am certainly not an expert in Congressional rules, so I want to focus my remarks on what the Contract could mean for social service reform.

First, however, I want to briefly talk about our approach in California. In California, Governor Pete Wilson has proposed over the past five years comprehensive reforms to our State's welfare system. These reforms--some of which have been enacted and are now being implemented--are built upon the following principles:

- Programs to help needy families should reward activities that lead to success: work, saving and staying in school
- They should not reward having more children
- They should not allow teenagers to set up households when they cannot support themselves
- They should rely on real jobs as the key to leaving welfare and getting out of poverty
- They should be based on mutual obligation, by which recipients have partial responsibility for supporting themselves and their families.
- Reform efforts should result in no new costs for the federal government, and should achieve State savings.

Our State's welfare reform principles are a clear example of why I believe that the most important and promising statement in the Contract concerning social welfare is, and I quote, "The best welfare solutions come from the States, not Washington, D.C." I urge you to remember this as you develop your social service reforms this year. As you know, this country was founded upon

the principle of Federalism, in which the States were seen as the laboratories of democracy. No matter what else you do, I urge you to renew the commitment of our founding fathers to Federalism. By doing so, you will fulfill the promise of the Contract to restore flexibility to the States to develop innovative, effective, and affordable solutions to our many pressing social problems.

I have been privileged to work for two Governors--both very committed to welfare reform. Yet, both Governor Pete Wilson of California and Governor Tommy Thompson of Wisconsin have had to squeeze their considered reforms of the welfare system through the tiny and twisted portal of the federal waiver process. This is a process that makes States stand on our heads to get permission to try to implement needed reforms, and even if we demonstrate that our reforms work, there is no guarantee that they will be adopted as permanent changes. Indeed, if the States required the federal government to demonstrate that its welfare reforms worked before they could be imposed on the States, we would not have the broken welfare system we have today.

The Contract gives us an opportunity to redefine the role of federal and state governments in social services. We, at the State level, realize that you have an obligation to hold us accountable if you pass tax dollars to us. Through block grants you can hold us accountable while still giving us the flexibility to design programs that meet the needs of our residents. The current system seems to me to be void of trust. It is as if the federal government does not trust the States to do what is in the best interests of our citizens.

What would States do with this new flexibility? Moving from Wisconsin to California a few years ago has taught me that there are incredibly significant differences between States, not just in demographics and economics, but also in institutions and politics. These differences would mean different designs in a system that provided states with flexibility and also held us accountable to better results. I suspect many of us would use the new flexibility in similar ways.

Many of us would redesign programs that do <u>not</u> assume that the people we serve are helpless. The current programs, AFDC in particular, treats clients as victims and patronizes them by "protecting" them from the real world, as if the State is the husband (in the traditional sense) or parent. This attitude is demeaning and it fosters dependency. Most adults on AFDC are quite able to help themselves, and would--if the disincentives of the current system were eliminated. Under Governor Wilson's leadership in California, we have made great progress in building a work incentive into our AFDC program, and with additional flexibility, we could implement the Governor's proposed two-year limit on aid to able-bodied adults. This additional reform of time-limited aid would not only greatly increase the incentive to work, but would also send the very important message that welfare is intended to be temporary assistance, not a way of life.

Many States would also design programs that recognize the importance of fathers in families. The present system marginalizes poor men. It makes them redundant. I have watched far too many women "marry" the State through the AFDC program. The State makes a poor husband, and a worse father. Again, as part of Governor Wilson's vision, in California we have already implemented a number of reforms designed to restore the role of the father and with additional flexibility we will do more. The rights and responsibilities of fatherhood cannot be deferred simply as financial; in California we have begun a campaign called "Focus on Fathers," that will heighten awareness of the role of men in the development of their children.

If given the flexibility to do so, many States would redesign their child protection systems to be child-centered and family-focused to assure better outcomes for kids. The current funding mechanism is designed to encourage placing children in the most restrictive care. Governor Wilson has just announced a major reform of the child protection system in California with the goal of assuring safe, nurturing homes for children, providing high quality and effective services to families, and assisting children to transition successfully from government care into adulthood. One of the key elements of our reform is something we are calling "flexible funding," which allows our 58 counties to use more creatively State funds to develop better and more appropriate services at the local level. At the federal level, you could also convert these programs into a block grant and thus join us in our effort to encourage local innovation.

Finally, I believe that many States would use the new flexibility to design innovative ways of dealing with one of the major social problems of our day, out-of-wedlock teenage births. What to do with our fast growing caseload of never-married mothers, many of whom also have never worked, is one of the more vexing problems. We have all followed with great interest the recent debate on orphanages. I do not believe that this issue is an issue of income transfer, it is a child protection issue and belongs not in AFDC but in child welfare. Give us flexibility and I know that we, in California, would address this issue of out-of-wedlock teen births. In California more than 50 percent of our AFDC caseload are women who had their first baby as a teenager. They generally don't finish high-school, and they become dependent on government help. That's why Governor Wilson is again proposing to require teenage girls who have children live with their parents if they want a welfare check. But we are also encouraging these young women to continue their education through a program we call Cal-Learn. Cal-Learn rewards teen mothers who stay in school and maintain passing grades by increasing their grants. On the other hand, teen mothers who earn failing grades, or who drop out of school, have their grants reduced. I think this is a very wise approach because it gets the States out of the business of setting girls up in their own apartments who are vulnerable and emotionally, financially, and educationally unprepared for life, and who begin parenting without social supports. Many do not feel that being a teen mom is a problem because of many of our grandparents were teen moms. Mine was, but that was in the early part of this century and the latter part of the last one. Life was different. Not finishing high school or even going to high school did not have the severe economic consequences that it has now. We live in a society in which a high school education, and even post-high school training are increasingly important in competing for the kinds of jobs that can provide long-term self-sufficiency. Children have always benefited more in a two-parent family than in a one-parent family. I firmly believe that the AFDC program is anti-poor fathers, and has driven more men away than we want to admit. Raising children alone has always been a risk factor for poverty. Society should encourage teens to delay parenting. We should not foster children having children. Finding good alternatives to welfare to the problem of out-of-wedlock teenage births will certainly be a challenge to all of the States, but we are ready for this challenge. Let the laboratories of democracy tailor the solutions to this very complex problem, which will make sense given each State's demographics, economics, institutions, and politics.

As a citizen, I am excited about the prospects for positive change that the Contract With America heralds for our nation and I wish you luck as you start your work to put these changes in place. As a State administrator, I am very hopeful that the Contract will give States the flexibility to implement reform in programs where real reform is long overdue. Thank you for allowing me to address you today.

Mr. CRANE. Thank you.
Mr. Moy.

STATEMENT OF PERRY MOY, OWNER, THE PLUM GARDEN RESTAURANT, MCHENRY, ILL.

Mr. MOY. Mr. Chairman and members of the committee, thank you for inviting me here today.

My name is Perry Moy, and I own the Plum Garden Restaurant in McHenry.

I would like to explain a little bit about myself to you. Restaurants are in my blood. My father came to Minneapolis from China at age 8, a very small boy seeking economic opportunity. He worked at his uncle's restaurant, literally sleeping in the kitchen, until he was 21 years old.

Like so many of his generation his plan was to return to China. He stuck to his plan, at least in part. He did go back, meet my mother, and marry. But as a naturalized American citizen he was called back by the draft and ended up serving in the Pacific front and in the occupation of Japan.

Soon after, I was born. My mother and I traveled to this country, and it turned into a lifetime. The Communists overtook China, and we were left here and couldn't get back in. Then my dad's unexpected death left my mother with three small children and no livelihood, so we set about creating a life.

I was 7. I began working alongside my mother in my uncle's restaurant in Park Ridge, Ill., washing dishes, sweeping, and answering the phones. Ten years later, with $4,000 in savings, my mother and I boarded a train. We stopped at the last stop, and it was a town called McHenry. We found a small storefront, paid $60 for the first month's rent and opened up a carryout restaurant.

In the same spot of the first Plum Garden, the carryout my mother and I started 30 years ago, I now own an 80-seat fine dining restaurant specializing in creative Cantonese cuisine. We employ 32 people, many of whom have been with me for more than a decade. Our restaurant is an important part of our small town, and I am very proud of what we were able to do.

I am not an expert on welfare or tax policy. I am here today to give you one citizen's perspective on the spirit behind the Contract With America.

Obviously, I am a big believer in the work ethic, in the free enterprise system and in economic opportunity. Hard work has been the rule for me. That is one reason why I believe so strongly in the kind of changes you are talking about for the welfare system, changes that emphasize work over long-term welfare dependence.

A number of my employees are single moms making a transition off welfare. I recognize in them the same desire I saw in myself years ago: The desire to better themselves, to provide for their kids and to get ahead in life.

I believe there is a fundamental dignity and a value in holding a job. Wherever you start out—a dishwasher, a fry cook or barperson or whatever else—I speak from personal experience in saying that the restaurant industry gives you a start as well as a career path if you want it. Any changes Congress can make in the system to foster the work ethic will take us down the right path.

I also support provisions of the Contract that would make the free enterprise system work more efficiently. Cutting the capital gains tax, for example, is a terrific idea. Ultimately, I believe that will direct capital in ways that make the most economic sense and will get away from penalizing people that make money.

I support, too, tax changes that make businesses more willing to invest in the equipment we believe will make us stronger and more competitive, giving us more confidence to invest, knowing these investments will yield long-term benefits.

The small business expensing rules and the proposed neutral cost recovery proposals especially would assure us that the Tax Code would allow us to depreciate 100 percent of the purchase price of an asset. This is an important consideration as we try to upgrade our equipment.

Liberalizing the estate tax rules is a good idea as well. Ninety percent of Chinese restaurants are "ma and pa" operations. My wife and I have three small children. Along with millions of other American moms and pops, we would love to see them become doctors, lawyers or even Congresspeople like yourself. But my piece of the American dream is the Plum Garden, and I would like to give the restaurant to my kids at the time when the time comes and not have to make them suffer for it.

I guess what I am saying is that in the real world we feel the impact of what goes on here in Washington. For example, when Congress cuts the tax deduction of meals to 50 percent, I see the impact—fewer businesspeople in my restaurant. When Congress raised the FICA tax on tips in 1988, I was out thousands of dollars for higher payroll taxes.

So as you develop tax policy over the coming weeks, keep people like me in mind. Think of an 18-year-old boy and his mother, life savings in hand, and trying to start a new business.

Thank you very much, Mr. Chairman.

Mr. CRANE. Thank you, Mr. Moy.

Ms. Klapperich.

STATEMENT OF ROBYN KLAPPERICH, SAN ANSELMO, CALIF.

Ms. KLAPPERICH. Good afternoon. My name is Robyn Klapperich and I live in San Anselmo, Calif. I have been a secretary at the Marin Primary and Middle School in Marin County for the past 3 years. I would like to share with you my family's experience in taking care of my elderly mother, Meredith McKendry.

Ten years ago, after my father passed away, my husband and I decided my mother should come and live with us. This seemed like a perfect arrangement because I am an only child and my mom is handicapped. She lost her leg to bone cancer and has worn a prosthesis for 38 years.

Approximately 6 years ago, my mother's financial advisor recommended an AMEX Life long-term care insurance policy for my mother. He discussed it at length with both my mother and me and said he was recommending that his mother get one also. At the time, my mother was in good health and we hoped we would never have to use the policy, but we felt it was such a good idea she signed up for it.

Four years ago, we began to notice subtle changes in my mother's behavior. She was becoming very forgetful, easily confused and had difficulty paying her bills. Most frightening of all, she couldn't remember how to start her car. She asked my son to write directions on how to start the car so she could tape them to the dashboard. She was also experiencing hallucinations.

These changes didn't happen overnight. It was a gradual process. I began making doctors' appointments to see if there was something we could do to help her. Unfortunately, there was nothing we could do but watch her deteriorate. It was very painful for all of us to watch a woman who had been so strong and independent failing. My mother had volunteered at the local hospital 2 days a week, played bridge and gone to the movies and out to lunch with friends. Gradually, that all ended. She was as frightened by what was happening as we were.

One morning we discovered that my mother had fallen during the night and had severely burned her arm on the wall heater. It was at that point that I realized that I needed to have someone come in to help take care of her. It seemed that our roles were being reversed. I was feeling like my mother's mother. She needed help brushing her teeth and getting dressed, things I had done for my children but never dreamed I would have to do for my mom. At one point she even said, as I was dressing her, "I can't believe it has come to this."

I was lucky because in our area there was a group called Senior Access that finds help for the elderly and ill. Through them, I found a wonderful young woman who was going to school to be a nurse. She was with my mom 4 hours a day to begin with, and as my mother's mental health deteriorated, she stayed 8 hours a day. At the time my mother purchased the policy, home health care coverage was not available so the insurance did not cover any of this cost. At that time, unskilled care cost between $10 and $12 an hour, depending on what services they had to provide.

As my mother became more dependent, I began to search for a nursing home for her. My mother's caretaker was able to give me recommendations about nursing homes in my area, which helped. My search was also made easier because I knew that my mother had long-term care insurance and I was able to look at only the finest facilities. I found a home I liked and put my mother on the waiting list.

Two years ago my mother had a bad fall and cracked her pelvis. After consulting with her physician, we decided that it was indeed time to put her into the nursing home. Putting my mother in the nursing home was the hardest thing I have ever had to do. It would have been even more difficult without the long-term care policy. I am afraid I would have had to put my mother into what I would have considered an inferior facility.

As of today, the nursing home cost for a semiprivate room in my mother's facility is $130 a day. With medication and a few extras, the cost is well over $4,000 a month. The AMEX Life long-term care policy covers $3,600 a month. The remainder I pay out of my mother's Social Security and retirement.

We have two children in college and because of this policy we did not have to compromise our lifestyle. I know my mother would

never have wanted us to make sacrifices for her care and I am so thankful that we didn't have to make the choice between my children's education and a nursing home for her.

As my generation looks forward to living longer, the problem of care for the elderly will become more severe. There is an enormous need for this kind of insurance. Most people are not aware of the high costs involved. I think people need to be educated and provided with incentives to take care of themselves.

I have been told that the Contract With America, in particular the Senior Citizens' Equity Act, would provide some tax relief and clarification for people in circumstances similar to mine. I also understand that the Family Reinforcement Act which would provide a tax refund to families taking care of elderly parents or grandparents would be very helpful. Anything that could be done to help would be very appreciated.

I would like to thank you for giving me the opportunity to testify today.

[The prepared statement and attachment follow:]

TESTIMONY OF ROBYN KLAPPERICH
SAN ANSELMO, CALIF.

Good afternoon. My name is Robyn Klapperich and I live in San Anselmo, California. I have been a secretary at the Marin Primary and Middle School in Marin County for the past three years. I would like to share with you my family's experience in taking care of my elderly mother, Meredith McKendry.

Ten years ago, after my father passed away, my husband and I decided my mother should come and live with us. This seemed like a perfect arrangement because I am an only child and my mom is handicapped. She lost her leg to bone cancer and has worn a prosthesis for 38 years. Approximately six years ago, my mother's financial advisor recommended an AMEX Life long term care policy for my mother. He discussed it at length with both of us and said he was recommending that his mother get one also. At the time, my mother was in good health, and we hoped we would never have to use the policy, but we felt it was such a good idea she did sign up for it.

Four years ago we began to notice subtle changes in my mother's behavior. She was becoming very forgetful, easily confused, and had difficulty paying her bills. Most frightening of all, she couldn't remember how to start her car. She asked my son to write directions on how to start the car so she could tape them to the dashboard. She was also experiencing hallucinations. These changes didn't happen overnight; it was a gradual process. I began making doctor's appointments to see if there was something we could do to help her. Unfortunately, there was nothing we could do but watch her deteriorate. It was very painful for all of us to watch a woman who had been so strong and independent failing. My mother had volunteered at the local hospital two days a week, played bridge and gone to the movies and out to lunch with friends. Gradually that all ended. She was as frightened by what was happening as we were.

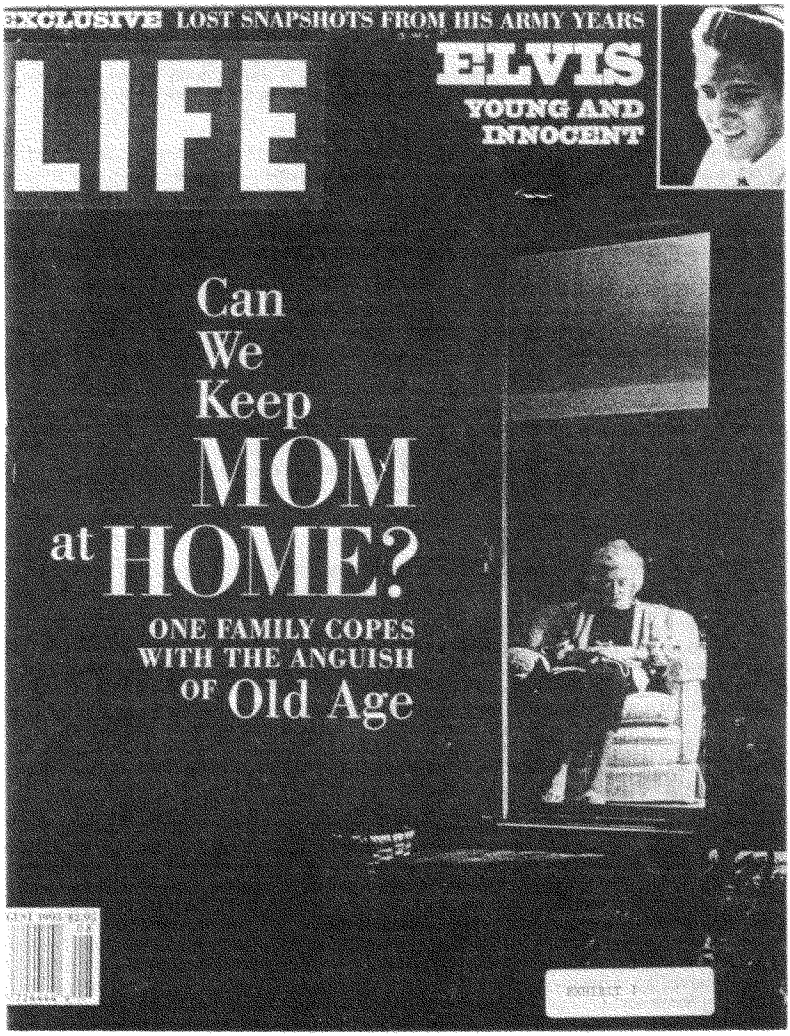
One morning we discovered that my mother had fallen during the night and had severely burned her arm on a wall heater. It was at that point that I realized I needed to have someone come in to help take care of her. It seemed that our roles were being reversed. I was feeling like my mother's mother. She needed help brushing her teeth and getting dressed, things I had done for my children but never dreamed I would have to do for my mom. At one point she even said as I was dressing her, "I can't believe it has come to this." I was lucky because in our area there is a group called Senior Access that finds help for the elderly and ill. Through them I found a wonderful young woman who was going to school to be a nurse. She was with my mom four hours a day to begin with and as my mother's mental health deteriorated she stayed eight hours a day. At the time she purchased the policy, home health care coverage was not available so the insurance did not cover any of this cost. At that time, unskilled care cost between $10 and $12 an hour depending on what they had to do.

As my mother became more dependent, I began to search for a nursing home for her. My mother's caretaker was able to give me recommendations about nursing homes in my area, which helped. My search was also made easier because I knew that my mother had the long term care insurance and I was able to look at only the finest facilities. I found a home I liked and put my mother on the waiting list. Two years ago my mother had a bad fall and cracked her pelvis. After consulting with her physician, we decided that it was indeed time to put her into the nursing home. Putting my mother in the nursing home was the hardest thing I've ever done. It would have been even more difficult without the long term care policy. I am afraid I would have had to put my mother into what I would have considered an inferior facility. The nursing home cost for a semi-private room as of today is $130. With medication and a few extras the cost is well over $4,000 a month. The AMEX Life long term care policy covers $3,600 a month. The remainder I pay out of my mother's social security and retirement. We have two children in college and because of this policy we did not have to compromise our life style. I know my mother would never have wanted us to have to make sacrifices for her care and I am so thankful that we didn't have to make the choice between my children's education and a nursing home for her.

As my generation looks forward to living longer the problem of care for the elderly will become more severe. There is an enormous need for this kind of insurance. Most people are not aware of the high costs involved. I think people need to be educated and provided with incentives to take care of themselves. I have been told that the "Contract With America", in particular, the Senior Citizens Equity Act, would provide some tax relief and clarification for people in circumstances similar to mine. I also understand that the Family Reinforcement Act, which would provide a tax refund to families taking care of elderly parents or grandparents, would be very helpful. Anything that can be done to help would be appreciated.

I'd like to thank you for giving me the opportunity to testify here today.

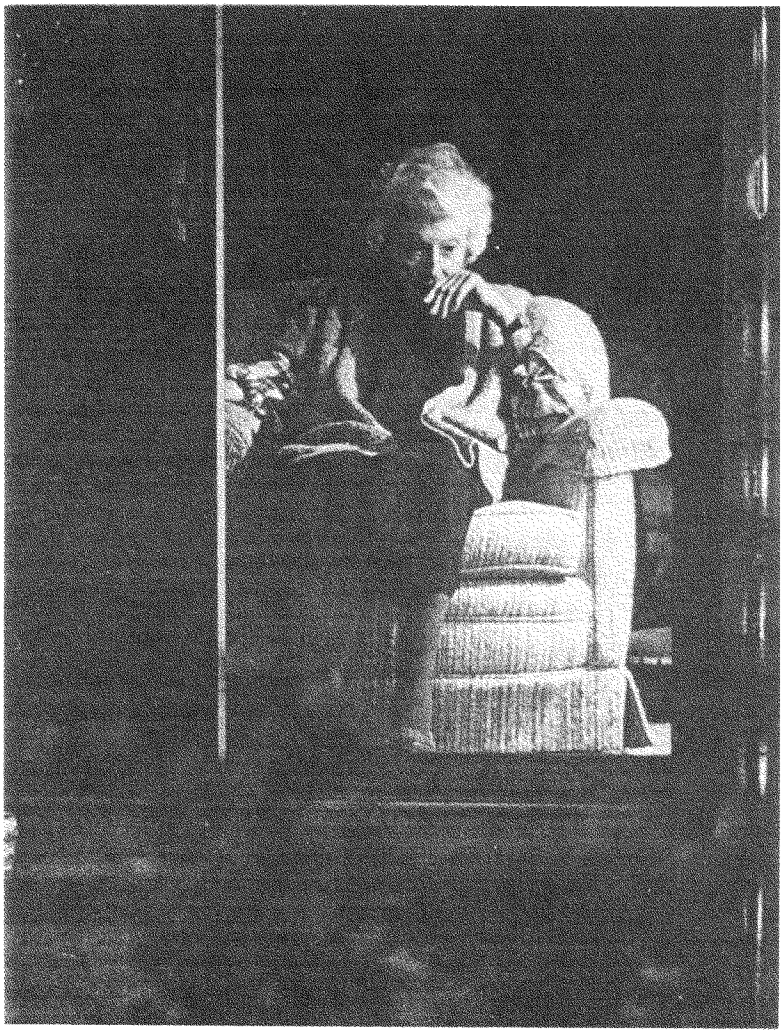
Reference: LIFE Magazine, August 1993, Pages 29-36.


EXCLUSIVE LOST SNAPSHOTS FROM HIS ARMY YEARS
LIFE
ELVIS
YOUNG AND INNOCENT
Can We Keep MOM at HOME?
ONE FAMILY COPES WITH THE ANGUISH OF Old Age

Robyn Klapperich has kids, friends, a husband, a job. Her mother has only Robyn. How one typical family is coping with the aging of America

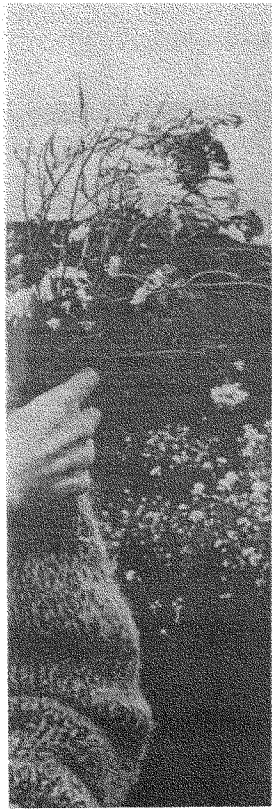
When MOTHER Needs MOTHERING

Photographs by Dana Fineman
Reportage by Jan Mason
Text by Claudia Glenn Dowling



I never wanted to live with my daughter. When she has to do somethin

for me, I get upset. But I'm so lucky to be surrounded by this family."



Eight years ago, soon after her father died, Robyn Klapperich realized that her mother, Meredith McKendry, then 73, could no longer live alone. Robyn (an only child) and her husband, John, a municipal water supervisor, bought a house in Marin County, Calif., with a separate mother-in-law apartment. "Mom wanted her independence," says Robyn, now 46, a secretary in a private school. "She said she didn't want a bedroom in my house, but if she had her own place, fine." The arrangement worked for five years: Meredith had her family nearby—and her grandchildren had someone to drive them to town—and she also had her own friends, her volunteer work at the hospital (6,957 hours of service as a Pink Lady), her life. Then Meredith became forgetful. She couldn't find her wallet, keys, the address book she had wrapped up in aluminum foil and put into the refrigerator. In 1991, shortly before LIFE first visited the Klapperich home (we went back twice after that), she asked her grandson to tape to the dashboard a reminder of how to start her car. Her family made her stop driving, a deeply symbolic loss of independence. And then there were the falls. Once, Jimmy and his sister, Katie, found her out cold. They called 911 and then their mother, who got home to find the kids crying in the driveway. As their father recalls, "They saw that Grandma is mortal."

Meredith helps her grandson, Jimmy, dress for the prom *(below)*. "She used help me with everything," he say "Now, some nights, sit and wonder if she's all right. I go over, see her sleep and go back to bed

John Klapperich helps his mother-in-law to her room when she gets too tired *(right)*. "I love the lady," he says.

"I wasn't exposed to what later life is like," says aide Kate Reichling, 25, walking by the Pacific with Meredith *(left)*. "It's built my compassion."

"I give Mom as much as I can—she deserves it. But I've got a life."

Katie *(foreground)* is home from the University of California, Davis; as family and friends gather for a cookout, Meredith watches from her room.

At three a.m., on a summer night two years ago, the phone rang. John answered. "Oh, John," said Meredith, who had been watching tennis on TV. "Martina Navratilova has fallen asleep on the couch. I couldn't wake her, so I put a blanket over her." John shook his wife. "Robyn," he said sadly, knowing it was another night she would come back to bed in tears, "it's for you."

"Do you think I'm losing my mind?" Meredith asked anxiously after several such episodes. Doctors couldn't diagnose the hallucinations but suspected that better nutrition might reverse Meredith's increasing dementia. Robyn began fixing her mother breakfast before work. An aide took over during the day. In the evenings Robyn prepared her mother's dinner, her family's dinner, did the laundry and dishes, packed lunches. Robyn and Meredith had always had a good relationship, the kind where they spoke every day because they *wanted* to, but now Robyn felt squeezed between her mother and her family. "I wasn't so much getting angry with my mother as with the situation," Robyn says. "I wished I didn't have to worry about her. But that felt so selfish." A support group she found through Marin Senior Services helped Robyn deal with her guilt. She vowed not to be a martyr: "It's O.K. to have my own life—my mother had hers." ▶▶

Debilitating illness leads to short tempers: Even cookie baking can turn into a confrontation.

TO EVERYTHING THERE IS A SEASON

In tasteful rooms of aqua and mauve, elderly ladies and a few men sit in wheelchairs or lie on their beds, staring at the light. Meredith rubs her thin hands together and smiles vacantly, maundering about the past. "These people are never going to get better," Robyn remarks. "Friends say to me, 'You're saying your mom should die!' And I really wish she would. Quickly. A stroke or a heart attack." It has come to this: Many find a sudden death preferable to a slow dying, a painful old age. Robyn visualizes Jimmy and Katie caring for her and says, "Dr. Kevorkian. The home kit. I will not do this to my children." The concept of hastening the end may horrify, but at the moment it is one of the few alternatives proposed for the enormous emotional, physical and financial tolls levied on the terminally ill and their families. With more people living longer than at any time in history, other solutions are desperately needed. In 1990 there were 31 million people over the age of 65 in the United States—12.5 percent of the population; the federal government's Medicare program spends more than $145 billion a year on health care for the elderly. When Robyn's generation reaches her mother's age, a fifth of the population will be old, and the costs are projected at a staggering $4.1 trillion annually. As Hillary Rodham Clinton's health care task force has heard over and over, now is the time to do something to avert fiscal disaster.

"I wish she was like she used to be, but she's not," says Robyn, who visits her mother, 81, every day. John and the kids visit several times a week. When the aide who used to care for her came by, Meredith asked her to call Robyn to "get me out of here."

Caring for the aged has traditionally had as subtext the Fifth Commandment: Honor thy father and thy mother. At the end of their parents' lives, children repay the years of care they received. This is still the norm. Four out of five disabled elderly people in the U.S. are cared for by relatives, three quarters of whom are daughters. The stresses on this "sandwich generation"—those with children and parents to provide for—have given rise to highly publicized incidents of "granny dumping," in which old people are abandoned at hospitals. But even the vast majority of Americans who happily care for their parents worry about the emotional and financial strains of long-term sendup.

Meredith's financial adviser had persuaded her to take out nursing home insurance, which will cover her care for the rest of her life. But such forethought is atypical, and costs can run as high as $60,000 a year. The alternative is to "spend down," or divest oneself of savings, to qualify for state welfare programs like Medicaid. This year New York State passed a groundbreaking law mandating that the state pick up the tab after three years of privately insured care, even if there are still untouched savings.

But there are not enough beds in the nation's nursing homes—at last count only 1.6 million—and the wait can be several months. Networks that coordinate such services as day care, transportation and meals sustain some people at home. Those who can afford it may buy into continuing-care facilities, condominiumlike setups that provide increasing levels of assistance, from cleaning and cooking to feeding, toileting and medical care. "I'm going to sign myself up for one of those places," says Robyn. "They play bridge, have little outings. It's a way to make new friends." Demand, however, far exceeds supply, and most are unavailable to Americans without large savings or private insurance.

Meanwhile, as a generation faces their parents' decline, graying baby boomers are discovering that even they cannot buck genetic destiny. "You realize," Robyn says, coming at last to her own private conclusion, "that you are not going to live forever." ▭

"I felt really bad because I knew she would never come home again."

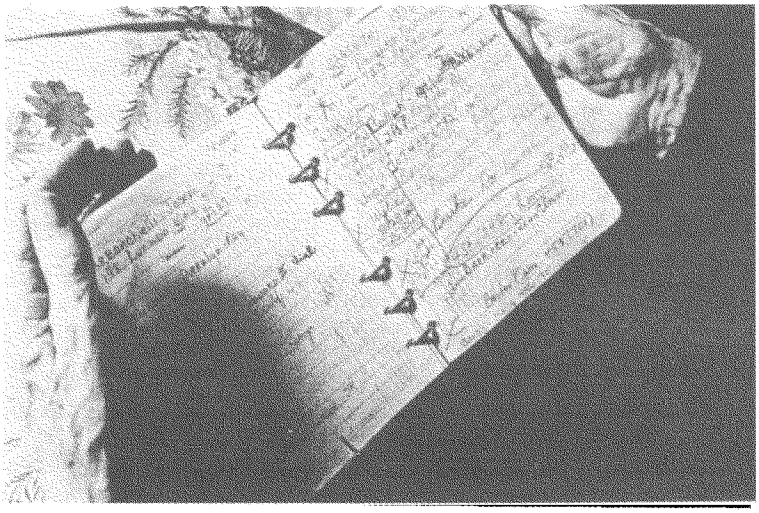
Meredith's life had become a catalogue of loss: mobility, independence, friends, faculties, personal dignity. By early 1992 she couldn't remember how to dial the phone or change channels on the TV. In lucid moments Meredith sometimes felt so infantilized that she called her daughter Mom. Robyn, too, was saddened. "The role reversal—becoming mother to my mother—was really awful," she says. "Things I didn't think I was capable of doing, I did—like changing her diapers. Sure, I changed my kids' diapers—but that's my *mom*. The difference is, the kids get older and you won't have to do it. But my mother is going in the opposite direction."

Robyn, worried about how long she could care for her mother at home, had started to look at nursing homes when, in February of this year, Meredith had another fall. She cracked her pelvis and couldn't stand. The accident precipitated the inevitable. "The kids and I became the supporting cast," John remembers. "It was down to Robyn and her mother." Robyn tried to be matter-of-fact about the admission to a nearby nursing home—a 70-bed facility that was well staffed, attractive and "didn't smell bad." She explained to her mother that she could get physical therapy and better care for her bedsore there. On the day of the move, Jimmy went to school as usual, John to work, but the house seemed terribly empty when they got home. ▶▶

Meredith is unable to move around, so Robyn must bathe her, give her pedicures and cover her with lotion *(left)*. "I try to stay calm and take it one day at a time," Robyn says.

In the past year Meredith has lost a dozen of her closest friends; everyone listed on these pages of her address book is gone. "Your world diminishes when your friends die," says Robyn.

"What's hardest is doing things for my mother she used to do for me."



Chairman ARCHER. Thank you.
Mr. Kettler, please.

STATEMENT OF DALE KETTLER, CHESANING, MICH.

Mr. KETTLER. Thank you, Mr. Chairman.

My name is Dale Kettler and I live with my wife and four children near Chesaning, Mich. I am pleased to be a constituent of Congressman Dave Camp, who is a member of this important committee. I operate a 500-acre family farm producing corn, wheat, and soybeans with my father and brother-in-law. The farm we operate is a designated centennial farm, having been in the family since 1878.

I am a farmer. That is not what I do as much as it is what I am. I live on the land first bought by my great-great-grandfather, a German immigrant and a Civil War veteran. I live in the house that he built. So you see, farming is more than a job and much more than a career to me; it is my culture and my way of life.

I would like to thank the Ways and Means Committee for allowing me to express my views on the Contract With America and the impact it will have on agriculture.

As an individual who for several years has been concerned about the direction our Nation has been going with tax and spending policy, I am excited about many of the provisions contained in the Contract With America. I will limit my comments to those provisions which I believe are within the jurisdiction of the Ways and Means Committee.

First, the provisions for capital gains tax reform are very important. Our family farm operation has a large investment in land and equipment. As a farmer, I do everything possible to minimize the wear and tear on my tractors and other equipment. Yet when it is sold to purchase new or replacement equipment, it is possible to receive more than the original purchase cost due to a combination of good maintenance and inflation.

Currently, I am taxed at 100 percent of the gain from the sale of such assets, much of which is due to inflation. This serves as a disincentive for me to sell these assets and replace them with new equipment. This in turn affects the activity of related businesses such as equipment manufacturers, suppliers, distributors, and local dealers. The 50-percent reduction of capital gains income from tax and indexing the purchase price of assets for inflation would be an important economic boost for our family farm.

Second is the provision which increases the Federal estate tax exemption from the current $600,000 to $750,000 and indexes it for inflation. Let me use our small family farm operation to illustrate the importance of estate tax reform. The 500 acres, buildings, equipment, and other assets we own easily exceed $600,000 in value. I can assure you this value does not mean I am wealthy from a financial standpoint as evidenced by the fact that I have an off-farm job in order to raise my family in an adequate lifestyle.

However, if I were to die and leave the farm to my spouse and/or children, the current $600,000 exemption would leave them with the likelihood of being forced to sell all or a portion of the family centennial farm just to pay the estate tax. I believe it would be a

shame if our farm that has been in the family since 1878 had to be sold to outside individuals or split up because of the estate tax.

Although increasing the exemption to $750,000 would be helpful, I encourage the Ways and Means Committee to increase the exemption to $1 million and retain the inflation indexing provision.

These two taxes, capital gains and the estate tax, in their current form combine to stifle growth and productivity in my industry. Older farmers are discouraged from selling their property to younger, more aggressive farmers because of the capital gains penalty and established operations are hesitant to expand because of tax liability over the $600,000 limit. This only stagnates an industry that really needs to be vibrant and competitive in this growing global economy.

Third is the provision in the Contract With America for a balanced budget amendment. I believe it is long overdue for the Federal Government to begin living within its income, just as my family and neighbors must do. Financial sacrifice and fiscal responsibilities are not new concepts in my family. I only regret that they are new concepts here. The Federal Government must not continue to spend beyond its income and saddle generations to come with the consequences.

I believe the proposed amendment which would allow deficit spending to occur if approved by a three-fifths vote of Congress and a complete waiver of the balanced budget amendment requirement if the Nation were at war are adequate protections against the dire consequences the opponents predict would occur.

Fourth, I would like to comment on a provision that is not an official part of the Contract With America but should be given serious consideration for inclusion. This provision is a tax deduction or credit for self-employed persons for the cost of health insurance. The previous tax deduction self-employed persons were allowed to take for 25 percent of the cost of their health insurance premium has expired. This creates both a financial burden and an inequity for self-employed persons.

It is common for a farmer to pay $4,000 or more for health insurance on his family. This is a necessary business expense for the self-employed person, yet it is treated differently for tax purposes than other business expenses.

The inequity occurs because the self-employed person is treated differently than a business that is incorporated. The self-employed person gets no tax deduction for health insurance premiums. However, if the business were incorporated, the corporate entity could purchase health insurance for the family members who are now the stockholders and then deduct the cost as a business expense.

I would urge the Ways and Means Committee to correct both the financial burden and the inequity by allowing self-employed persons to deduct 100 percent of the cost of their health insurance premiums as a legitimate business expense, just like any other business.

In conclusion, I wish to commend the Ways and Means Committee for moving promptly to begin enactment of the Contract With America. My family, my neighbors, and my industry are watching closely to see if the promises made will be kept with the citizens of our Nation.

I urge you to hold true to the principles, the vision, and the mission of the Contract and keep those promises. Thank you for your valuable time and allowing me to participate in this hearing.

Mr. BUNNING [presiding]. Thank you, Mr. Kettler.

I would like to ask Ms. Anderson, your testimony states that in California more than 50 percent of the AFDC caseload consists of women who had their first baby as a teenager.

Do you support the provisions in the Contract With America welfare bill under which the taxpayers would not be obliged to pay cash welfare payments to women under 18 who have children out of wedlock?

Ms. ANDERSON. Yes, we do. But we don't consider them women. We consider the fact that they are still minors, that they are still girls. As I had indicated in my summary, what we are proposing this year in the budget, the Governor is proposing in the budget is what we call a teenage disincentive which says that if you are under the age of 18 and you are on AFDC, that you cannot go off on your own and get your own apartment, that you must stay with your parents, and that if you say that you have been abused by your parents, that we would go in exactly like we do for other child welfare programs, determine whether or not you are in an abusive situation. And if you are, we would then remove you from the home the way we do other children and we would put you in supervised setting.

The hope is we would put you in a family setting with another family. And if not, we would put you in a group home like we do other children now. We would not remove the child from you we would keep the child with you because we don't believe in splitting up families.

But it is our belief, and the Governor is very focused on this, it is our belief that young women under 18 are themselves still children and that they need to be supervised and helped to finish school and do all the kinds of things for them to grow up and become responsible citizens and financially able to take care of their children.

But at the same time, their young children are vulnerable so we don't want them at home in unsupervised settings. I think one has to look at—just imagine a 17 year old, and most of you look like you have teenagers and you know how our teenagers in the United States probably think. I used to say—I have children who are now 29 and 25—that I wouldn't let my 16-year-old daughter take care of the dog. So why would we let a 16 year old be in her own apartment by herself taking care of an infant? I think that doesn't speak well for us as a Nation.

I think the other thing is when we put a teenager in her own apartment, she becomes vulnerable to all the prey that is out there. And if you look at teenage birth information, especially in California, you will see that most of our teenagers do not get pregnant by teenage men.

So I suspect that we need to pay a lot of attention to what we think about young women, how vulnerable we want to make them. And I really do believe when we allow them to have their own apartments, get a cash grant, that we as the government are involved in government-sponsored child abuse.

Mr. BUNNING. Thank you.

I would like to address my remarks to Mr. Moy. If anyone was listening to your story, it is the story of the American dream. I mean, we must restore that in order to make sure that your children and your children's children are able to duplicate the same story that you have.

Mr. MOY. Thank you, Congressman.

Mr. BUNNING. What in your opinion is the most important portion of the Contract that would allow this to happen for you and for your children?

Mr. MOY. Well, I think that the most important part of the Contract With America is the taxing issues and problems that we face, capital gains as I mentioned, the estate tax. I think that we as a country have to help people and not punish people for making money.

I think that that is the most important part of the Contract. And I think we have to address those issues so that as my American dream is the Plum Garden, I can be comfortable and secure in handing that over to my children if they so want it and I think it is as important for Mr. Kettler here and all small businesspeople across the country.

Mr. BUNNING. Thank you.

Mr. Gibbons, you may inquire.

Mr. GIBBONS. Yes. First, I want to say to our witnesses from California, we are concerned about the damage you are having in your State right now. We wish you well in coping with it. And I bring that up because if we go along the path that we apparently are following right now, a couple of years from now we probably aren't going to be able to help you with those kind of natural disasters anymore because there just will not be the money available.

Now, Ms. Anderson, I know you are an expert in welfare and I assume you know a lot about how it is financed. What would be the impact upon California if in all the welfare reform that we do, and apparently this is what we plan to do, we do not keep the fact that a young dependent child is entitled to these benefits, in other words, there is no longer an entitlement to these young dependent children? What impact is that going to have upon the financing of welfare in California?

Ms. ANDERSON. Well, sir, I think it depends on how you structure whatever it is you are going to structure, but I suspect that if we don't have an entitlement, that we will rechange how we think in this country about what our individual responsibilities are and how we will go about that.

I also believe that many people on AFDC right now won't be there, that without an entitlement, they will do other things. I believe one of the things they will do is do family formation.

I believe that if we restructure AFDC or whatever we do in the right direction, that fathers will become far more attractive to mothers in ways that we haven't seen in the past 30 years. I believe that poor men will have much more worth when the mother gets pregnant than he does now. I believe that families would rally around each other in the ways that we have done for hundreds of years when crises happen. I believe Americans would probably

even save more for rainy days the way we did when some of us were younger.

So I believe that if we structure this in the right way, that change always requires some dislocation, but I believe that change is not something we ought to be afraid of. And given however it may look, that I don't think it will be as bad as most of us think it is because I believe the belief right now is that the system we have in place is without harm and that is not the case.

Mr. GIBBONS. Well, I certainly hope that you are correct in all those changes in human behavior. That is something, of course, that only time will tell. But if the balanced budget amendment goes through, and it is probably going to go through, and if the Contract is adopted, and it is probably going to be adopted, there will be a 30-percent cut in Federal spending that has to take place each and every year, which means that probably the Congress will say, well, we are tired of paying these entitlements to the State of California for their poor.

Can the State of California pick up all that burden?

Ms. ANDERSON. Well, you know, I have watched my Governor for the past 4 years tighten our belt and manage and establish priorities. And if you give us the money back in our paychecks and quit taking it out of our paychecks, I think we would be more than happy to let this balanced budget go.

When I see what Governor Pete Wilson has done is that California has been in a recession and he has managed, he has set priorities, he has managed the government the way most families manage their own finances, and I think that we are ready for that kind of a change.

Mr. GIBBONS. Well, I notice that that same Governor has asked for Federal aid for more than half of the California counties as of today and I am not sure that we are going to have the money for those kind of disasters that seem to hit California more than they do other areas in the future. I hope you are right about that.

Mr. Moy, let me ask you a question. Do you have health insurance?

Mr. MOY. Yes, sir, I do.

Mr. GIBBONS. You personally? How about those 32 employees in your restaurant, do you have health insurance for them?

Mr. MOY. Yes, definitely. And what I have done is that I first initiated a policy where they began to work for me and they received a wage and then I gave them incentive to stay with me by offering them benefits.

Mr. GIBBONS. Do your competitors in the restaurant industry supply health insurance for their employees?

Mr. MOY. I believe a lot of them do. A lot of them do and I think they have used this as an incentive to keep staff strong.

Mr. GIBBONS. All right. Thank you.

Mr. BUNNING. Mr. Camp will inquire.

Mr. CAMP. Thank you, Mr. Chairman.

Ms. Anderson, you mentioned in your written testimony and I think in your verbal remarks the current system seems to be void of trust, that no one seems to trust the States. And I think in the debate that we have over the next few weeks and months, how do we satisfy the people who don't trust the States?

And as we look toward block granting programs, possibly, and giving more responsibility and authority to the States I think we are going to hear that from opponents. If you have any thoughts on that I would like to hear them.

Ms. ANDERSON. I think the Federal Government has to do what the Governor has done in his proposal with the counties in California and that is to say let's look to outcomes, let's together decide what are the outcomes that we want to happen in these programs and hold us accountable for those.

And I don't know why—I have some ideas about why there is such a lack of trust, but I think we need to get past yesterday and not build a future on how the States did things 30 years ago or 100 years ago. I think we can sit down and agree on what these programs need to have as outcomes and then give us the block grant and then hold us accountable for that.

Mr. CAMP. Thank you.

My next question really goes to Mr. Moy and to Mr. Kettler. In the Contract With America, the small business—we would increase small business expensing to $25,000 annually. It is currently $17,500. Would that be helpful in the restaurant business, and Mr. Kettler, would that be helpful to farmers?

Why don't you start first, Mr. Moy?

Mr. MOY. Definitely. I bought my first walk-in for $600. I just replaced my walk-in last year for $5,000. So I think there is definitely an inequity there due to inflation and just the cost of goods. I think we should even raise it a little bit more.

Mr. CAMP. Thank you.

Mr. KETTLER. I couldn't agree more with Mr. Moy. I think any time you allow us the latitude to expand, we will take that latitude and we will expand. We will get more efficient. We will make better use of our own money. As Ms. Anderson said, if you give me the means to manage my own money, I will manage it.

Mr. CAMP. I want to thank all the witnesses for their testimony and, Dale, I appreciate you coming all the way from Michigan.

Thank you very much, Mr. Chairman. I yield back the balance of my time.

Mr. BUNNING. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Ms. Anderson, I heard you comment that you did support the elimination of cash payments for teenagers or children having children, but under the Contract, is it not true that only the cash payment would be eliminated, the food stamps and the health care would remain?

Are you familiar with that portion of those provisions?

Ms. ANDERSON. Well, I think that we are—if the child remains at home and—I mean, the teenager remains at home with her parents, then I think it depends on how you want to structure that and I think States ought to be allowed to structure that the way they want to.

If the teenager wants to stay with their own family, then I think giving them a cash amount and setting them up in their own apartment is detrimental to them and to their child long term and we really ought to be looking at the child welfare system for them, which is not a place that we give them food stamps. It is not a

place that we do anything but we provide for them through payments to the foster parents or payments to the group home. And I think that we should think long and hard before we establish a young person in an adult role before they are ready.

Mr. COLLINS. Yes. Well, the purpose of that is to also put in place parental responsibility by having the teenager live at home. This puts the responsibility on the teenager's parents which I think could be very helpful in rendering solutions to children having children if other parents knew they would have that responsibility placed back on them.

Mr. Moy, is your restaurant a family restaurant?

Mr. MOY. Yes, sir.

Mr. COLLINS. With the $500 tax credit for each dependent child at home, then possibly some of those $500 credits would be spent in your family restaurant in your area; is that right?

Mr. MOY. I hope so.

Mr. COLLINS. I do, too.

Ms. Klapperich, I can appreciate your situation. As a young person from the age of about 12 to 17, I, my mother and dad, we took seniors into our home, and that was back in the early fifties, for the purpose of taking care of them before the nursing home ever became popular. And I have seen a lot of elderly people that were in the condition that I see your mother was in and I can appreciate what you went through.

Mr. Kettler, you are a small businessman. You say you are a farmer. A farmer is a small businessman; is that not true?

Mr. KETTLER. That is very true. I am a small fish in a big pond. I can appreciate the things Mr. Moy goes through. I have a small farm in a huge industry called agriculture.

Mr. COLLINS. Maybe you can produce some of those vegetables that Mr. Moy will sell to some of those families that are going to get the $500 tax credit.

Mr. KETTLER. I am going to corner him in the hallway as soon as we leave.

Mr. COLLINS. We plan to reinstate the 25-percent health care deduction. It takes quite a bit of equipment to farm 500 acres of land; is that not true?

Mr. KETTLER. Yes, it is true. We have a huge outlay both in land and in equipment. The most visible, I think, people look at tractors and I always try to bring out the point that having a tractor that may cost between $50,000 and $100,000 is like going to a car dealer and just buying a motor, because a tractor doesn't do anything until you hook things behind it. So you know, there are—it is just a huge investment.

Mr. COLLINS. Annually, what type of investment do you make on equipment, do you have any idea? I know you probably don't buy equipment every year. Say you average it over a 10-year period. What would be the amount of equipment you would purchase in a 10-year period?

Mr. KETTLER. Right now, my tractors and combines are both getting up in age just because we try to maintain our equipment and hold on to it. I probably spend maybe $10,000 a year on maintenance for the 500 acres of farm.

Mr. COLLINS. Well, maintenance is a very important part of equipment, too. I appreciate each of you being here.

Thank you, Mr. Chairman.

Mr. BUNNING. Mrs. Kennelly.

Mrs. KENNELLY. Yes. First, let me thank Ms. Klapperich for coming. I know that you deal with what so many people in America deal with, trying to have children on the one hand and older parents on the other and tuition costs for college go up and parents' health care costs more.

And I thank you for taking the trip and coming and pushing that because long-term care, as we all know, is very expensive and unless we keep talking about it and getting it into the mix, we are not going to do anything about it.

Mrs. Johnson and I have for years looked at long-term care where you get an ability to at least buy insurance to protect yourself, but we keep having to move it and trying to have people get it discussed as we talk about these things that are going to happen very quickly.

So I thank you very much for coming to be with us.

Ms. Anderson, can I just take this a little further with you because we are all wrestling with the situation about what do we do when someone does get pregnant out of wedlock, has a child, and is young. Of course, the best thing is to have them stay at home within the family situation, but as we know, often there isn't an intact family for her to stay in or for some reason she just can't.

And you are suggesting as an alternative a group home where the mother and child would be together with a support system?

Ms. ANDERSON. I am suggesting that, first, we look for a family, a family foster home for her and her child. I think a family setting is the best setting. Children learn how to be a family by being in a family. The best learning tool for a family is being within one.

If that is not appropriate and for every young woman or young girl that will not be appropriate and then we would put them in a group setting with other young girls who have children where they would be supervised, where they could finish their high school education, where they can learn the kind of parenting skills they need, where we can teach them the kind of financing skills they need, where we can teach them cooking and all those other kinds of home maintenance skills they are going to need as they get out on their own. So I am not thinking about and the Governor clearly is not thinking about putting these young girls out on their own with their infants.

Mrs. KENNELLY. I do know your Governor has supported staying at home, staying in school.

Ms. ANDERSON. Yes.

Mrs. KENNELLY. That is in a family setting.

Ms. ANDERSON. Yes.

Mrs. KENNELLY. Of course, you have eliminated, as so many others have, the idea of separation of mother and child.

Ms. ANDERSON. Yes.

Mrs. KENNELLY. You are looking at foster care to support the foster care we have now.

Ms. ANDERSON. Yes. Actually, we are seriously saying that for us when a teen mom cannot live at home, it is not an income transfer

issue, it is actually a child protection issue and that we need to start treating it as if it was a child protection issue.

And what we have done in the past is treat it as an income transfer issue, so we send money and we don't pay attention to what is going on. Our view is we need to stop doing and we need to start treating her as if it were a child welfare issue and treating her like all other children who are being abused and neglected by their parents.

Mrs. KENNELLY. And 18, would that be the cutoff?

Ms. ANDERSON. Yes. That is an adult in our society now, but if she hasn't finished high school, we have a Cal-Learn program that I think goes up to the age of 19 which tries to get her to finish high school.

One of the things that we look at is that teen moms who don't finish high school have a high chance of creating that situation all over again. So high school education is clearly important to us and we have the Cal-Learn program in place that supports high school completion, it supports good, decent grades, and it has a sanction in for children who don't produce good grades. And it is for pregnant and parenting teens.

Mrs. KENNELLY. Thank you for these positive suggestions. Thank you very much.

Mr. BUNNING. Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

I thank the panel for coming today. I didn't get a chance to hear your testimony, but I have read your remarks and I am reminded why I came to Washington and it is because of you that we are out there fighting to make this a better place to live.

My family is in the family farm business in Nebraska and my entire family farms, and I can't tell you how much I heartily agree with each of your points in your written testimony here. You are not rich when you have a $600,000 farm when you are talking about equipment and land.

And for that to be the minimum as far as estate tax exemption and we are going to raise that to a paltry $750,000, that is hardly an increase when you are talking about the family farm. And you can count on this Congressman to do everything he can to get it to a slightly higher number where it will help more farmers.

Mr. KETTLER. Thank you very much.

Mr. CHRISTENSEN. I hope that we can do that.

Mr. Moy, I would like to ask you a question on the minimum wage because there is some talk about raising the minimum wage.

I was wondering what your thoughts are on that and if raising the minimum wage was sending exactly the wrong signal to small business owners because maybe we should have a subminimum wage for these high schoolers that get out and go to work rather than raising the minimum wage.

Won't a minimum wage increase do almost just exactly the opposite of what we should do?

Mr. MOY. I agree with you, Congressman. My feeling is that if the minimum wage was increased, it would be detrimental to our industry especially because we start out people right away, we accept people as they come in without any type of formal education and I feel that it would hurt the small business operator like my-

self if we are faced with the increased cost of an increase in minimum wage. So I think there is a potential for indexing, like you say, but I think that as an entry level job supplier to this country, the increase in minimum wage would really hurt us.

Mr. CHRISTENSEN. Yesterday we heard testimony from one of the witnesses that you have a 93-percent chance of staying off the poverty rolls if three simple things happen: One, you graduate from high school; two, you have a job; and three, you don't have children out of wedlock. Three very simple measures, but three that seem to be very hard for this society to achieve. Basically 7 percent of the people—7-percent chance of hitting the welfare rolls if those things don't happen.

And Ms. Anderson, in California, I was wondering what is being done to encourage more of our young people toward not having illegitimate or out-of-wedlock births. What is being done as far as your State is concerned?

Ms. ANDERSON. We have got two things happening. One is we have the Cal-Learn program that emphasizes pregnant and parenting teens in schools. It says we want you to go to school and be successful in school and if you are successful, we give an increase in your grant. If you are not successful, we will give you a decrease in your grant.

We also have case management around that because we think when in many cases when a young person has a child out of wedlock, there are other issues that are going on in that family and we want to try to get in and deal with those other issues.

The other thing that we have in that proposal is to say if you get pregnant and you are a minor and you want to leave home, we are not going to let you do that—at least we are not going to support that with a paycheck. And if you say that you are being abused at home, that we will then move you to a foster family setting and if that is not appropriate, to a group home.

So we are doing everything, at least with the AFDC caseload, that we can to stress high school education, but we have also done things in the larger AFDC program. We have said that we believe that a couple of things need to happen, that we believe in work and that AFDC should be—work should be more than AFDC.

So we have changed the structure of our program around. We have cut the AFDC grant, but we have allowed people on AFDC to make back every dollar that we have cut through work. We have also said that one of the things that has to happen on AFDC they have got to be able to save. I call it the American dream account. You can't—every time you make a dollar, put a little bit in the bank, we can't take that away from you.

One thing that, at least everything I have learned about this country we do is we future. The only way you can future is to be able to put something aside. So we allow people to have a savings account, keep up to $2,000 in one savings account which we call a rainy day account. And we have what we call the American dream account and with that savings account you can save for a home, you can save for your own business, and you can save for your college education for your kids.

It is important that we believe that we give a new message in AFDC and that message is that we think that you are a rational,

capable human being, capable of getting out here and doing everything else everybody else is doing, that we are not going to treat you differently, that we expect if you have a child that you and the father will jointly be responsible for that.

And every now and then, a crisis is going to occur that you are going to be in bad times. We expect to be there in crises but we do not expect this to be a lifetime place for you to be.

And so with that message getting out there, hopefully kids will say, gee, this isn't what I want to do, this is not what I want to do with my life.

Mr. CHRISTENSEN. Thank you.

Mr. BUNNING. The gentleman's time has expired.

Mr. Shaw will inquire.

Mr. SHAW. Thank you, Mr. Chairman.

Ms. Anderson, you are associated with Riverside County?

Ms. ANDERSON. Riverside County is one of the counties in California, yes.

Mr. SHAW. It is one of the programs that we often hear about as being a very successful program. How do they go about motivating these youngsters where these other programs are failing?

Ms. ANDERSON. If you ever met Larry Townsend, you would know this is a man—I have known a lot of welfare directors—who actually believes that his clients are capable and can do something. I mean, he talks about work every time I see him. He sends me CDs that his people make about work. He goes out and looks for jobs. His employees go out and look for jobs. His clients go out and look for jobs. He really stresses work. I think that makes all the difference for him and I believe if we could remove some of the barriers that we have, he would even have more people working. And I think it is an attitude difference and he has a serious attitude difference.

Mr. SHAW. I have met him and I agree with you. Would you expand on what some of these barriers might be? Would you say one of the barriers is the current welfare program?

Ms. ANDERSON. One of the barriers is the current welfare program, yes. A couple of the barriers is the paperwork you ask us to do. If a worker, an income maintenance worker has a person on their case who has a job, it is a huge workload. So if I am a worker and you come up to me and you tell me I got a job, I am going to be real upset with you because you have just made my work really more difficult. So we got a lot of incentives in here for the recipient not to work because you are going to make my job harder if you work. Then we have a lot of——

Mr. SHAW. Is that Federal redtape?

Ms. ANDERSON. A lot of it is Federal, some of it is State, based on the Federal regulations, that we need to undo the way we have structured the program, that we really talk about education first and a whole lot of other things we want you to do.

I think we have to believe that work is one of the best educational tools there is out there and that when people go to work and they learn about work, sometimes they are not going to be successful, but over time they will be successful and that we need to move away from more of this in the classroom stuff and more into the work force stuff.

Mr. SHAW. Did you hear Governor Weld this morning?

Ms. ANDERSON. Yes, I did.

Mr. SHAW. He spoke to that question.

Ms. ANDERSON. Yes, he did.

Mr. SHAW. And he said he was a great believer that the best place to learn a skill is to work.

Ms. ANDERSON. That is right. I agree with him totally.

Mr. SHAW. You agree with that?

Ms. ANDERSON. I agree with that totally.

Mr. SHAW. Is that partly because of the attitude change that is necessary to instill in these people?

Ms. ANDERSON. Yes. I think people have to know that you expect something out of them. I think that the human animal is like any other one, we live up or down to your expectations. If we have no expectations of people, they live right up to those no expectations. If we have expectations of them, they live up to those.

We have a system that has no expectations. It doesn't expect anything out of people and it gets nothing out of them. We need to change that expectation system around and people live up to that.

We also need to—I always say we treat these people like they are not capable. They can bring any excuse to us and then we let them off the hook. We need to stop that. We need to demand things out of them, hold them accountable, and they will come around.

And we don't do that. They bring us an excuse and we go with it and we just let them get off the hook all the time. And I think we need to change that way of dealing with them.

I think one of the problems that we have is that if the system went away, what would happen to us, the bureaucrats. I think we are scared of our own unemployment, not their employment. And I think we need to be very aware of that.

Mr. SHAW. Well, I think that many of the bureaucrats are going to have to adopt the attitude that you have that they will lose their jobs. Thank you.

Thank you, Mr. Bunning.

Mr. BUNNING. Ms. Dunn.

Ms. DUNN. Thank you, Mr. Chairman.

And I apologize to the witnesses but I was detained in my office and couldn't be here to hear your statements and the questions. So please stop me if I am asking something that is repetitive.

My concern right now is where the responsibility lies for all the parts of the welfare reform program that we are trying to design here in the committee. And I have heard the Governors state that they would like us and read that they would like us to send block grants to their States with no strings attached.

If that were the case, I don't understand why the money would need to come through the Federal Government where it goes through a buffer of lots of bureaucrats and takes away a huge amount of money that could be effective in the States.

And so I would like to ask you, Ms. Anderson, do you have a sense, if you were designing the program that we are putting together from all the alternatives, of what responsibilities you would like to see left with the Federal Government versus what you

would like to see the States assume as we turn back more responsibility to the States?

Ms. ANDERSON. Well, when I think about that, I sort of would like probably a lot less of the reporting that we have to do. I would like to not to have a waiver process to do something. I would like to figure out what are your needs in terms of outcomes, what are you looking for, and for us jointly to determine what the outcomes of this program ought to be and figure out how we can get there.

I don't know if we—if you should look at just AFDC when you look at this program. I think you ought to look at a larger view. I think you need to bring the Wagner-Piesner Act, the Carl Perkins Act, the disability Federal regulations, the alcohol and other drug regulations into place, because when you look at the population on AFDC, I think you need to look at that whole variety of things and not narrowly focus on just AFDC because I think there are a lot of things that impact this program that I wish you would put on the table.

And I think that I have heard and I know that Governor Wilson clearly doesn't mind being held accountable, giving us taxpayer funds. He is not suggesting you put the money on a stump and run. He is suggesting you give us a lot more flexibility, give us reasonable outcome measures and we would be held accountable to those.

Ms. DUNN. Good. And I am sure you have discussed, since you are from California, the issue of the legal aliens, but could you state for my information whether you believe that that should—that that should remain a guideline that the Federal Government requires that there be no funding for welfare for legal aliens?

Ms. ANDERSON. Governor Wilson is very clear on legal aliens, that he believes that they enhance the country. He supports them. But when you bring them into the country, that you carry out, the Feds keep up their responsibility. If you say that you are going to be there for 5 years with them in terms of funding, to do that when you bring refugees in. We have a 36-month, right now, responsibility, which the Feds haven't lived up to. We want you to live up to that so in the area of whatever you do on the legal immigration side, we hope that you just keep your word and your promise with that and if you bring people in, that you support them the way you said and you don't walk away from that.

Ms. DUNN. If we did not retain the strings that are attached to States that say you may give no funding to legal aliens, would the State of California fund welfare for legal aliens?

Ms. ANDERSON. If you say that we would not give funds to legal aliens, I think the Governor has been very clear that he has not ever suggested that we would not provide services to legal aliens. It has always been the illegal aliens that has been at issue.

Ms. DUNN. Thanks.

Mr. BUNNING. Ms. Klapperich, I would like to ask just a couple of questions because H.R. 8, which is the Senior Citizens' Equity Act, addresses some of the problems that you might have had.

Has Medicaid or Medicare paid for any of your mother's long-term health care problems?

Ms. KLAPPERICH. No. They pay for some of her medications once her other insurance has picked up some of the costs.

Mr. BUNNING. Would you like for your employer to offer you the option to purchase long-term health care insurance?

Ms. KLAPPERICH. Yes.

Mr. BUNNING. That is part of H.R. 8.

Ms. KLAPPERICH. Yes.

Mr. BUNNING. The Contract With America provides for a similar treatment for long-term care health insurance such as that for health and accident insurance. Long-term health care premiums would be excluded from the employee income and would be deductible as a business expense for the employer.

What effect would this proposal have on your decision to purchase long-term health care insurance for yourself?

Ms. KLAPPERICH. Having had the experience that I have had with my mother, there is no question that I would purchase long-term care insurance whether there are tax incentives to do that or not.

My husband and I are very committed to long-term care insurance and try to let everybody we know hear about it and know what our experience has been. If there were tax incentives to do it, of course, we would be thrilled with that, but it is something that we are going to get anyway.

Mr. BUNNING. The Chairman would like to thank you for your testimony. When we hear from the real people, as we call the people that come like you to our committee and testify, we really appreciate your effort. Some of you have come from long distances. Thank you for being here and we are looking forward to seeing you again.

Thanks.

If the next panel would please be seated. John Motley, NFIB; Carol Ball from the board of directors of the U.S. Chamber of Commerce; Paul Huard, National Association of Manufacturers; and Sheldon Friedman, the AFL–CIO.

Since we have one of our leadership people with us, the chairman of our conference, he has a special introduction that he would like to make.

Mr. Boehner.

Mr. BOEHNER. Mr. Chairman, I appreciate the opportunity to introduce to the committee a constituent, more importantly a close friend of mine from my district. I owe a great deal to Carol Ball, who is with us today representing the U.S. Chamber.

When I decided to run for Congress, no one knew me in the northern part of my district. Carol was one of the first people aboard my campaign. She and I had worked closely in Columbus on business issues that came before the State legislature in Ohio and became very good friends. And I think I can say safely today that if it weren't for Carol's help, I wouldn't be in the Congress today. Probably some of my colleagues wish that was the case. You don't have to speak up now.

But Carol founded and runs Ball Publishing Co. in Darke County, Ohio, and they publish a paper called the Early Bird. It is really the first countywide newspaper in Darke County. She served as a national board member for the U.S. Chamber of Commerce. In addition, she serves on her local chamber and has been instrumental in helping build it into a successful organization.

Carol understands the meaning of success because she has had to do it on her own. She fully appreciates I think the hardships and difficulties experienced by many small businesspeople because of the oppressive tax policies of the Federal Government. I often turn to Carol for advice on matters that are affecting small businesses. I believe that she can provide valuable wisdom and insight for this committee and for this Congress.

And Carol, I would like to welcome you to the Ways and Mean Committee on behalf of your Member of Congress.

Welcome.

Ms. BALL. Thank you.

Mr. BUNNING. Since Mr. Boehner has done such a great job in introducing you, we will let you start us off, Ms. Ball.

STATEMENT OF CAROL L. BALL, REGIONAL VICE CHAIRMAN AND MEMBER OF THE BOARD OF DIRECTORS, U.S. CHAMBER OF COMMERCE, AND PUBLISHER AND CHIEF EXECUTIVE OFFICER, BALL PUBLISHING CO., ARCANUM, OHIO

Ms. BALL. Thank you, Congressman Bunning, and thank you so much, Congressman Boehner, for that very kind and generous introduction.

I am here today in my role as regional vice chairman and member of the board of directors of the U.S. Chamber of Commerce and even though I may be summarizing some of the notes I have in front of me, I do ask that my statement be placed in the record.

Mr. BUNNING. Without objection.

Ms. BALL. And the chamber does greatly appreciate having this opportunity to testify before the House Ways and Means Committee on the House Republican Contract With America.

Since its inception, the chamber has been dedicated to one basic goal: To advance human progress through an economic, political and social system based upon individual freedom and incentive, initiative, opportunity, and responsibility. We believe achievement of this goal requires the combined efforts of both the public and the private sectors and clearly the Contract With America shares this vision by placing our fiscal house in order, reducing the intrusiveness of Federal regulations, providing for the safety of our citizens from both internal lawlessness and external forces, creating incentives for individuals to get and keep jobs, and reducing the tax burden on individuals and businesses. The tenets of the Contract go to the heart of the America fabric.

We commend Speaker Gingrich and the chairman of the committee and the other members of the committee for addressing these issues so early in the new Congress. The Contract covers numerous proposals grouped into 10 areas. A number of these reflect longstanding chamber policies and priorities.

Last October, the chamber surveyed our entire membership on these issues. Unfunded mandates and the balanced budget amendment were rated the two most important issues with capital gains tax cuts, welfare reform, and regulatory relief close behind. And more recently the chamber surveyed the 800,000 readers of its magazine, Nation's Business, on the 10 areas included in the Contract.

Here again, the support for the balanced budget amendment, reductions in individual tax rates, capital gains tax cuts, welfare reform, and regulatory relief was overwhelming.

The chamber is committed to working with you on these provisions of the Contract and on other critical pieces of legislation that will be considered during the balance of the year to make them a reality. And let me turn to those provisions of the Contract that fall directly under the purview of this committee.

Tax policy has a large role in our economic environment and good tax policy can stimulate investment, foster new business creation, spur job growth, encourage individuals to work and save more, but however, bad tax policy can retard capital formation, hinder entrepreneurship, reduce job growth, and discourage the work force. The chamber has long championed the need to reduce the tax on capital gains. Cutting the capital gains rate and indexing capital investments for inflation would spur investment activity, create jobs, and expand the economy, benefiting all income classes.

In 1993, 55 percent of the individual income tax returns reporting capital gains were filed by taxpayers with adjusted gross incomes under $50,000 and 73 percent of the returns with adjusted gross incomes under $75,000. An adoption of a neutral cost recovery system also has been long advocated by the chamber, allowing businesses to fully recover the economic costs of their depreciable assets. And we also support increasing the amount of equipment purchases the business can immediately expense from $17,500 to $25,000 per year. We believe this provision would encourage businesses to invest more. And the current $600,000 estate and gift tax exemption has never been indexed for inflation nor increased since it was fully phased in in 1987. We need to look at this.

In addition to the aforementioned provisions, there are a number of proposals that could lessen the tax burden of families, married couples, and the elderly. The chamber believes that reducing the tax burden on these sectors and returning disposable income to those who earned it will enhance consumption, boost economic activity, and encourage added participation in the work force.

These are some of the problems we face. We are here to help you. We look forward to working with you and we thank you for having us here today.

[The prepared statement follows:]

TESTIMONY
on
THE CONTRACT WITH AMERICA
***before* the**
HOUSE COMMITTEE ON WAYS AND MEANS
for the U.S. Chamber of Commerce

by
Carol L. Ball
Regional Vice Chairman
January 12, 1995

Mr. Chairman and members of the Committee: good afternoon. I am Carol L. Ball, Publisher and Chief Executive Officer of Ball Publishing Company located in Arcanum, Ohio. I am here today in my role as Regional Vice Chairman and member of the Board of Directors of the U.S. Chamber of Commerce.

The Chamber speaks for large and small businesses from every line of commerce and industry, from the smallest communities to the largest cities of America. We represent 215,000 businesses, 3,000 state and local chambers of commerce, 1,200 trade and professional associations, and 72 American chambers of commerce in 65 foreign countries.

The Chamber greatly appreciates this opportunity to testify before the House Ways and Means Committee at the outset of this historical transition to address the House Republican *Contract With America*.

Since its inception near the turn of the last century, the Chamber has been dedicated to one basic goal. In fact, this goal is expressed in our mission statement: "To advance human progress through an economic, political and social system based upon individual freedom, incentive, initiative, opportunity and responsibility." The Chamber believes that achievement of this goal requires the combined effort of both the public and private sectors. The government's role is to create an environment that is safe from both outside aggression and inside strife, protects individual freedom and encourages prosperity. Within such an environment, the private sector can do its part by creating a vibrant economy, a rising standard of living and a business sector that is competitive in the global economy of today and tomorrow.

Clearly, the *Contract with America* shares this vision. By placing our fiscal house in order, reducing the intrusiveness of federal regulations, providing for the safety of our citizens both from internal lawlessness and external forces, creating incentives for individuals to get and keep jobs, and reducing the tax burden of individuals and businesses, the tenets of the *Contract* go the heart of the American fabric. We commend Speaker Gingrich and you, Mr. Chairman, on the *Contract* and for beginning the process of ridding the business community of government impediment that too often stifles growth.

A number of these provisions reflect long-standing Chamber policies and priorities. Last October, the Chamber surveyed its entire membership on these issues. Unfunded mandates and the balanced budget amendment were rated the two most important issues for American business. Capital gains tax cuts, welfare reform and regulatory relief were close behind. More recently, the Chamber surveyed the 800,000 readers of its magazine, *Nation's Business*, on the ten items included in

the *Contract*. Here again, the support for the balanced budget amendment, reductions in individual tax rates, capital gains tax cuts, welfare reform and regulatory relief was overwhelming. The Chamber is committed to working with you on the provisions of the *Contract* and other critical pieces of legislation that will be considered during the balance of the year to make them a reality.

Let me turn now to those provisions of the *Contract* that fall under the purview of this Committee. Tax policy plays a disproportionately large role in our economic environment. Good tax policy can stimulate investment, foster new business creation, spur job growth and encourage individuals to work more and save more. However, bad tax policy can retard capital formation, hinder entrepreneurship, reduce job growth and discourage the work force.

For example, implementation of a luxury tax several years ago not only failed to produce anticipated revenues, but devastated the entire pleasure boat industry. Elimination of the capital gains deduction in 1986 resulted in fewer capital transactions, lower investment and less overall tax revenue. The first of these mistakes has been corrected; the latter awaits your efforts.

The Chamber has long championed the need to reduce the tax on capital gains. Cutting the capital gains rate and indexing capital investments for inflation would spur investment activity, create jobs and expand the economy -- benefiting all income classes. In 1993, 55 percent of the individual income tax returns reporting capital gains were filed by taxpayers with adjusted gross income under $50,000, and 73 percent of the returns were with adjusted gross income under $75,000. Furthermore, capital-gains rate reductions have historically proven to be a revenue-raiser for the federal government.

Adoption of a neutral cost recovery system also has long been advocated by the Chamber. Because inflation erodes the value of capital expenditures, companies never fully recover the true economic value of their investments through depreciation. Neutral cost recovery would permit businesses to fully recover economic costs by allowing upward adjustments to the historical cost bases of their depreciable assets. These adjustments would stimulate investment, enhance productivity growth and increase economic activity.

The Chamber also supports increasing the amount of equipment purchases that businesses can immediately expense from $17,500 to $25,000 per year. We believe this provision would encourage businesses to invest more resources into productivity-enhancing equipment because it would reduce their up-front capital costs. Accelerating the timeframe that businesses can depreciate their equipment would give owners an incentive to purchase additional equipment and expand their businesses sooner rather than later. Along with the *Contract's* capital gain reform and neutral cost recovery provisions, increased Section 179 expensing would help stimulate much needed capital investment in this country.

The current $600,000 estate and gift tax exemption has neither been indexed for inflation nor increased since it was fully phased-in in 1987. The current system depletes the estates of those who have saved and can force a successful family business to liquidate. The relatively low threshold for imposing estate and gift taxes motivates people to make financial decisions for gift and estate tax reasons rather than for investment and business objectives, needlessly wasting resources that could be put to productive use. Reducing the need for expenditures of time, energy and money for non-productive pursuits would permit business owners to devote their efforts and capital to the country's economic growth.

One of the biggest problems facing the American economy today is the decline in the rate of savings. Savings is the yarn used to weave the American economic fabric. Insufficient savings means inadequate capital formation, faltering productivity growth, flagging real wage growth and a lower standard of living. The Tax Reform Act of 1986 reduced the incentives for savings and capital formation by curtailing individual retirement accounts for many individuals. The Chamber believes that reintroduction of a tax-exempt savings vehicle would provide a significant help in correcting this deficiency.

In addition to the aforementioned provisions, there are a number of proposals that would lessen the tax burden of families, married couples and the elderly. The Chamber believes that reducing the tax burden on these sectors, and returning disposable income to those who earned it, will enhance consumption, boost economic activity and encourage added participation in the work force -- all of which help to create a more vibrant economy.

Too often in the past, our government has compounded economic and social problems by imposing needless regulation, increasing our tax burden, removing incentives to work and thwarting the decisions of the marketplace. Nowhere is this more obvious than in the fiscal mismanagement of our government finances. More than 25 years of excessive spending have saddled us with large annual deficits and a growing level of debt. The Balanced Budget Amendment would go a long way toward restoring fiscal responsibility and enhancing credibility. The Chamber urges you to pass this amendment and send it to the states for ratification.

You, the members of the Ways and Means Committee together with the balance of the 104th Congress, have the opportunity to change our destiny. The provisions outlined in the *Contract with America* provide a clear and bold first step. You have already achieved a remarkable, inspiring and historical beginning and we at the Chamber look forward to actively working with you to complete the process.

Thank you. I would be happy to answer any questions.

Mr. BUNNING. Thank you, Ms. Ball.

Mr. Motley.

STATEMENT OF JOHN J. MOTLEY III, VICE PRESIDENT, FEDERAL GOVERNMENTAL RELATIONS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. MOTLEY. Thank you, Mr. Chairman.

First of all, let me say it is a pleasure to follow my good friend, Carol Ball, here who has been an active member of not only the chamber but NFIB for years and she gives a great deal of herself, as you know, Congressman Boehner.

Thank you for the opportunity of coming here today and testifying on behalf of the NFIB and our 600,000 members across the country, specifically on those elements of the Contract which come before the jurisdiction of the Ways and Means Committee. I have a lengthy statement which I will submit for the record and summarize for the committee.

First of all, let me share with you five criteria by which we believe most small businesspeople judge any actions in the tax area. First of all, keep it simple. Complexity is the bane of small business owners. Many of them even to this day do not hire accountants to do their books; they do them themselves just like they do most other things in their businesses themselves.

Second, cash flow is the key. Having money up front rather than applying for deductions and credits later on is critical to the life or death particularly of newer businesses.

Third, capital formation is needed for growth. Once you survive, then you have to worry about the next phase, how you are going to grow the business and how you are going to get the capital to do it.

Fourth, tax policy needs to promote economic growth for the country as a whole because small business both rises or falls with the economy of the rest of the country.

And last, it needs to be fiscally responsible. The day has passed when we can do things in this country where we are not willing to pay for them up front.

How do small business owners feel about the Contract? Generally they support the Contract With America because it addresses their deep concerns about the role of government in the day-to-day operations of their businesses. Specifically, they feel more strongly about some elements than others, such as expensing, estate taxes, and capital gains because these elements are more small business friendly than some of the other elements in the Contract, but as a whole, they believe that it is something that needs to be done. It is one of the reasons that they went to the polls in November in record numbers. Let me comment briefly, if I can, on several of those aspects of the Contract that we believe small business owners support very strongly.

First of all, the expensing of capital assets is a vastly preferred method of depreciation within the small business community. It is simple. It helps firms' cash flow and it encourages investment in economic growth across the board.

Second, clarifying the home office deduction, which needs to be clarified and also needs to be broadened from the recent court deci-

sions because it is very confusing to people who want to start small businesses in their homes. And in many cases, the home is the cradle of new small businesses in this country. I have a number of relatives who still run their businesses out of their homes, even though their businesses have grown beyond the point of just being day-to-day or every-other-week affairs. Also, as we move into the information age and into the technology age, I believe that home-based business is going to play a greater and greater role.

Therefore, we have to provide clarity. And what is in the Contract With America is a great step in this direction and we would strongly urge you to be very specific in the report language that goes along with the bill to the floor.

Third, easing the estate tax burden. Estate taxes destroy successful businesses that have been built over lifetimes and they drain them of resources that they can use for more productive purposes. The burden needs to be reduced, and if you have any other goals in the future, eliminated completely. There is no reason why we should destroy successful businesses in the country.

Fourth, cut and index capital gains because it will attract capital to small businesses and reward risk takers and we need them.

And fifth, reduce middle-class taxes. Most small business owners are part of the middle class. The average income of NFIB members is about $40,000 a year. And a cut in individual taxes in any shape or form provides cash flow for those businesses.

Let me very quickly suggest six other areas where NFIB believes you can expand on the Contract and also perfect it. First of all, and most important, to provide a 100-percent deduction for self-employed individuals for the purchase of their health insurance. The 25-percent deduction that they had before is gone and they are one of the largest single groups of people in this country without health insurance today. Twenty-two percent of them don't have it and by providing them equity with larger firms, you can encourage them to go out in the marketplace and purchase health insurance.

And second, let me also suggest that you closely take a look at exempting all closely held business, farm and ranch assets from estate taxes completely. By our estimation, the revenue loss is only $1.2 billion a year, and for that you can exempt it and ensure that no business is ever destroyed because of a tax collector and no jobs are lost because somebody has to pay estate taxes in this country.

On expensing, we think $100,000 is a better figure than the $25,000 that is the Contract. If you want to provide the equivalent of expensing, why not just provide expensing?

On capital gains, exempt investments in smaller businesses which need the money a great deal and do not have access to the public securities market to raise capital. Exempt those investments completely from capital gains.

Simplification is needed. Myriads of forms and accounting methods for the smallest firms are a big problem and you should think seriously about allowing the smallest firms to use simpler methods, even though they may not be as precise, until they grow to the point where they have to be very precise in identifying their income.

And last, the whole question of independent contractors is terribly, terribly confusing not only to independent contractors but to

the people who employ them. It is a real problem and needs to be defined, and what we would suggest is a second safe harbor which has several simple tests in it which give these small business owners some degree of certainty.

I would like to conclude, Mr. Chairman, with just a word about rates and to remind the committee that most small businesses in the United States are unincorporated. More than 80 percent of the business tax returns that are filed in this county are filed as individuals—either proprietorships, partnerships, or subchapter S corporations. Fifty percent of NFIB members file that way.

And successful self-employed individuals have been hit tremendously since 1990 with tax increases, roughly a 60-percent increase since 1990 in taxes that the successful small business self-employed people pay.

Therefore, we would suggest that if you want to provide a significant tax reduction to small business owners in this country, provide them cash flow and capital formation, that you should seriously, at some point in time, take a look at reducing rates as proposed in the bill introduced by the Speaker and Mr. Armey just before the conclusion of the last Congress.

Thank you.

[The prepared statement follows:]

STATEMENT OF

JOHN J. MOTLEY III

VICE PRESIDENT
FEDERAL GOVERNMENTAL RELATIONS

NATIONAL FEDERATION OF INDEPENDENT BUSINESS (NFIB)

Subject: The Contract with America: A Small Business View

Before: House Committee on Ways and Means

Date: January 12, 1995

Thank you, Mr. Chairman. My name is John Motley, and I am Vice President for Federal Governmental Relations for the National Federation of Independent Business (NFIB). NFIB is the nation's largest small business advocacy organization, representing over 600,000 small business owners from all fifty states. The typical NFIB member has five employees and has $250,000 a year in gross annual sales. NFIB sets its public policy positions through regular polling of the membership.

Goals of the Contract with America

Mr. Chairman, I appreciate the opportunity to participate in this hearing examining the provisions of the Contract with America that fall within the Ways and Means Committee's jurisdiction. The process in which you are now engaged is historic -- it is the beginning of a debate that will hopefully lead to a substantial reduction in the tax, spending, and regulatory burden imposed by the federal government on the small business community and the American people.

Small business owners have a tremendous stake in the outcome of this debate. The economic goals of the Contract with America -- less taxes, spending, and regulation -- are what small business owners have wanted for years, as shown over and over again in NFIB surveys. In 1986, small business owners identified their federal tax burden as the third biggest problem facing their businesses, according to a study done in that year by the NFIB Education Foundation entitled *Problems and Priorities*. Then, a follow up study published in 1992 showed federal taxation moving up to the second biggest problem faced by small employers. And in a study completed by the NFIB Education Foundation in October of 1994, entitled *Small Business Economic Trends*, small business owners identified their tax burden as the number one problem facing their businesses.

In that same 1994 survey, regulation and red tape was identified as the second largest problem of small business owners, after holding the top spot in the previous survey. Finally, numerous surveys have shown over the years that **small business owners want the size and scope of the federal government scaled back, and that they want to balance the budget through spending cuts, not tax increases.**

NFIB members have been sending a clear message to every level of government in the country for years: **Get off our backs, out of our pockets, and off our land.** Throughout our testimony, we will make recommendations that we believe will make parts of the Contract more small business friendly, but **it is important to state NFIB and its members support the Contract enthusiastically and embrace its goals.**

Small Business: America's Path to Jobs and Independence

Small business has a huge stake in the outcome of your deliberations on the elements of the Contract before this committee. It is equally true that America as a whole has a huge stake in how small business fares in whatever tax and economic legislation this committee reports. Evidence continues to clearly suggest that small business plays a unique and rather remarkable role as a job creator and provider of personal opportunity, security and independence for millions of Americans. Consider the following:

Jobs. Since the early 1970s, small firms have created two of every three net new jobs Bin this country (created jobs minus lost jobs). A substantial majority of that job growth came in the very smallest firms -- those with fewer than five employees. The nation's small business job machine has shown a capacity to produce in either good or tough times. **From 1989 to 1991, a period of minimal economic growth, firms with fewer than 20 employees created all net new jobs in the country. Firms of all other sizes lost employment during that period.**

Demographics. Almost all businesses are small businesses. There are approximately five million employers in the United States. About 99% of them are small employers. And almost all small businesses are very small -- so-called Mom-and-Pop, Main Street, family enterprises. More than half of businesses with employees employ fewer than five people. Almost 90% of employers employ fewer than 20. Small business as a whole employs more than half of the private sector workforce. **Most small firms are not set up as C corps, but as proprietorships, partnerships, and subchapter S corporations.**

Values. Small business holds out to our citizens great hope. Small business offers a road map to the American dream that allows any American with a good idea and talent to follow it to economic freedom and security by starting their own business and working hard to make it a success.

It is this culture, these values, that primarily drive people to start a business -- not because they have money or want to make a lot of it. In a 1991 NFIB Education Foundation study entitled *New Business in America*, new business owners were asked why they went into business. Answers such as "Use my skills," "Control over my own life," and "Build for the family" were all cited twice as frequently by respondents than was "Earn Lots of Money." And having money to start with is not a distinguishing factor in wanting or being able to start a business and pursue the American dream. **More than half of all businesses begin with less than $20,000 in capital. One in four of *Inc.* magazine's 500 fastest growing companies in 1992 started with less than $5,000.**

None of this should lead you to believe that surviving as a small employer is easy. To the contrary, it is difficult. About half of all businesses do not survive the first five years.

There are numerous reasons why businesses fail. One of them is government -- government taxes, government red tape, government regulations, and government paperwork. That is why what you do here in the first 100 days of the 104th Congress is so important. You have a unique challenge and opportunity -- an opportunity to free small business owners and entrepreneurs from the drag of government so they can do what they do best, create opportunity and wealth for the American people. The rest of this testimony will look at how the Contract and the changes it makes in tax policy can foster further small business creation, growth, opportunity and jobs.

Small Business and Tax Policy: What's Important

Before examining individual items in the Contract with America, I would like to propose a set of criteria by which you can judge the value of tax cuts and reforms to small business owners. Of course, every business owner, regardless of the size of their business, wants to pay less in taxes. **But it would be a mistake for you to think that both the small and large business owners would always agree about how to deliver tax relief.** Small business owners face a unique set of problems running their businesses, and they want a tax code that either reduces those problems, or at the very least does not aggravate them.

When making your decisions about how to cut taxes, NFIB and its members hope that you would think about what we call the Three C's of small business and taxes: Complexity, Cash Flow and Capital Formation.

■ **Complexity is the bane of small business owners.** Most perform numerous roles within their business -- manager, marketer, sales associate, benefits administrator, bookkeeper and accountant. Unlike large firms, there is no legal counsel down the hall to read new IRS regulations. There is no software, and in many cases, no computer, to assist in properly depreciating a piece of equipment or figuring out the alternative minimum tax. And in many cases, a small employer cannot afford to consult an accountant or tax advisor to help determine the best way to utilize the tax code. **Tax regulations and paperwork destroy small businesses.**

In 1992, the burden of regulation and paperwork was the fastest rising problem identified by the NFIB Education Foundation's *Problems and Priorities* study, registering as one of the top ten problems for small business. In 1994, regulation and paperwork topped the list of small business problems for a time, and remains second today. Why is this significant for this committee's deliberations? Because the IRS is by far the biggest paperwork and regulatory problem for small business owners -- bigger than OSHA, EPA, DoL, and others. **Regulations and paperwork associated with paying taxes are in and of themselves a tax -- a regressive tax that is higher per capita on small firms than on large firms.** For these reasons, reducing the complexity of our tax code for small firms has been a major NFIB goal for years and a lens through which we believe this committee should look at tax proposals in the Contract.

■ **Cash flow, not profit, is the key to starting a successful small business.** In *Problems and Priorities*, cash flow ranked as the third highest problem for small business, behind only the cost of health insurance and federal taxation. Coming up with the cash to pay bills and make payroll is a constant challenge in a small firm. For tax policy, this means that small firms would rather deposit less taxes in the first place, than reclaim them later through deductions or credits. Money left in the business -- cash flow -- is the difference between life and death for most new businesses.

■ **Once a small firm is sure it will survive, obtaining funds for expansion and growth -- capital formation -- becomes important.** Small firms have fewer capital formation options than large firms -- they cannot raise money through the securities and financial markets and must get their capital from the business itself, from the bank, or from family members and associates. Because many small businesses are founded with investments in human capital rather than physical capital, the banking system has a more difficult time evaluating the risks involved correctly. Therefore, banks are also an inadequate source of capital, at excessively high interest rates and short maturities -- stifling much entrepreneurial talent.

Shortages of capital was listed as a top concern of small businesses in both the 1981 and 1986 White House Conferences on Small Business and continually appears at the top of NFIB surveys of its members. Most recently, it has consistently been a top priority in the state conferences leading up to the 1995 White House Conference on Small Business. Small businesses need tax changes that will create incentives for investment in small firms by both investors and business owners themselves.

Beyond the three C's, NFIB and its members have two additional criteria for judging the proposed tax cuts in the Contract. First, will a proposed tax cut promote economic growth and job creation? And second, is the proposed tax cut fiscally responsible, with potential revenue losses offset by spending reductions?

With these criteria in mind, here is how NFIB views tax proposals in the Contract with America:

The Job Creation and Wage Enhancement Act

The Job Creation and Wage Enhancement Act consists of six basic parts: (1) a small business appreciation package; (2) capital gains reform; (3) neutral cost recovery; (4) taxpayer debt buydown; (5) private property rights; and (6) regulatory impact analysis. Beyond stating that the regulatory relief and property rights initiatives are supported by and of vital importance

to NFIB members, I will limit our specific comments to those items within the committee's jurisdiction.

Small Business Appreciation

NFIB greatly appreciates and supports the provisions contained in the small business appreciation portion of the bill, and its inherent acknowledgement of the role small business plays in the economy. Each provision of the small business appreciation package touches upon issues that NFIB has worked on for years, and we are happy they will be voted upon in the House.

Current law allows businesses to fully deduct the first $17,500 they invest in equipment in the year it is purchased. The Contract with America would raise that limit to $25,000 a year. **Small firms like expensing for several reasons: it is simple; it helps cash flow; and it encourages capital formation.**

Expensing allows small firms to escape the complexity associated with figuring out and tracking the depreciation schedules for many different pieces of equipment. Expensing deals with the cash flow problems faced by small firms by allowing them to deduct more up front -- putting those dollars back in the hands of the business faster, instead of keeping it in the hands of the government. Expensing helps the small business owner who needs working capital as well as the entrepreneur who is looking to expand or strengthen the business through the purchase of an important piece of equipment. And finally, expensing is good for the economy. If businesses are allowed to write-off their investments in the year they are purchased they are much more likely to make such investments, thereby increasing growth and jobs.

NFIB believes that increasing expensing is the best tool this committee has to encourage investment by small and medium size firms. In fact, we believe expensing is a far better way to encourage investment by these firms than the neutral cost recovery proposal in the Contract. As a result, NFIB proposes placing more emphasis on your expensing proposal as a way of keeping the promises and goals of the Contract with America. Specifically, **NFIB proposes raising the expensing limit to $100,000 per year.** We believe this would be a tremendous step for small business and the economy as a whole, leading to substantial growth.

A second feature of the small business appreciation package is the home office deduction. This proposal addresses the decision made by the Supreme Court in its Soliman decision a few years ago, in which the court placed new limits on the ability of business taxpayers to take the home office deduction.

This issue is very important to continued small business creation and growth. NFIB and its members. Home based businesses are the cradle of many successful enterprises both large and small. Home-based businesses will continue to increase in the information age, with fax machines and modems making it more feasible. In addition, a home based business is an increasingly attractive option for two wage earner families in which one parent would like to be at home with the children. The home business path to independence and income should not foreclosed because of the ongoing controversy over how and whether such a business deducts its expenses.

Much of the controversy over who can take this deduction centers on the reference in Section 280A of the Internal Revenue Code to the home office deduction being taken on a portion of a home that is the "principal place of business," and the ambiguous and subjective nature of that phrase. The Job Creation and Wage Enhancement Act rightly attempts to clear up that ambiguity by more clearly defining "principal place of business" as (1) the location where the taxpayer's essential administrative or management activities are conducted on a regular and systematic basis; and (2) the office is necessary because the taxpayer has no other location to perform these administrative and management activities.

NFIB supports your proposal. It is a big step in the right direction. We have had some concern that it may leave too much subjectivity remaining on criteria for taking the deduction, but we have been pleased with the committee staff's willingness to listen to these concerns and its willingness to further clarify Congress's intent with report language.

The final section of the small business appreciation package provides estate tax relief for farmers, ranchers, and small business owners. NFIB believes that estate tax reform is crucial to the continued survival of small businesses in America, and we commend the Contract's authors for including it. We also urge the committee to expand its vision on this issue and to consider protecting all closely held farms, ranches and small businesses from destruction by the IRS.

Current estate tax rates cripple a small business passed on to heirs, and often force them to liquidate a business they have worked in their whole lives. High estate taxes may provide government revenue in the short run, but the long-run losses far outweigh the gains -- a productive business is extinguished, many jobs are lost, and the American dream of growing a business and preserving it beyond one's lifetime by passing it on to heirs becomes impossible to achieve.

Consequently, NFIB strongly supports the Job Creation and Wage Enhancement Act proposal to raise the estate tax exemption from $600,000 to $750,000, and to index the exemption to inflation. It is a very needed first step. **We further propose that the value of closely-held business, farm and ranch assets in an estate be exempted from estate taxes altogether.**

Exempting closely-held business, farm and ranch assets from estate taxes would ensure that the business will continue and that the jobs of its employees will be protected. Moreover, this exemption would eliminate the strong disincentive that now exists for business owners to continue to develop their business and create jobs as they reach their later years in life. A recent study by the Tax Foundation found that today's estate tax rates have the same disincentive effect on entrepreneurs as a doubling of current income tax rates.

Because all assets are included in determining estate tax calculations, many productive businesses worth even far less than the current exemption level become victims of the estate tax. Because so many small businesses operate on cash flow, often with extremely small or negative profit margins, current law allowing small businesses to spread their tax liability over ten years does not provide adequate relief. Unlike a publicly traded corporation, which exists beyond the lifetime of even major shareholders because stock can simply be sold on the public exchange, closely held businesses are devastated by the death of an owner.

Total federal estate tax revenue represents only about $10 billion annually. Business assets represent roughly 12.3% of this $10 billion -- about $1.23 billion a year. **In other words, for $1.23 billion annually, every closely held farm, ranch, and small business in America could be exempt from the federal tax collector's axe.**

Capital Gains Tax Reform

NFIB supports cutting capital gains taxes to encourage investment and job creation. Because of the particular difficulties small businesses have in obtaining capital, as discussed earlier, a capital gains cut would be beneficial to the growing portion of our nation's small businesses, and, in turn, our nation's economic growth.

Consequently, NFIB strongly supports the Job Creation and Wage Enhancement Act's proposal to exclude 50 percent of a capital gain from taxation, and to index the capital gains tax rate to inflation (in an October 1994 survey, 69% of NFIB members supported indexing capital gains for inflation). The Microsofts and WalMarts of the world were resourceful or lucky enough to overcome significant capital formation hurdles. Unfortunately, many other potential success stories will never be told because of lack of capital. Adopting the capital gains tax cut proposal in the Job Creation and Wage Enhancement Act will free currently frozen supplies of investment capital which will fuel small business and economic growth for years to come.

Additionally, because of the unique difficulties small businesses face in obtaining capital discussed earlier (lack of access to the securities market, difficulty in getting bank loans, etc.), **we would further propose a complete exemption from capital gains taxes on targeted equity investments made in small businesses that are held for a certain length of time.** A targeted small business capital gains tax cut is certainly not a new notion. In 1989, Senator Bob Packwood, Congressman Bob Matsui and others introduced bills providing for a rate reduction targeted to small business venture capital investments held for certain lengths of time. The

proposal was supported in 1992 by presidential candidates Bush and Clinton but, although included in the 1993 Budget Reconciliation Act, was substantially gutted by limiting amendments. Fixing this language to eliminate these limitations and expanding the scope of qualified small business investments will help target investment in small firms and unleash their economic potential.

Neutral Cost Recovery

Neutral cost recovery (NCR), as proposed in the Job Creation and Wage Enhancement Act, would adjust current depreciation allowances both for inflation and the time value of money (approximately 3.5% -- which has been the average return on capital in the U.S. for over a century). Firms would continue to write-off assets over a period of years, but future depreciation allowances would be increased by the rate of inflation and a percentage equal to the real discount rate. If done correctly, firms would ultimately be able to deduct the full real present value of their investments, in the end achieving the economic equivalent of expensing.

Neutral cost recovery addresses a worthy goal. But there are several reasons why the proposal is far less beneficial to small firms than it is to larger firms. First, it is more complex and more difficult to understand and use. As mentioned earlier, small business owners find the process of depreciation complicated, cumbersome, and sometimes costly. Second, because of cash flow problems, small business prefers write-offs to be front loaded instead of back loaded. That is, the quicker the deductible costs of an investment can be recouped, the better. Neutral cost recovery takes a reverse approach. It reduces the deductibility of depreciable assets in the early years while increasing it in the later years. This reduction in the early years is not helpful to small firms whose major short term need is cash for operating costs, and the higher deductions in the later years only benefits the relatively few small firms that purchase longer term depreciable assets.

NFIB does not oppose neutral cost recovery, particularly when done in combination with a substantial increase in expensing. However **we do believe that increasing expensing to $100,000 would do a far better job of accomplishing the promises and goals of the Contract -- increasing investment and jobs -- and doing so in such a way that is far more beneficial to small firms.**

Taxpayer Debt Buydown

The Job Creation and Wage Enhancement Act would allow taxpayers to designate up to 10% of their tax liability to be used to reduce the federal debt. Congress would then be required to cut government spending by an equal amount. NFIB strongly supports the taxpayer debt buydown included in the Contract. In a June 1993 survey, 78% of NFIB members said they supported this exact proposal, and deficit reduction has been one of the top concerns of small business owners in NFIB surveys for years.

The American Dream Restoration Act

The American Dream Restoration Act is a three pronged approach to middle class tax relief: (1) a $500 per child family tax credit; (2) reform of the marriage penalty; and (3) tax deductible Individual Retirement Accounts with penalty-free withdrawals for certain specified uses. NFIB very much supports the Contract's inclusion of middle class tax relief. We would like to offer some suggestions today about how exactly this should be done.

Small business owners have two basic reasons for supporting a middle class tax cut. First, contrary to the stereotype put forward by some, most small business owners are part of the middle class, whether they are struggling entrepreneurs taking small salaries to stay afloat or the owners of growing businesses plowing profits right back into the firm. NFIB statistics show that the typical NFIB member takes home less than $40,000 a year. This, combined with the earlier mentioned survey results showing deep small business concern about taxes, clearly illustrates how small business would benefit from middle class tax relief. Secondly, small business benefits from the positive economic effects whenever money that would have been in the hands of government is instead left in the hands of the American taxpayer and consumer.

I would like to suggest, however, a different vehicle for delivering on the Contract with America's promise of middle class tax relief -- a way more beneficial to a broader slice of the middle class and to small business owners. **The middle class tax cut most supported by NFIB members is an individual tax rate reduction, as was proposed by Speaker Newt Gingrich and Majority Leader Dick Armey in the final days of the 103rd Congress. Their proposal would reduce individual tax rates by about 20 percent across the board.**

NFIB believes that a tax cut should be neutral -- benefiting those with children as well as those without. We agree wholeheartedly that taxes are too high -- but they are high for everyone. A rate reduction would deliver the broadest possible benefit to the middle class. Furthermore, the most important tax priority of small business owners over the years has been low rates. NFIB members believe, whether they have children or not, that their tax burden is too high and should be lower. Eighty percent of Americans reporting business income on their tax forms are unincorporated, meaning that their business pays individual tax rates, not corporate tax rates. The best way to deliver a tax cut to them and their employees, as well as to every middle class American is through a tax rate reduction.

Looking Beyond the Contract With America

The tax provisions of the Contract with America are bold, far reaching, and, as stated earlier, move in a direction strongly supported by small business. But we agree with statements made by you, Mr. Chairman, as well as Speaker Gingrich, that the Contract is an important beginning, not the entire agenda. With this in mind, I would like to take this opportunity to present to you items on NFIB's tax reform agenda for small business that are not part of the Contract with America. NFIB believes that some of the issues we will mention could and should be included in your 100 day agenda -- simply because they are so urgent and are such natural extensions of the Contract.

As I have already stated, NFIB proposes (1) exempting all closely held business, farm and ranch assets from estate taxes; (2) exempting investments in firms under a certain size from capital gains taxes; and (3) increasing expensing to $100,000.

Health Insurance Tax Deduction for the Self Employed

The 25% deduction that self-employed business owners receive for their health insurance premiums expired on December 31, 1993. The 103rd Congress failed to renew it for 1994. Unless you act before April 15, when taxes are due, the self-employed will learn that they have lost their deduction while corporate executives retain a full 100 percent deduction simply because they work for C corps. NFIB strongly urges you to restore the self-employed deduction retroactively within the first 100 days, and Mr. Chairman, the small business community applauded published reports in December reporting your commitment to getting this done.

The 25% deduction has been temporarily extended from year to year since it was first enacted in 1986. It has repeatedly been held hostage to other, typically very unpopular causes like the tax increases in 1990 and 1993, as well as the Clinton health care plan last year. The deduction is a small but meaningful incentive for unincorporated business owners - sole proprietorships, partnerships, and subchapter S corporations -- to purchase health insurance for themselves and their families. If this group of business owners were given the same, long overdue, 100% deduction for their health insurance premiums that C corps receive, many would purchase insurance, substantially reducing the number of uninsured Americans in this country. **Self-employed Americans are one of the largest groups of uninsured citizens.** There are nearly three million self employed Americans without health insurance.

Mr. Chairman, NFIB urges the committee to retroactively restore the 25 percent deduction to the self-employed and to send a clear signal that business as usual is a thing of the past by increasing the deduction to at least 50 percent and making a commitment to reaching parity as soon as fiscally possible. There is simply no reason to continue this blatant discrimination against self-employed business owners.

Simplified Accounting Method and SBEZ Tax Form

The real complexities of the tax code for small business lie in the increasing variety of accounting methods (at least eight) an owner must be familiar with to complete and file a tax return. This complexity is a major hurdle to compliance -- turning traditionally honest business owners into tax evaders because they do not know or understand the tax rules with which they must comply. To address this, **NFIB supports simplified accounting methods for firms under $10 million in gross annual sales in the following areas: cash accounting, full expensing of all assets and bad debts, simplified rules for deduction of meals and automobile expenses and a full exemption from alternative minimum tax (AMT) calculations.** NFIB would welcome the opportunity to work with the committee to further develop such a meaningful proposal.

For similar reasons, NFIB would like to work with this committee to create a simplified small business tax form, or an SBEZ form based on the 1040 EZ form for individuals. The Internal Revenue Code is 1,339,000 words long. With its complicated accounting rules and calculations it has become a quagmire for small business owners, many of whom do their own taxes. We urge this committee to pass legislation instructing the IRS to create a simplified SBEZ tax form designed for the use of small business owners.

Simplified Small Business Pension Plan

The rising administrative costs and legal complexity of pension plans are forcing small business owners to drop their pension plans in ever increasing numbers. For the same reasons, many newer businesses are unable to set up such plans. Current law already allows employers to set up Simplified Employee Pensions (SEPs). However, even SEPs are complex to administer, and as a result they have not been effective in encouraging small business owners to establish pension plans.

NFIB supports enactment of a new pension system that will encourage small business owners and their employees to save for their retirement. A simplified pension plan should be available to all employees, contain no non-discrimination or participation rules, and be flexible enough that it will appeal to a wide variety of employers. NFIB has in the past supported a bill offered by Senate Finance Committee Chairman Bob Packwood that would simplify the pension system and we continue to do so. Again, NFIB looks forward to working with you, Mr. Chairman, on this important issue.

Safe Harbor for Independent Contractors

The definition, for tax withholding and other purposes, of who is an employee and who is an independent contractor is so complex that it is difficult for employers to know when they are violating it. In addition, it can make it difficult for independent contractors -- small businesses themselves-- to exist at all because of fear of an IRS audit. A mistake or disagreement over how to classify a worker with the IRS can mean audits, legal expenses, and fines. This can be very expensive, enough in some instances to close a business for good. **The definition of who is an independent contractor should be clarified by Congress with a new safe harbor.** NFIB strongly supports the creation of a new safe harbor with a few simple tests that will allow an employer to easily determine who is an independent contractor and who is not. In past Congresses, NFIB has proposed language to create such a safe harbor, and we would like to work with the committee to make this major simplification of the code happen.

Conclusion

Mr. Chairman, I want to thank you again for this opportunity to testify before the Ways and Means Committee. I also want to thank you for starting this Congress in such an impressive fashion -- with an aggressive agenda that offers tax relief, regulatory relief, and a commitment to fiscal discipline. Again, the message small business owners everywhere are sending to government is: Get off our backs, out of our pockets, and off our land. On behalf of the more than 600,000 small business owners of NFIB, I want to express my hope that we can work together to enact this kind of agenda, and I hope you will consider the specific suggestions we have offered to help achieve the goals of the Contract for America.

Thank you, Mr. Chairman.

Mr. BUNNING. Mr. Huard.

STATEMENT OF PAUL R. HUARD, SENIOR VICE PRESIDENT, POLICY AND COMMUNICATIONS, NATIONAL ASSOCIATION OF MANUFACTURERS; ACCOMPANIED BY GIL THURM, VICE PRESIDENT, TAXATION AND ECONOMIC POLICY

Mr. HUARD. Thank you, Mr. Bunning. I appreciate the opportunity to testify on selected tax provisions of the Contract With America on behalf of the National Association of Manufacturers and our 13,000 members, over 8,000 of whom are smaller firms with under 500 employees.

Since the hour is late, I will submit my complete statement for the record and try to summarize as much as I can.

Let me begin by noting that the Federal tax system, as we know it today, contains a number of grave deficiencies. Among the principal ones are these: First, it relies excessively on the taxation of income from work, savings and investment, and often subjects such income to multiple levels of taxation.

Second, both entrepreneurial risk taking and the free flow of capital are significantly deterred by excessively high rates of taxes on capital gains.

Third, for business taxpayers, especially those in capital intensive industries that are trapped by the alternative minimum tax or who are subchapter S corporations, the capital cost recovery system for investment in plant and equipment is among the worst in the industrialized world.

Fourth, the foreign-source income of U.S. firms is taxed much more harshly than that of competing firms in other industrialized countries, imposing a major competitive disadvantage in many cases.

Fifth, the national savings rate is scandalously low, not only limiting the amount of investment capital available to create new jobs, but also placing additional strains on the Social Security system.

Finally, the Federal income tax system, as it exists today, is abysmally complex, resulting in the certain waste of scores of billions of dollars every year in wholly unproductive compliance costs.

Given the serious problems I have outlined, the NAM is pleased to note that the Contract With America contains a number of suggested changes that would effectively address some of these problems. These include, first, the fact the Contract would cut capital gains taxes and inflation index the cost basis of capital assets. The NAM has long been an enthusiastic supporter of such changes.

Second, the Contract would provide incentives for putting money into individual retirement accounts. The NAM has been a consistent supporter of IRA expansion as one desirable way to improve the national savings rate. For the longer term, however, there will still be a need for overall structural reforms that will eliminate the multiple levels of taxation on an earned dollar that is then saved or invested, and second, that will properly integrate the corporate and individual tax systems.

The Contract would also furnish much needed relief for small businesses by expanding the estate and gift tax exemption and by increasing the amount of capital investment that may be expensed rather than depreciated.

There is, however, a glaring omission here. No relief is provided here for the excessively high rates of tax paid by subchapter S shareholders on retained earnings that are reinvested in the business, and we strongly urge that you deal with this problem as part of the Contract.

The Contract would improve the existing depreciation system by moving toward the economic equivalent of expensing through the neutral cost recovery system. While the goal here is a laudable one, there are a number of overriding issues you need to consider. One is that the NCRS does not realistically address the fact that many capital intensive industries contain many companies that are trapped in the alternative minimum tax and would continue to be even with the NCRS.

Indeed, a more appropriate short-term attempt at improving the capital formation climate might be a substantial reduction in the impact of the alternative minimum tax on depreciation, or even outright repeal of the AMT.

As a long-term goal, outright expensing is probably more desirable than the economic equivalent of expensing. Many firms, particularly smaller ones, are forced to live off their cash flow and, for them, calculating the present value of a stream of future deductions does not really generate much in the way of spendable funds.

In closing, I would make two overarching recommendations. First, any tax cuts enacted as part the Contract should be fully funded by offsetting spending reductions. Failure to do so would almost inevitably lead to a rise in interest rates that would negate the positive effects of such tax cuts.

Second, while the Contract's tax provisions are in many respects desirable in the short run, they are nevertheless a piecemeal approach and leave unresolved many of the problems of the current tax system. We therefore should not lose sight of the continuing need for a complete overhaul of the Federal tax structure, and we urge you to start work on such an effort as soon as you have completed your work on the tax provisions of the Contract.

Thank you.

[The prepared statement follows:]

OVERVIEW OF SELECTED PROVISIONS OF THE "CONTRACT WITH AMERICA"

TESTIMONY OF THE
NATIONAL ASSOCIATION OF MANUFACTURERS
BY PAUL R. HUARD
SENIOR VICE PRESIDENT, POLICY AND COMMUNICATIONS

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

JANUARY 12, 1995

The National Association of Manufacturers (NAM) is a voluntary business association of more than 13,000 firms, large and small, located in every state. Our members range in size from the very large to the more than 8,000 smaller members that have fewer than 500 employees each. The NAM's member companies employ 85 percent of all workers in manufacturing and produce more than 80 percent of the nation's manufactured goods.

We appreciate this opportunity to testify on provisions contained in the "Contract With America" that are within the jurisdiction of the Ways and Means Committee. Since today's hearing is in the nature of an overview, my testimony will accordingly be quite general.

The federal tax system as it exists today has a number of grave deficiencies. Among the principal ones are these:

- Overall, it relies excessively on the taxation of income from work, savings and investment, and often subjects such income to multiple levels of taxation. A dollar earned is taxed and, if the remainder is saved or invested, the earnings or gains on that savings or investment are taxed yet again. Similarly, a dollar of corporate earnings is taxed under the corporate income tax and, if then paid out to a shareholder, immediately taxed again under the individual income tax.

- Both entrepreneurial risk-taking and the free flow of capital are significantly deterred by excessively high rates of tax on capital gains. In the case of long-held assets where much of the so-called "gain" is the result of inflation, the tax is confiscatory and can actually exceed the taxpayer's real economic gain.

- For business taxpayers, especially those in capital-intensive industries who are subjected to the alternative minimum tax (AMT), our capital recovery system is among the worst in the industrialized world. This limits the ability of many firms to make job-creating investments. A similar problem exists with Subchapter S corporations whose retained earnings are subjected to unreasonably high tax rates.

- The foreign source income of U.S. firms is taxed much more harshly than that of competing firms based in other industrialized countries, imposing a major competitive disadvantage in many instances.

- The national savings rate is scandalously low. This not only limits the amount of investment capital available to new and existing businesses but also places additional strains on the Social Security system, the long-term viability of which is highly questionable given current demographic trends.

- Finally, the federal income tax system as we know it today is abysmally complex, resulting in the certain waste of scores of billions of dollars every year in wholly unproductive compliance costs. There is a growing view that the system is now so bad that it can't be fixed and instead should just be scrapped and replaced with something new.

Given the serious problems outlined above, the NAM is extremely pleased to note that the "Contract With America" contains a number of suggested changes to the nation's tax laws that would address these problems in a positive manner. These include:

- Cutting capital gains taxes and inflation-indexing the cost basis of capital assets. The NAM has long been an enthusiastic supporter of both such changes.

- Providing additional incentives for putting money into individual retirement accounts (IRAs). The NAM has been a consistent supporter of IRA expansion as one desirable way to improve the national savings rate. For the long term, however, there will still be a need for overall structural reforms that (1) will eliminate the multiple levels of taxation on an earned dollar that is saved or invested and (2) will properly integrate the corporate and individual tax systems.

- Furnishing much-needed relief to small businesses by expanding the estate and gift tax exemption and increasing the amount of capital investment that may be expensed rather than depreciated. There is, unfortunately, a glaring omission here. No relief is provided from the excessively high rates of tax paid by shareholders of a Subchapter S corporation that retains and reinvests its earnings, and we strongly urge that you deal with this problem as part of the Contract's package of small business reforms.

- Improving the depreciation system by moving towards the economic equivalent of expensing -- the Neutral Cost Recovery System (NCRS). While the goal here is laudable, there are a number of overriding issues that you should consider. One is that the NCRS does not realistically address the fact that many capital-intensive taxpayers end up trapped in the alternative minimum tax (AMT). Indeed, a more appropriate short-term reform might be substantial reduction of the impact of the AMT on depreciation or, even better, outright repeal of the AMT. Moreover, as a long-term goal, outright expensing is probably more desirable than the economic equivalent of expensing. Many firms are forced to live off their cash flow and for them calculating the present value of a stream of future deductions doesn't generate spendable funds.

In closing, I want to make two overarching recommendations:

First, any tax cuts enacted as part of the Contract should be fully funded by offsetting spending reductions. Failure to do so will almost inevitably lead to a rise in interest rates that will negate the positive effects of such tax cuts.

Second, while the Contract's tax provisions are in many respects desirable in the short run, they are a piecemeal approach which leave many of the problems of the current federal tax system -- which I outlined at the beginning of this testimony -- substantially unresolved. In some cases, such as the complexity issue and the overly harsh treatment of foreign source income, the problems are not even addressed. You therefore should not lose sight of the continuing need for a comprehensive overhaul of the federal tax structure and we urge you to start work on such an effort as soon as you have finished dealing with the "Contract With America."

This concludes my prepared testimony, Mr. Chairman. We would be pleased at this time to address any questions you or other members of the Committee might have.

Mr. BUNNING. Thank you.
Mr. Friedman.

STATEMENT OF SHELDON FRIEDMAN, ECONOMIST, ECONOMIC RESEARCH DEPARTMENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. FRIEDMAN. Thank you. I appreciate this opportunity to testify on behalf the AFL–CIO. You have my complete statement, which I request be printed in the record of this hearing.

The central concerns of working people today are job security and good wages and for good reason, and it is through the lens of these concerns that the AFL–CIO views the tax proposals of the Contract With America. And viewed through this lens, we do not feel that the major provisions of the Contract in the tax area will move us toward these goals.

The case simply has not been made that the major cuts in the area—for example, of capital gains, depreciation and so forth—will create any good new jobs, in particular good jobs here in the United States.

But while that is an unknown, what is well known and quite clear is that these and many of the other provisions will deprive the Nation of badly needed revenue while providing wealthy individuals and corporations with massive tax breaks which they neither need nor deserve.

Several of the provisions of the Contract, notably the capital gains tax cut, the neutral cost recovery depreciation proposal and the "American dream savings account" super-IRA proposal are, in our view, fiscal time bombs that would cause huge revenue losses down the road.

Beyond the inequity of the distributional effects of these proposals, the real concern that we have is, how would these tax cuts be financed? We are very concerned that it will be done by terminating necessary Federal programs. The AFL–CIO is, therefore, strongly opposed to consideration of tax cuts before the budget offsets are known.

The capital gains tax cut, in our view, is especially unjustified. Income from capital gains is already taxed at highly preferential rates. Further cuts would make a bad situation even worse. This preference for capital gains is inherently unfair to working people whose wages would be taxed at a higher rate than profits of wealthy individuals on the sale of their stocks and bonds.

The fact of the matter is that some 93 percent of all the tax returns in the country today report zero income from capital gains. More than two-thirds of the benefit from this preference would accrue to those wealthy individuals with incomes of more than $200,000 a year. We are talking about the richest 1 percent in the country. And nothing in the Contract would change this skewed distribution of the benefits from capital gains.

The deep cuts, 50-percent cut plus indexing would exempt some two-thirds of all capital gains income from taxation, would lead to revival, in our view, of the tax shelter industry with all the attendant waste and attempts to shift ordinary income into capital gains for no other reason than the avoidance of taxes.

The neutral cost recovery proposal and other tax breaks for corporations, in our view, are not justified either. U.S. corporations already are taxed at a lower rate than their competitors in Germany and Japan. If you look at the proportion of Federal revenues derived from corporate income taxes, they have declined every decade in succession since the fifties.

Back in 1953, 31 percent of Federal revenues were derived from the corporate income tax; 20 years later, in 1973, that proportion had fallen to 16 percent. And by last year, only 9 percent of Federal revenues were derived from the Federal income tax. Clearly, this is not an area where further tax cuts are justified or needed.

Nor do we feel the estate and gift tax exemption should be increased. Only 25,000 estates in the entire country today, roughly 1 percent of the total, pay any tax at all under this very generous $600,000 exemption that exists. I ask you to compare that exemption with median net worth, which is about $36,000 in this country. Who is it we want or need to help by raising this exemption? The proportion of Federal revenues that has been derived from the estate and gift tax has been cut in half in the last 20 years. Today it raises only about 1 percent of all our Federal revenues. It was more than 2 percent back in the mid to late seventies.

With regard to the fundamental issue of the family tax credit, which would provide modest but welcome relief to moderate-income families with children, but would ignore workers without children, we have several concerns. Families with incomes above $200,000 or at that level don't need a tax cut. Under the proposal in the Contract, they would get it.

But the real issue is—and I will try to wrap up; I am mindful of the time—how would this tax relief be paid for? If working Americans could get tax relief financed by closing wasteful, job-destroying loopholes—and we have a list of them attached to our statement—if there were a way that could be done, there would be no question about the desirability of such tax relief. But that is not the choice being offered by the Contract With America.

It will do little good for working families to give them a $500-per-child tax credit while cutting back on aid to education or student loan programs. It will do little good to those who are anxious that they may lose their jobs to give them a tax credit while at the same time slashing retraining programs that could help them if they lose their jobs.

It will do little good to give workers a tax credit and then have the Federal Reserve take that as a signal to raise interest rates to slow the economy, throw them out of work and raise their mortgage payments and student loan payments and car payments. These are some of our most fundamental concerns.

I thank you for this opportunity to testify. There are many issues that I have not covered, such as the welfare reform provisions of the Contract, which we hope to address at a later time. Thank you.

[The prepared statement and attachments follow:]

STATEMENT OF SHELDON FRIEDMAN, ECONOMIST
ECONOMIC RESEARCH DEPARTMENT
AMERICAN FEDERATION OF LABOR
AND
CONGRESS OF INDUSTRIAL ORGANIZATIONS
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
ON THE "CONTRACT WITH AMERICA"

January 12, 1995

The AFL-CIO welcomes this opportunity to present its views on the tax provisions of the House Republican "Contract With America." The central concerns of working people today are job security and good wages. The current economic expansion has created many jobs, but it has done little to alleviate economic insecurity or reverse the fifteen year slide in real wages.

The fundamental question that the AFL-CIO urges this Committee to ask is: will a family tax credit of $500, a new backloaded IRA, a new capital gains tax preference, or a new more generous depreciation schedule really help provide the long-term, well paying jobs and the economic security that American workers need and deserve?

Taken as a package, the tax provisions of the Contract do not meet these objectives. Instead, they would deprive the nation of badly needed revenues, while providing the wealthy and corporations with massive ill-deserved tax breaks.

According to Treasury Department estimates, the tax provisions of the Contract would reduce federal revenues by $205 billion over the next five years. These initial revenue losses, moreover, are just the tip of the iceberg. Between 1995 and 2005, the nation would hemorrhage $725 billion in lost revenues. Several of the Contract's provisions, notably the capital gains tax cut, the so-called "neutral cost recovery" depreciation proposal, and the "American Dream Savings Account" IRA proposal, are fiscal time bombs that would lose relatively little revenue at first, while causing a huge revenue drain down the road.

The beneficiaries of most of this tax cutting largesse would be corporations, and individual taxpayers at the very top of the nation's increasingly unequal income and wealth pyramid. Again according to Treasury Department estimates, 54% of all the proposed tax cuts would accrue to taxpayers with incomes above $100,000 per year, the richest five per cent.

Beyond the enormous revenue loss and the inequitable distribution of the proposed tax cuts, the AFL-CIO has serious concerns about how the cuts would be financed. The elaborate detail of many of the tax provisions of the Contract that are before this Committee stands in sharp contrast to the Contract's failure to identify specific spending cuts to pay for them. The AFL-CIO is mindful of Chairman Archer's insistence that all tax reductions must be paid for before they are enacted. However, we are very concerned that this reasonable approach will be accomplished by terminating necessary federal programs. While it is true that a high proportion of the American public express understandable frustration to pollsters by advocating less government, most do not favor cuts in specific programs such as education, transportation or health care, and with good reason. Such programs can have a far greater bearing on their quality of life than a tax cut, particularly a tax cut that will accrue primarily to corporations and the well to do. The AFL-CIO is therefore opposed to the consideration of tax cuts before the budget offsets are fully known.

The possibility that a balanced budget amendment to the Constitution may pass, requiring deep and as yet unspecified spending cuts if it does, renders even more problematic the financing of the Contract's proposed tax cuts.

The claim in some quarters that the tax cuts in the Contract would stimulate so much economic growth that revenues will actually increase is redolent of voodoo economics at its worst. A far more likely scenario is that the tax cuts will cause Chairman Greenspan and his

FOMC colleagues to become even more confirmed in their disastrous belief that higher interest rates and tighter monetary policy are required, in order to restrain the economy to the maximum 2.5% growth rate that they deem acceptable.

Capital Gains

Of the myriad ill advised tax cuts in the Contract, among the least justified and least fair to working people is the proposal to deeply cut taxes on capital gains. According to the Treasury Department, the proposed cuts in capital gains taxes would deprive the nation of $61 billion in revenues over the next five years, and would cost $183 billion between 1995 and 2005. The dogged insistence by some that deep cuts in capital gains taxes will not cause revenue losses is sheer economic nonsense.

Even without the new cuts proposed in the Contract, the income from capital gains is already taxed on highly preferential terms. The 1993 tax law changes which increased the top tax rate to 39.6% on amounts of taxable income in excess of $250,000 kept the top tax rate on capital gains at 28%, a full 11.6% lower. To make matters worse, a brand new tax preference was created which lowered the maximum tax rate on capital gains to 14% for certain new investments and certain newly issued stock.

The further reductions in taxes on capital gains proposed in the Contract would make a bad situation dramatically worse. Tax preferences accorded income from capital gains are inherently unfair. They result in taxing the wages and salaries of working people at a higher rate than the profits made by the wealthy on their sales of stocks, bonds, real estate and other property. It is a tax preference not available to most working men and women who pay the lion's share of taxes and who must meet their income tax obligations every payday.

The fact that 93% of all tax returns report zero income from capital gains underscores how skewed in favor of the rich this tax preference is. According to Joint Committee on Taxation estimates, more than two thirds of all the benefits from capital gains tax preferences accrue to taxpayers with incomes in excess of $200,000 per year. Nothing in the new capital gains proposal before this Committee would change this skewed distribution.

Cutting capital gains taxes will also stimulate the tax shelter industry, which is based heavily on schemes to convert ordinary income into preferentially taxed capital gains. The huge 50% differential, plus indexing, would exclude almost two thirds of capital gains from taxation. This will prove to be an irresistible lure to these wasteful, revenue losing and highly inequitable tax shelter activities.

Neutral Cost Recovery

The AFL-CIO strongly opposes additional tax breaks for corporations at this time. U.S. corporations are already taxed more lightly than their competitors in such highly successful industrial nations as Germany and Japan (see Appendix 1). Corporations have also shouldered a smaller proportion of the federal income tax burden in each successive decade since the 1950s. Corporate income taxes accounted for only 9% of federal revenues in 1993, down from 16% in 1973 and 31% in 1953 (see Appendix 2). Against this backdrop, there is no justification whatsoever for further deep cuts in the form of a "neutral cost recovery" depreciation scheme that will cost $120 billion in lost revenues over the next ten years, according to Treasury Department estimates.

Social Security

The "Contract With America" would phase out the 1993 increase from 50% to 85% in the percentage of Social Security benefits received by senior couples with incomes above $44,000 ($34,000 for senior individuals) that would be subject to federal income tax. The cost of this proposal would be $15 billion over the next five years and $49 billion between 1995 and 2005, according to Treasury Department estimates.

Since the revenues from the 1993 increase were earmarked for the Health Insurance Trust Fund, the AFL-CIO is concerned that its repeal will worsen the impending crisis of Medicare financing.

The proposed increase in the Social Security outside earnings limit to $30,000 by the year 2000 will result in an additional drain of $7 billion from the Social Security Trust Fund over the next five years. We oppose this change.

Estate and Gift Tax

The AFL-CIO strongly opposes increasing the estate and gift tax exemption. Revenues from the federal estate and gift tax fell from 2.1% of all federal revenues in 1977, to only 1% in 1992, despite an enormous increase in concentration of wealth during the 1980s. The main reason for plummeting revenues despite sharp increases in concentration of wealth was the even sharper increase in the estate and gift tax exemption, from $120,667 for 1977 to $600,000 starting in 1987.

The current exemption is so generous that only 25,000 estates paid any tax at all in 1991. The $600,000 exemption is more than sixteen times the $36,623 median net worth of all households. Even among older households, who tend to be richer, the $600,000 exemption compares with median net worth of $88,192 for households age 65 and up.

Increasing the estate and gift tax exemption to $750,000, as proposed in the Contract, would cost $6.7 billion in lost revenues over the next five years, and $20.7 billion between 1995 and 2005, according to Treasury Department estimates, for the exclusive benefit of the well to do. Rather than lowering estate taxes, the Congress should review this area. Why, for example, should capital gains in an estate escape all income taxes?

Family Tax Credit

The proposed Family Tax Credit would provide modest but welcome tax relief to moderate income families with children, but would ignore workers without children. It would also aid many families whose income is not so modest, and these are serious concerns regarding how it would be paid for. The full $500 per child credit would be available to families with adjusted gross incomes of up to $200,000 per year, and a partial credit would be available up to income levels of $250,000.

It is difficult to believe that families with incomes of $200,000 per year need or deserve a $500 per child tax credit. Families at this income level are among the richest one per cent in America. Extending eligibility this high in the income pyramid also swells the cost of the proposed family tax credit, estimated by the Treasury Department at $124 billion over the next five years, and $289 billion between 1995 and 2005.

A more serious problem is how the family tax credit would be paid for. It will do little good for working families to give them a $500 per child tax credit, while simultaneously cutting back on federal aid to education or student loan programs. It will do little good for working families anxious that their breadwinners may lose their jobs to give them a tax credit, while simultaneously cutting federal retraining programs that could help them if they did. It will do little good to give working families a tax credit, if the Federal Reserve takes this as a signal to raise interest rates, thereby slowing the economy, eliminating jobs, and boosting mortgage payments, car loan payments and student loan payments by as much as or more than the value of the tax credit.

If tax relief for hard pressed working families of moderate means could be paid for by closing unjustified, wasteful, job destroying tax loopholes of primary benefit to corporations and the wealthy, there would be no question about its desirability. Unfortunately, that is not the choice being offered to working people by the "Contract with America." Instead of closing existing tax loopholes, the Contract would open many new ones. The AFL-CIO must therefore express serious reservations about any family tax credit or other so-called middle class tax cut that would trigger harmful spending cuts, or interest rate increases by the Federal Reserve.

If, on the other hand, this Committee is interested in exploring loophole closings to finance tax relief for working Americans, the AFL-CIO would be pleased to offer specific and detailed recommendations. Examples can be found in appendices 3 and 4, attached to this statement.

If tax relief for working Americans could be paid for by closing existing tax loopholes, the AFL-CIO would interested in presenting its views to this Committee on the structure of that tax relief.

Conclusion

The AFL-CIO strongly opposes the tax provisions of the "Contract with America" which are of primary benefit to corporations and the wealthy, including the capital gains tax cut, "neutral cost recovery" depreciation changes, the increased estate and gift tax exemption, and most of the proposed IRA liberalizations, especially the so-called "American Dream Savings Account." These proposals would rob the nation of billions of dollars of badly needed revenues, make the tax system even less fair to working Americans, and yield little or no economic gain.

The AFL-CIO is concerned that the proposal to phase out the 1993 increase in the taxable portion of Social Security benefits received by upper income retirees would worsen the looming Medicare financing crisis.

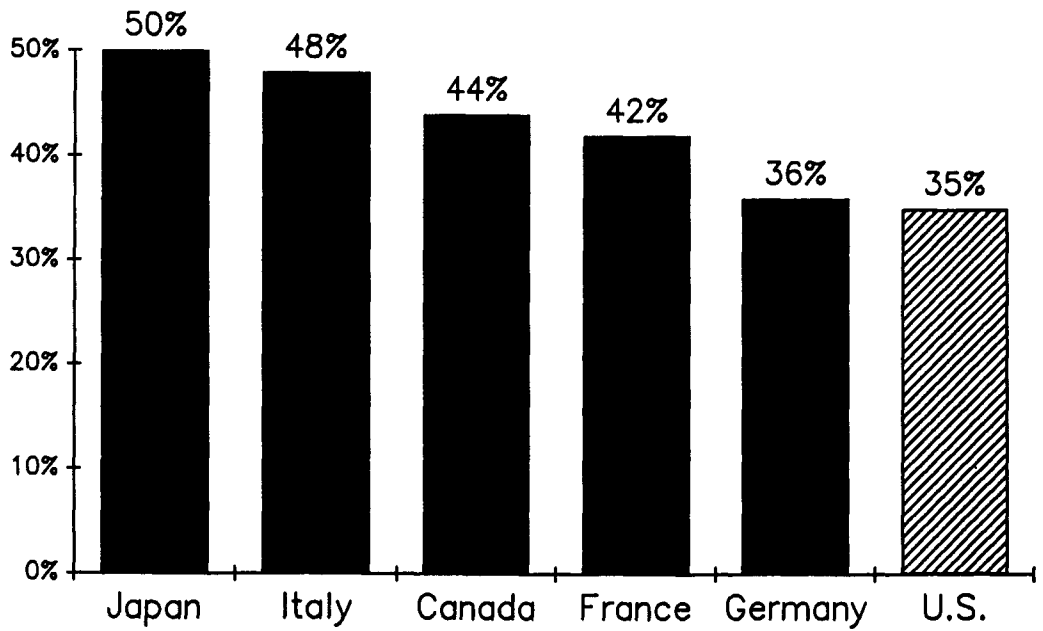
With regard to the family tax credit, the AFL-CIO would favor tax relief for working people and their families if it were paid for by making the tax code more progressive, and by closing tax loopholes such as the foreign tax credit, rather than by unspecified spending cuts that could be harmful to workers' well being. Furthermore, a tax cut that triggers the Federal Reserve to raise interest rates could make workers worse off. Tax relief, moreover, should not be provided to those who have incomes of $200,000 per year!

More fundamentally, the tax provisions of the Contract will not alleviate, and will most likely worsen, the deep seated economic insecurity of American workers. They will do nothing to create more good jobs, reverse the fifteen year decline in real earnings, or assist workers who become unemployed.

The AFL-CIO has views on the other Contract provisions that are within the purview of this Committee, including welfare reform and tax proposals in the Contract that have not been addressed explicitly in this testimony. We look forward to presenting these additional views at a later time.

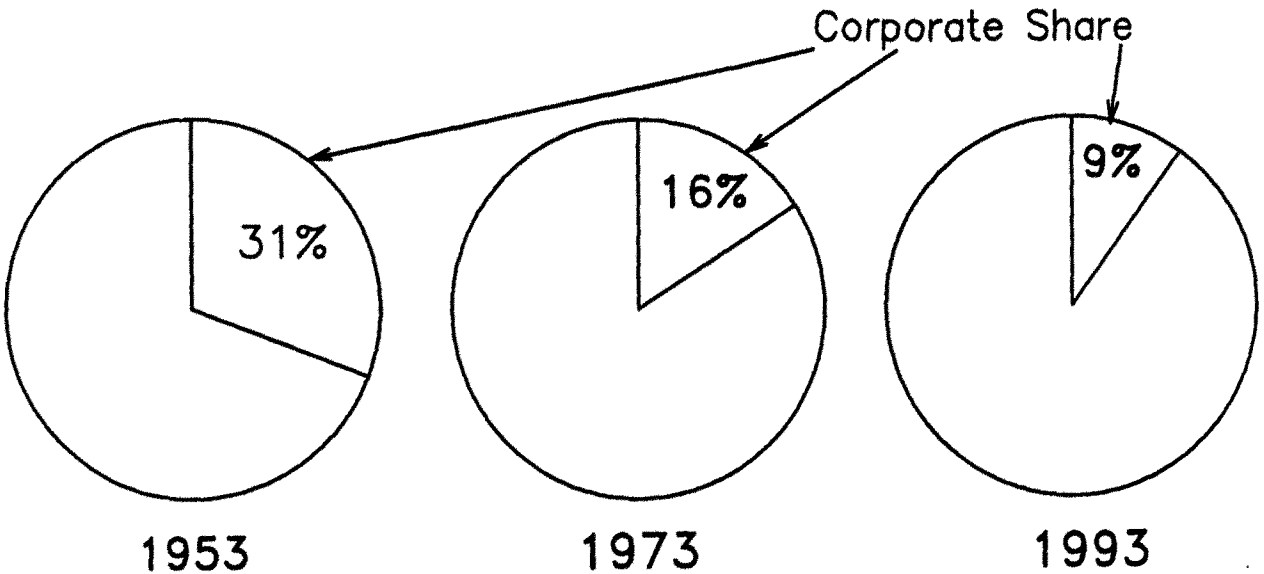
Thank you again for this opportunity to testify.

Corporate Tax Rates in Selected Industrialized Countries



Source: Organization for Cooperation and Development, Price Waterhouse, and National Bureau of Economic Research

Declining Share of Federal Revenues From the Corporate Income Tax



Source: Committee on Ways and Means, U.S. House of Representatives

Appendix 3

AFL-CIO FACT SHEET

TAX EXPENDITURES WHICH SHOULD BE PHASED OUT TO INCREASE TAX FAIRNESS, SAVE JOBS AND RAISE REVENUES

1. **Change the Foreign Tax Credit to a Deduction**

U.S.-based multinationals are able to take a credit against their U.S. corporate income tax obligations for income taxes that they pay to foreign countries. This provides them with an incentive to invest abroad rather than in the U.S., costing the Treasury and shifting production and jobs overseas. The latest IRS estimates show that U.S.-based multinationals took nearly $25 billion in foreign tax credits in 1990. If the credit was treated as a deduction (as are corporate taxes paid to U.S. states) the Treasury would have raised an additional $16.5 billion.

REVENUE GAIN = $16.5 billion (1 year AFL-CIO estimate)

2. **Eliminate Deferral of Income from Controlled Foreign Corporations**

U.S.-based multinational corporations do not have to pay taxes on all of the profits earned by their operations in other countries. Instead they are often allowed to defer these taxes until the profits are "repatriated," meaning returned to the U.S. This encourages these companies to reinvest abroad and costs the Treasury. The 1994 Federal budget estimates that deferral costs $1.6 billion per year.

REVENUE GAIN = $8 BILLION (5 year AFL-CIO estimate)

3. **Crack Down on Transfer Pricing Abuse by Multinational Corporations**

During the 1992 campaign, President Clinton estimated that $13 billion per year could be raised by making foreign multinational corporations pay their fair share of taxes. Both U.S. and foreign-based multinationals are able to avoid taxes by shifting their costs of production on paper. For example, a firm can overcharge itself for an item produced by one of its subsidiaries in a low tax country. That shifts its income out of the U.S. and into the low tax location. A simple way to end this practice would be to adopt a formula approach, similar to that used by many states, for computing how income earned by multinationals should be allocated among nations. Professors John Zdanowicz and Simon Pak of Florida International University have developed a sophisticated method for estimating the extent of lost tax revenue due to such transfer price manipulations. Their most conservative estimate is that the Treasury lost $28.7 billion due to such transactions in 1992.

4. **Stop Misclassification of Employees as "Independent Contractors"**

Dishonest employers often misclassify their employees as independent contractors in order to avoid paying for social security, employment taxes, and various benefits. The House Committee on Government Operations has estimated that such abuse of independent contractor status costs about $2 billion per year in lost revenues.

REVENUE GAIN = $10 BILLION (5 yr. House Government Operations estimate)

5. **Tax All Corporate Income at 35 Percent Rate**

Corporate income taxes accounted for over 30 percent of Federal Revenues in the early 1950s. Today they pay for less than 10 percent of the U.S. Budget. Other OECD countries rely more on corporate income taxes to raise revenue than they did in past years. Today, only corporations that earn in excess of $10 million pay at the full 35 percent statutory rate. Below that they face marginal rates of 15, 25, and 34 percent, depending on their profit levels. CBO estimates that eliminating

the lower bracket and taxing all corporate income at the same rate would raise an additional $1.9 billion in 1995 and $3.7 billion by 1999. Non-corporate small businesses would not be hurt by this provision, because it would not apply to sole proprietorships, partnerships, or subchapter S corporations.

REVENUE GAIN = $16.2 BILLION (5 year CBO estimate)

6. **Amortize a Portion of Advertising Costs**

Corporations that spend huge sums on advertising are able to deduct these amounts as a cost of doing business. But in many ways advertising is less a business cost than an investment in brand recognition. The benefits of this expenditure last many years beyond the year in which they are incurred. When firms invest, such as when they buy new equipment or facilities, they are not allowed to take an immediate deduction for such expenditures. Instead they must amortize the expenditures, and deduct the costs over time at the rate that their capital is presumed to wear out. Because advertising is at least in part like an investment, with benefits lasting for years, it would make sense to require firms to treat part of this expenditure as an investment rather than a deductible expenditure. CBO estimates that requiring 20 percent of advertising costs to be treated as capital expenditures and deducted over a period of four years would raise $3.3 billion in 1995 and $5.9 billion in 1996.

REVENUE GAIN = $18.3 BILLION (5 year CBO estimate)

7. **Limit Mortgage Interest Deduction for Mansions**

To encourage home ownership, the tax code has historically treated investments in a home more favorably than other investments. Such a policy makes sense for most home owners. But it would also make sense to lower the limit on the amount that is eligible for a deduction. Why should the tax code give preference to the purchase of mansions by the well-off? CBO estimates that, if the limit on the amount of principal eligible for a deduction was lowered from $1 million to $300,000, an additional $1.6 billion could be raised in 1995, increasing to $5 billion by 1999.

REVENUE GAIN = $20.6 BILLION (5 year CBO estimate)

8. **Tax Capital Gains at the Same Rate as Ordinary Income**

Taxing capital gains at the same rate as ordinary income would generate additional revenues of about $15 billion per year. Currently the top federal income tax rate on capital gains is 28%, versus 39.6% for ordinary income. This benefits the wealthy overwhelmingly, since most lower and moderate income taxpayers have little if any capital gains. To make matters worse, the gap in rates on ordinary income versus capital gains creates an incentive for wasteful tax shelters, devices used by the wealthy to convert ordinary income into capital gains for no economic purpose other than to reduce their taxes.

9. **Tax Unrealized Capital Gains at Death**

Taxing unrealized capital gains at death would yield revenues of $9.5 billion per year. Gains on assets that a spouse inherits would not be included, nor would gains on assets donated to charity. Safeguards could be included to prevent forced liquidation of assets, such as family farms, to pay taxes.

REVENUE GAIN = $35.2 BILLION (5 year CBO estimate)

Appendix 4

AFL-CIO Reviews the Issues

Report No. 70
December 1993

ENDING FOREIGN TAX LOOPHOLES: AN ISSUE OF JOBS AND TAX FAIRNESS

Working Americans are increasingly concerned by the decline in the number of good jobs that pay good wages. This concern has been motivated by the fact that U.S. trade deficits have ballooned, while investments that could create new production and new jobs have departed for foreign locations.

The debate over the North American Free Trade Agreement has drawn attention to the export of jobs overseas. Economists estimate that 20,000 jobs are lost for every $1 billion increase in the trade deficit.

Two major loopholes in the tax code contribute to this export of U.S. jobs and production. They are the foreign tax credit and the foreign tax deferral privilege. These loopholes are essentially subsidies, paid for by U.S. taxpayers, that encourage U.S. based multinational corporations to invest abroad rather than at home. It is time, in the interest of jobs and tax fairness, to close these loopholes.

The Foreign Tax Credit: An Example

A simple example may best explain how the foreign tax credit scheme works—as the accompanying table illustrates.

Suppose a corporation makes a profit of $100,000 in the state of Iowa and is taxed at the state statutory rate of 10 percent. The corporation may deduct from its gross profits the 10 percent or $10,000 paid to Iowa; the firm's taxable income at the federal level is then $90,000. If the firm pays its federal taxes at the 35 percent rate established under the new federal budget, the result will be $31,500 in federal revenues (35 percent of 90,000). This illustrates what occurs when taxes are treated as a cost of doing business and are deducted, rather than given the preferential treatment of a tax credit.

EXAMPLES OF THE FOREIGN TAX CREDIT (FOR A PROFIT OF $100,000)

Country/State	Foreign/State Tax Rate	Foreign/State Tax Paid	U.S. Federal Tax Paid
U.S. - Iowa	10%	$10,000	$31,500
Ireland	10	10,000	25,000
Spain	35	35,000	0
Japan	50	50,000	0*

*In this case, the hypothetical firm will have excess credits of $15,000, which could be carried back, or forward, or used to offset the taxes due for profits from another country, such as Ireland.

Examples of Corporate Tax Rates in Various Countries	
U.S. Corporate Tax Rate: 35%	
High Tax Countries	Tax Rate
Canada	44%
Japan	50
France	42
Italy	48
Germany	36
Low Tax Countries	Tax Rate
Ireland	10%
Hong Kong	12
Panama	10
Bahamas	0
Bermuda	0
Note: In Practice Rates vary because of various exemptions, tax holidays and the like.	
Sources: Price Waterhouse, Organization for Economic Cooperation and Development, National Bureau of Economic Research	

Now change the scenario and assume that the firm is doing business in Ireland, but is based in the U.S. Again, it is taxed at the rate of 10 percent. The U.S. federal taxes on its $100,000 profit would be $35,000 (35 percent of $100,000) before applying the credit. But, because foreign taxes are credited instead of deducted, the $10,000 paid to Ireland is subtracted from the amount that would be due to the U.S. As a result, the U.S. treasury receives only $25,000 ($35,000 minus $10,000).

Suppose the corporation makes profits of $100,000 in Spain, where the tax rate is 35 percent. In this case it pays $35,000 to the Spanish government and zero dollars to the U.S. treasury when the foreign tax credit is applied.

Finally, examine the case where the corporation is gaining income from business in a country with higher tax rates than the U.S. In Japan, the corporation pays almost 50 percent or $50,000 in income taxes. Applying the $50,000 in foreign tax credits to the before-credit U.S. taxes of $35,000 once again means that the U.S. treasury receives zero revenue. However, that may not be the end of the story. The corporation is able (subject to certain limitations) to apply the excess credits of $15,000 ($50,000 in tax credits from Japan minus $35,000 credited toward U.S. taxes) to taxes due on income from other low tax countries. The corporation can also carry the excess credits back up to two years or forward up to five years to offset taxes on income earned earlier or later.

Understanding Foreign Tax Deferral

The deferral privilege allows U.S. corporations to pay no income taxes on the earnings of their foreign subsidiaries, unless, and until, the profits are returned to the U.S. In a sense, deferral is an interest free loan from U.S. tax payers for firms that wish to expand overseas subsidiaries by keeping their profits abroad. Because it rewards firms for reinvesting profits in other countries, it creates an incentive to invest, and to create jobs, in other countries rather than in the U.S. A U.S.-based firm that invests and reinvests overseas without ever returning the profits to the U.S. becomes completely immune from taxes on its foreign profits.

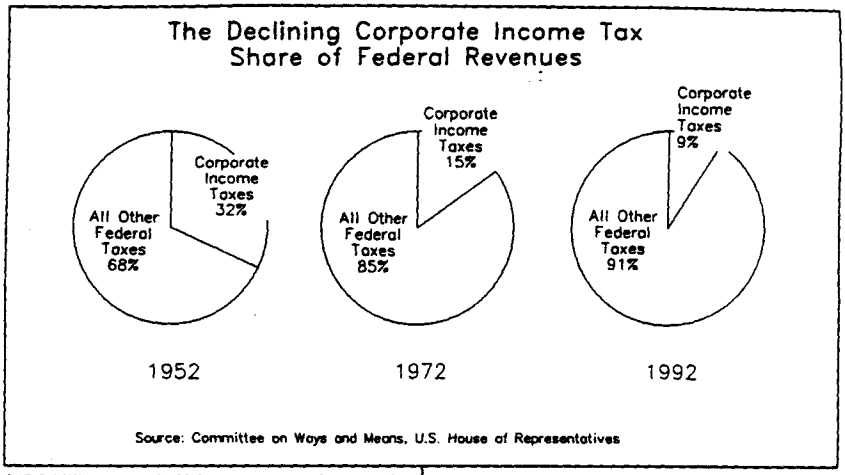
The Two Loopholes in Concert

Together the foreign tax credit and the deferral process provide great benefits to corporations who move production and jobs from the U.S. to other countries. Under deferral, they pay no U.S. federal taxes until they bring their profits home. If they do return profits to the U.S. the foreign tax credit allows them to subtract tax payments made to other countries from their U.S. obligations.

These two tax schemes assume that corporations can avoid U.S. taxes whether they invest in high tax countries or low tax countries. Deferral encourages investment in low tax countries because the corporation pays no U.S. taxes and low foreign taxes until profits are returned to the U.S. The foreign tax credit helps corporations to avoid U.S. taxes, even when they invest in high tax countries. In such cases they pay no U.S. taxes, and get excess credits which often can be used to offset taxes due on profits returned from low tax countries.

Tax Fairness

To American families, whose federal taxes are, for the most part, withheld from their paychecks at an average effective rate of 23 percent, the foreign tax credit and deferral loopholes are astonishing. A 1993 study published by the National Bureau of Economic Research shows that this astonishment is justified. The authors, Rosanne Altshuler and T. Scott Newlon, report that a sample of 340 U.S. parent corporations had foreign-source income of



$47.3 billion and paid U.S. taxes on that income of only $1.6 billion. (Their figures are for 1986—the latest available when they performed their analysis.) Thus the effective U.S. tax rate on foreign source income was 3.4 percent. In the manufacturing sector, which accounted for 90 percent of the foreign source income, corporations paid only 2.3 percent in taxes.

The AFL-CIO has long supported the basic principle of tax fairness which says that equal incomes should be treated equally. The foreign tax credit and the deferral privilege both violate this principle by granting privileged status to income earned abroad. At a time when both the federal government and the state governments are being squeezed by inadequate revenues, the tax credit amounts to a form of "revenue sharing" between the U.S. treasury and various foreign treasuries. The deferral privilege amounts to an interest free loan from the U.S. Treasury for corporate investments abroad, and in many cases results in outright immunity from U.S. taxes for profits that remain overseas.

Contrast the situation of a firm that operates domestically with that of a firm that invests abroad. A firm that keeps its production in the U.S. and employs American workers pays taxes to state and local governments and pays federal income tax in the year that it makes its profits. It cannot defer its federal taxes to a later year nor can it subtract taxes paid at the state and local level from its federal tax obligations.

A firm that chooses to move production to another country not only injures the workers who lose their jobs, but adds insult to that injury by sending part of the bill to the U.S. taxpayers.

The Drain On The Nation's Revenues

For 1990 (the latest figure available), U.S. based multinational corporations used foreign tax credits to reduce their income tax bills by $25 billion. The AFL-CIO estimates that treating the credit as a deduction would have raised an additional $16.5 billion in federal revenue. The Joint Tax Committee of Congress estimates that ending deferral would increase revenues by another $1 billion.

Surely there are more appropriate ways to spend $17.5 billion dollars other than subsidizing the foreign operations of U.S.-based corporations. The nation has desperate unmet needs in infrastructure investment, education, and health care, to name a few examples.

Answering The Critics

The large corporations and their supporters argue against eliminating the privileged status that income earned abroad now enjoys. They argue that eliminating deferral and the foreign tax credit would place an undue burden on U.S. businesses who are trying to compete in the international marketplace.

These critics of reform are correct that tax subsidies for investment abroad have benefitted multinational corporations and their stockholders. But these benefits have not been shared with the vast majority of Americans who rely on jobs in the U.S. for their income and who pay their taxes.

Complaints that corporations cannot afford to be deprived of these foreign tax loopholes ring hollow when one examines the declining share of U.S. revenues that have come from corporate income taxes over time (see graph).

Critics argue that if foreign taxes were deducted rather than being credited, other governments would "retaliate" by removing foreign tax credits that they offer to their companies that are doing business in the United States. They characterize efforts to change the foreign tax credit as "protectionism."

What these critics are saying is that the U.S. cannot stop subsidizing overseas business, or foreign governments will stop subsidizing foreign subsidiaries operating in the U.S. But there is no obvious reason why any nation should be required to provide subsidies to production occurring beyond its borders.

The foreign tax credit, in effect, turns over the taxing authority of the U.S. government to foreign governments. It says, in a sense, that if a foreign government chooses to tax a corporation, the U.S. will not, and if the foreign government increases the taxes it collects from the corporation, the U.S. will reduce its tax collections in response.

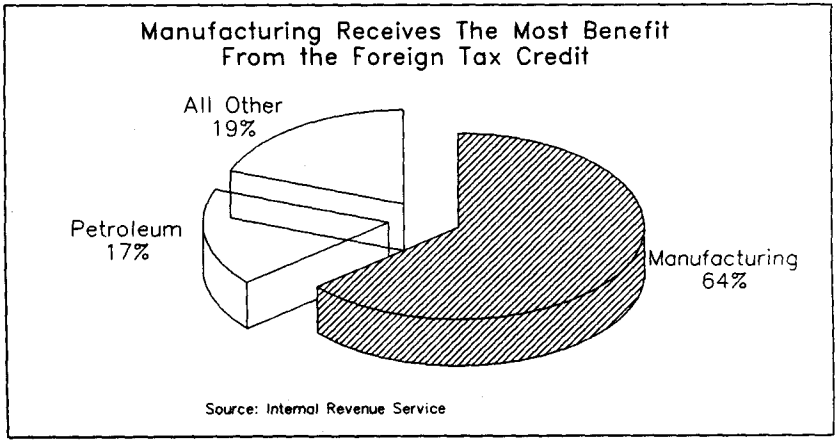
It Is Time For Reform

As a candidate in 1992, President Clinton criticized tax subsidies that encourage the movement of U.S. production to overseas locations. Now is the time for Congress and the President to act, by changing the foreign tax credit to a deduction and abolishing deferral. This would eliminate two incentives that contribute to the export of U.S. jobs and production. It would add to federal revenues. It would move the U.S. system of international taxation closer to the principle of tax fairness.

Removing the privileged status that income earned by U.S. multinationals abroad now enjoys should not be viewed as a protectionist move, or as an unfair effort to raise revenue at the expense of business. Rather, it is a matter of closing a loophole and treating equal incomes equally.

Prepared by Robert E. Lucore
AFL-CIO Economic Research Department

For additional copies, write to:
AFL-CIO Publications and Materials Office
815 16th Street, N.W.
Washington, D.C. 20006



© AFL-CIO 1993. No portion of this publication may be reproduced by anyone other than an affiliate of the AFL-CIO without express written permission.

Mr. BUNNING. Mr. Collins will inquire.

Mr. COLLINS. Thank you, Mr. Chairman.

You know, I find it interesting to listen to people talk about estate taxes and the fact that people shouldn't get a break—well, a person who dies is not going to get a break anyway but maybe the estate will. I have heard there are two ways to be a millionaire, to have $1 million or owe $1 million. If a person dies owing $1 million, but yet it is worth $1 million to be able to borrow it, the estate is in trouble. They are going to have to deplete those assets to pay those taxes, and I think that is wrong. I am hoping that we can go farther than this $750,000.

Mr. Huard, you mentioned the alternative minimum tax and I was glad to hear that. Give us some background on alternative minimum tax and exactly why you think that should be repealed. I found with interest the other day that Mr. Gephardt had the same comment when I questioned him about the alternative minimum tax.

Mr. HUARD. Basically, the alternative minimum tax is one of those perverse things that bites you when you are down. They make you recalculate your taxable income using much longer depreciation schedules, less favorable depreciation schedules, and of course, it results in a larger taxable income base.

At times of high profits, or when your business continues to grow, you never have to pay the alternative minimum tax. But when you have a year when you lose money, you could have a regular tax return that says you have got a net operating loss and you are writing checks to the Treasury for the alternative minimum tax, basically, a prepayment of your regular tax that you otherwise owe down the road, but they want it up front. It is, like many things, a bad response to a cosmetic problem.

In the natural business cycle, you have many corporations who have years when they pay tax and years when they pay no tax. And you get various public interest groups who select out the years where they pay no tax and they say, isn't it awful, what can we do about it? And the alternative minimum tax was one of the more stupid responses to that question.

Mr. COLLINS. I agree, I don't like the alternative minimum tax either. I have seen years that you had low profits and you still had to write that check, or even no profits.

Mr. Friedman, you don't seem to have anything, or we don't have anything in our Contract With America that you really approve of, other than the $500 for dependent children for low- or medium-income families. Above that, you have no desire to see the rest of the Contract or any of the Contract approved, I gather from your testimony.

But I oftentimes have heard from people who belong to organized labor, especially when we have trade agreements, that they are very concerned about our businesses moving to different nations, especially those nations who have low-wage rates. But I think one of the greatest competitors to American people and American jobs is the Tax Code. And that is one of the things that we are trying to change, so that we can encourage those businesses and give them a competitive edge to stay here rather than leave this Nation.

And I also find it very interesting that you are opposed to corporations or businesses, large businesses or anyone else making a profit—especially the fact that, as organized labor, you have a contract with employees as well as those employers, and on behalf of those employees you all are always trying to enhance their benefits or their salaries.

So I find it very interesting that you hate to see those corporations or those businesses or those people further their moneys or further their profits so that you can have an opportunity to negotiate on behalf of your membership.

Mr. Motley, would you give us your opinion from the National Federation of Independent Business about the alternative minimum tax? Are you in agreement with Mr. Huard on that?

Mr. MOTLEY. I am completely in agreement with him, no differential at all. If you take a look at our testimony, we are suggesting major simplifications for firms under $10 million a year in gross annual sales, which we think is an arbitrary but decent cutoff between smaller and larger businesses. And one of the things that we suggest is the total elimination of alternative minimum tax for them. I don't see any reason why it shouldn't be done for all businesses and for everyone.

Mr. COLLINS. And you said the average annual income of your membership was $40,000?

Mr. MOTLEY. Yes, Mr. Collins.

Mr. COLLINS. Middle income?

Mr. MOTLEY. It definitely is middle income, although if you take a look at the small business community, what you find out is you have got barbells. You have an awful lot of what you call "lifestyle businesses" where people are working very, very hard. They don't want to grow; maybe the location that they are in, or the town that they are in is not allowing them to grow. They don't have a desire to become a regional or national firm.

Then you have other businesses that want to grow. And therefore, you have barbells, and the barbell on the bottom side is much bigger than the one on the top side. There are a significant number of self-employed individuals who are in business that make substantial amounts of income, but the vast majority of them are down under $50,000 a year.

Mr. BUNNING. Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

And I thank this distinguished panel for coming here today.

Mr. Motley, I want to tell you how much I appreciate you being here because of the organization that you represent, the NFIB, I believe the NFIB to be the greatest small business advocate out there. And you have a representative in Omaha, Nebr., by the name of Lee Terry who has worked awfully hard to represent small business and worked hard to continue the ideas that the NFIB stands for.

During your travels and your time, have you got a sense from the small business community as far as our Contract With America? Have you conducted a survey to find out where they stand on the provisions of the Contract, if there is a percentage of various things in it they like better than others? Or have you done that yet?

Mr. MOTLEY. We haven't done anything specific. Of course, as I believe you know, we do poll our members on a continuing basis. And there are over—I think the Contract has 50 individual elements in it, and there are over 20 that we have polled on, and in each case, the members have been in favor generally, by very large percentages, of those 20, even some of the elements of the welfare reform package we have polled on.

But there is also a general sense that the small businesspeople have been extremely frustrated over the last half dozen to dozen years about an increasing level of government regulation and taxes. And they were very angry about it. And our judgment—and I just left an NFIB board meeting over the last couple of days—is that our members are where the Contract is. They support it. They turned out very heavily and they want us to see it enacted.

Mr. CHRISTENSEN. I know that one of the bills that have come before us this week that we are excited about cosponsoring is a national moratorium on new regulations. That is going to give some relief to our small business owners out there.

Ms. Ball, you are with the chamber, besides running your own company. How does the chamber feel about the Contract when it comes to capital gains reduction and looking at other ideas that are going to help out the small business owner?

I also would like to have your comments on the minimum wage and how—there is talk about increasing that minimum wage, when in fact I think that will take away jobs rather than give more money to those people who are on minimum wage.

Ms. BALL. Representative Christensen, I think that the capital gains reduction has been a long beat drum of the U.S. Chamber of Commerce from all sides of its membership, from the smallest members—and I am a small business owner—to some of the largest members. And we have beat this drum long and hard, and now we are hearing an echo that it may come to pass and we are greatly looking forward to it.

In regard to minimum wage, I think if we went back years, several years past and the chamber did some work in regard to minimum wage, and even the New York Times, which I wouldn't call a small owner business newspaper, said that the best minimum wage was a zero minimum wage.

And I think there are things that can best be done rather than raise minimum wage. I think minimum wage really hurts the people on the lower end. And speaking as a business owner and paying my own employees, I think anybody would be very naive if they think that a minimum wage would stop with just the lower end of the business employees. If I gave a $1 an hour increase to somebody that I might have on minimum wage—but I don't have—everybody in my business would expect a $1 an hour increase in minimum wage.

Mr. CHRISTENSEN. Mr. Motley, briefly, could you, in a nutshell, tell me what small businesses' position is on neutral cost recovery and how it differs from, say, large corporations?

Mr. MOTLEY. We would prefer expensing, and there are very, very simple reasons for it. Number one is that expensing is a very simple method of depreciation, where we believe neutral cost recovery is much more complex.

Number two, one of the reasons that neutral cost recovery is in the Contract is that it raises money in the first couple of years. Just for the fact that it raises money there is less money going into the business community and less money going back to smaller firms in cash flow. So we don't believe that it is as friendly as where it proposes to get, and that is expensing.

So, therefore, we would prefer to see if you are going to spend money in the area of increasing incentives for firms to purchase plant and equipment that you move, just as Paul said, in the direction of true expensing rather than an equivalent to expensing.

Mr. CHRISTENSEN. Thank you very much.

Thank you, Mr. Chairman.

Mr. BUNNING. Mrs. Johnson.

Mrs. JOHNSON. Thank you, Mr. Chairman. I, too, am interested in the issue of expensing versus neutral cost recovery.

Mr. Huard, you made the point that many of the big companies, because of the AMT, can't benefit from neutral cost recovery anyway; and it clearly doesn't advantage the small companies, given limited resources. What is the advantage of neutral cost recovery as a component of this package over additional expensing?

Mr. HUARD. Well, the honest answer is, I am not sure there are any advantages. I think—I mentioned in my testimony that we thought it was desirable after you get through with implementing the Contract to look at overhaul—complete structural overhaul of the tax system, and in that context, I think you can achieve across-the-board expensing.

The fact of the matter is, you can't achieve across-the-board expensing in the context of the existing Internal Revenue Code because the revenue cost is prohibitive. So only when you are scrapping the entire current code and starting fresh can you look realistically at expensing for companies of all sizes and for investments of all amounts.

In the context of the Contract, I have to admit you might be better off doing as John suggests and increasing the expensing limit and cutting back or repealing the AMT, and you might have a more potent bang for the buck than you would from NCRS.

Mrs. JOHNSON. Could you help us identify that, what appears to be an increasingly small sliver of businesses that would benefit from neutral cost recovery? Small companies will not, and if companies affected by the AMT will not, you know, exactly what is that group? You can get back to us on this.

What is that group that may and to what extent will they? So——

Mr. HUARD. That requires a little research. We will get back to you.

[The following was subsequently received:]

Monica M. McGuire
Director of Taxation
Taxation and Economic Policy

August 16, 1995

Ms. Traci Altman
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Traci:

The following information is submitted on behalf of Paul Huard, Senior Vice President, Policy and Communications, National Association of Manufacturers, as a reply to Representative Nancy Johnson's inquiry made during the January 12, 1995, Ways and Means Committee hearing on selected provisions in the "Contract With America."

The profile of a company which would benefit over time from the Neutral Cost Recovery System (NCRS) proposal would be one that invests in assets with longer recovery periods; however, such a company would have to give up the current law benefit of front-loaded accelerated depreciation. Some NAM member companies expected to benefit from the NCRS have expressed concern that if the NCRS were adopted today, then the benefit to occur only later would be likely eroded or eliminated with changes made by future Congresses looking to save money.

Sincerely,

Monica M. McGuire

Manufacturing Makes America Strong
1331 Pennsylvania Avenue, NW, Suite 1500 - North Tower, Washington, DC 20004-1790 • (202) 637-3076 • Fax:(202) 637-3182

Mrs. JOHNSON. It does. We have talked about increasing expensing for many years in this committee, and we fought hard and we got from $15,000 to $17,500. Big deal. Now we may take the giant step to $25,000. But we have had excellent testimony that $50,000 to $100,000 is really where we ought to be looking, and I think this issue of simplicity and of growth capital is really what ought to be driving our Contract.

I did want to mention, Mr. Motley, that this committee has already publicly committed itself to retroactively reinstating the 25-percent deduction on health premiums, but has certainly not forgotten our strong commitment, as part of health care reform, to moving deductibility up toward 100 percent for self-payers in the way that large companies are able to deduct premiums.

I thank you for your testimony and yield back the balance of my time.

Mr. BUNNING. Ms. Dunn.

Ms. DUNN. Thank you, Mr. Chairman.

I am interested in the estate tax relief that you referred to, Mr. Motley, in your testimony; and I wonder if, for our benefit, you would design for me your perfect approach to estate tax relief beyond doing away with it altogether, which certainly would be a possibility I would hope we would look at at some point.

Could you do that? In which way would it most benefit small business?

Mr. MOTLEY. Thank you for the question. Representing smaller businesses, we looked at the impact that estate taxes have on smaller, closely held firms, farms, and ranches; and they can be devastating, even if the business is only a small portion of the estate where a part of the business has to be sold off by the heir.

Or even more—Mr. Collins, you are in business for yourself and you realize what you have to do in terms of purchasing insurance. That money can be used more productively in the business. It drains the business of a lot of productive capital over the years.

What we are suggesting is that we look at it a little bit differently. Instead of looking at the heirs, you look at the assets of the business and hold the assets of the business, the farm, the ranch harmless to guarantee that it continues so that the jobs that those businesses, farms and ranches provide can continue.

It could be left to a vice president or a foreman; it could be left to anybody else, not necessarily an heir. What we are trying to do is alleviate the negative impact of estate taxes and planning for estate taxes on the business itself.

Only 12 percent of estate tax revenue each year is attributable to closely held business assets. Exempting all closely held business assets in the United States from estate taxes would cost, in our estimate, about $1.2 billion a year. And with some necessary restrictions on the proposal, that number would drop even further, somewhat down under $1 billion.

I think you would relieve a tremendous amount of worry and concern and frustration by the people who have started businesses. You would also relieve a tremendous amount of concern for people who work for those businesses. And it just seems that what we want to do in this country is encourage people to start businesses in their hometowns and localities, provide jobs and provide eco-

nomic growth; and then all of a sudden, when the person who happened to found it passes away, we take the chance of wiping it out. It doesn't happen all the time. It seems to be counterproductive economic policy.

We are not suggesting exempting all assets from estate taxes, only closely held business assets. Assets in large corporations, which can be publicly traded, are generally no problem; and we are not suggesting eliminating estate taxes for very, very wealthy people whose assets may be in other areas. Just the productive, closely held assets of businesses, farms and ranches, by some estimates in the neighborhood of $800 million or $1.2 billion a year.

Ms. DUNN. Thank you very much.

I would like to also have the point of view of each of you on Dick Armey's flat tax proposal, on how—and this is outside the Contract, but it is something that we will be looking at in the next couple of years—how you would be affected and what your attitude would be toward a flat tax such as that 17 percent supported by Representative Armey.

Mr. MOTLEY. Let me start, and we can move down; and that is to say, I agree completely with Paul, we need to take a look at the basic Tax Code of the country. For small business owners, it is a nightmare. They get in more trouble by not understanding it and having to do their own books than anything else.

Our members when we polled them in a vacuum on flat taxes liked the idea, nearly two-thirds would like to see it done. But in all honesty, we have to take a look at compared to what. What are the other options that are on the table? From a small business standpoint, we would prefer to eliminate both the income tax and the payroll tax and move to something else.

The vast majority of small businesses in this country today pay more in payroll taxes than they pay in all other taxes combined—Federal, State, local, income, sales taxes, everything else. So I think when the committee looks at redoing the tax system, you must also take a look at the payroll tax, and I think that is something that you should move to quickly after this, and hopefully we will all participate in it with you and help you make those decisions.

Ms. DUNN. Thank you.

Ms. BALL. I don't know how the flat tax will finally roll itself out after everybody gets done talking about it, and I think it is really too soon to be speaking about it from my point of view. It is something I think needs looking at, as all tax policy needs looking at is about what I would have to say on it.

Mr. HUARD. Well, the Devil is always in the details, but I am prepared to at least make some fairly warm preliminary comments that it is something that definitely deserves serious inquiry. It would solve a lot of the problems in the existing tax law, particularly in the area of complexity. If you can get a system that significantly lowers the rates from their present levels, then you can seriously talk about doing away with a lot of the special purpose deductions and credits so we don't have to spend our time arguing about corporate welfare and subsidies in the Tax Code. There is a lot of merit to Mr. Armey's approach.

Mr. FRIEDMAN. From what I have seen of Representative Armey's proposal, it would make a bad situation dramatically worse. It is my understanding it would exempt capital income from taxation, it would make a Tax Code which is far less progressive than it should be even less progressive. It would raise less revenues than the current income tax system, thereby causing further elimination of programs. It would put more of an unfair burden on working people and less of a burden on those who can best afford to shoulder the cost of government, which are the wealthy individuals in our society.

Mr. Collins, you, I thought, asked me a question earlier. I don't know if the Chair would indulge me in an opportunity to answer it. I didn't get a chance.

Mr. BUNNING. See, I haven't had a chance to question anybody yet. Can I get a couple of questions in?

Your time has expired, Ms. Dunn.

I would like to ask you, Mr. Friedman, yesterday in his testimony, Les Samuels, the Treasury Assistant Secretary, criticized the Contract's tax provisions as not being sufficiently targeted. That is what he said. Who do you think should be doing the targeting for investment decisions, the Federal Government or individuals and/or businesses?

Mr. FRIEDMAN. Well, I think that, in general, individuals and businesses should make decisions, but they do it based on ground rules that are either set by the market or by public policy. And if you are talking about giving away huge sums, billions of dollars of the public's money—which is really what, for example, capital gains tax preferences would amount to—the public would have some right, it seems to me, to expect particular performance by the recipients of that largesse, even if it was otherwise a good idea, which I am not convinced of.

For example, what would there be in the provisions of the Contract, the tax provisions, that would assure that investments would take place in the United States? If somebody made a profit speculating on peso futures, which might be an area where a lot of profit could be made just now, they would get the benefit of the capital gains tax break on that—as I read the Contract. I don't see what public or social purpose is derived by making such blanket grants of public resources available. Working people can't take a break on their wages; they have to pay taxes on every dollar of their wages.

Mr. BUNNING. I guess we have a different opinion on the public's money. You consider the revenues that we extract from the individual taxpayer as the public's money? Or where do we draw the line on whose money is what?

Mr. FRIEDMAN. If there is a tax rate, if the Congress determines a tax rate on income, whatever it is, it seems to me it ought to apply equally to all sources of income. It is inherently unfair to tax the wages of workers at a higher rate than the investment income or capital gains of wealthy individuals. That is really the point I am trying to make.

Mr. BUNNING. This is a question for the whole panel.

Also in Les Samuels' testimony he said the Contract's tax provision failed the administration test for fairness because they would reduce the progressivity of the income tax. Do you agree that this

should be our primary measure of fairness? Aren't there other measures of fairness, like job creation, rewarding work, increased economic opportunity, that we ought to consider at least equally with fairness?

Mr. HUARD. Fairness, Mr. Bunning, is frequently used by its proponents as a pseudonym for income redistribution or achieving equality. The fact is that the Tax Code, as it presently exists, is more than amply progressive. I believe the top 10 percent of the taxpayers pay an astounding amount of tax to the government. I forget what it is, but it is well over 50 percent, so that the Tax Code is already sufficiently progressive.

The idea that we have to penalize success by taking away an ever increasing amount of additional income is what is wrong with the Tax Code, and it is why we are never going to have increased economic growth. The proponents of progressivity and the opponents of things like capital gains tax cuts are dealing with a logical impossibility. They are all warm and enthusiastic supporters of increased investment, increased jobs, but they can't get past the idea that if you provide incentives to do that, it is going to benefit the people that have the money to save and invest.

Ms. BALL. Congressman Bunning, I think I would have to say on all of his statements, and even the ones that you did, a qualified yes.

Mr. BUNNING. Thank you.

Mr. Motley.

Mr. MOTLEY. Congressman, I think fairness is in the eye of the beholder; and I can remember trying to make a case during the last tax increase that we had at the beginning of this administration, when the people within the administration would not want to listen about the unfair nature of the huge tax increases that were imposed upon self-employed businesspeople in this country—virtually the only people who took a huge hit, roughly 60 percent over 4 years. Their taxes went up. FICA went up. Income taxes went up all across the board. So I really do think it is in the eye of the beholder.

You have to do certain things in this country to get people to take risks and when people take risks, generally most other people in the United States benefit from it. So I think you have to balance the two against each other. And I would agree with Ms. Ball and Paul Huard.

Mr. FRIEDMAN. I think fairness or ability to pay is a very important criterion in evaluating any tax system. And if you look at what has happened in our country, the polarization that we have had in the last 15 to 20 years, contrasted with 30 or 40 years before that, where economic growth benefited all segments of our society, that had been the norm.

Since the mid to late seventies we have had the wealthy getting wealthier, and the middle- and low-income levels in our society going downhill; and we have had, for the most part, a tax system which, while it mainly didn't cause that problem, it did compound it. So at the very same time, for other reasons—globalization, technology, whatever it may be—we had the rich getting richer and the poor getting poorer, we had a tax system that was cutting more

deeply the taxes for the rich while raising, through the payroll tax in particular, taxes on moderate- and low-income people.

And, you know, the fact of the matter is, fairness does matter. And we have a tax system today which is terribly unfair—unfair to working people, unfair to people of moderate means who work for a living; and I fear that most of the proposals in the Contract in the tax area would take us even further in the wrong direction.

Mr. BUNNING. I will get right to you, Mr. Collins, but I want everyone here to remember that a good Democratic President by the name of Kennedy in the sixties proposed a major reduction in the capital gains tax, and it didn't turn out as it was scored. It turned out to be a net positive for our country. And I think that we ought to remember that it is a bipartisan-type thing rather than a partisan.

Mr. Collins, go ahead with Mr. Friedman.

Mr. COLLINS. Mr. Chairman, I don't believe I asked Mr. Friedman a question. I made a comment, but if he wants to comment back, I would be glad to exchange.

Mr. FRIEDMAN. You made a point, which I agree with quite strongly, maybe for different reasons, which is that you, I believe, stated that the Tax Code is the source of a loss of jobs from the United States today; and I agree very strongly with that point. If you look, for example, at the foreign tax credit, which gives U.S.-based corporations a huge subsidy for exporting U.S. workers' jobs, that ought to be changed; this is something that more detail is provided on in the attachment to our statement.

There are a whole host of provisions in the Tax Code that reward corporations for destroying or exporting jobs. The tax treatment of mergers and acquisitions is one example, which was a contributor to a great deal of job loss in the late eighties, and even still to some degree today. So I agree with that point.

I am certainly not opposed—and I am sorry that I created the impression that I was opposed—to corporations making a profit. The point I was trying to make is, when they do, they ought to be willing to pay a fair share of taxes on those profits. While their profits have been holding up, their taxes have been coming down; and we would like to see corporations pay a fairer share of taxes.

Mr. COLLINS. You know, I am a small businessman and have been for 32 years. I have been contracting with a very large, one of the Fortune 500 companies for 24 of those 32 years. I was always of the mindset that I hated to see that corporation, even though they were a conglomerate and very big compared to me, I hated to see them spend any money that was unnecessary, whether it be in taxation or whether it be in the operation of their business. I always felt like every nickel that they spent that was unnecessary was a nickel that I couldn't earn. And I feel that same way toward your membership, that every nickel that a corporation spends is a nickel less that your membership has an opportunity to bargain for.

But also there are a lot of hidden taxes in this country. Corporations and businesses really don't pay tax. They collect those taxes through consumer goods or services that they render. And after the 1993 tax bill was passed here, I went back to my district and I explained it somewhat like this: The next time you walk in the gro-

cery store, you stop at the front door and you look across that store and you will see shelf after shelf filled with items—many, many different brands, many, many types of items, thousands of items. First of all, those items didn't grow there. They were transported there.

And we had just increased the fuel tax, a fuel tax that is going to be reflected in the price of every one of those items.

And if you go down through there and look at the names on every brand that is there, you will find some of those big conglomerates that we just penalized with additional taxation. That additional taxation is, too, going to be built into the price of that item. Your membership, my constituency, they are going to pay those hidden taxes when they pick those items up.

Businesses don't pay tax, they collect it from men and women who work, who draw an income, and spend that income on behalf of their families and for existence.

I enjoyed the exchange. Thanks for coming. Thank you, each of you, for being here.

Mr. BUNNING. Thank you. I want everybody here to know how deeply we appreciate your testimony. We all know that—we asked you to talk about the Contract With America. And you all know that we have a big job in the first 100 days, but that does not mean that this committee will not look into the overall Tax Code after the first 100 days, and you can bet your life, we are looking forward to it.

Thank you very much for your testimony.

[Whereupon, at 3:42 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

TESTIMONY OF
CONGRESSMAN CHRISTOPHER SHAYS

BEFORE THE
HOUSE WAYS AND MEANS COMMITTEE

Chairman Archer, Congressman Gibbons, and members of the Committee, thank you for providing me the opportunity to testify before your committee to discuss the five bills within the Contract With America that are under the committee's jurisdiction. This is an important part of moving the contract forward. I would like to take this opportunity to share my views with you on these five proposals.

I. THE AMERICAN DREAM RESTORATION ACT

H.R. 6, the American Dream Restoration Act, of which I am a cosponsor, will help restore economic viability to the American family, and promote greater individual savings.

As you know, the bill provides a tax credit of up to $500 per child for families with incomes under $250,000. Phase out of the credit would begin at $200,000, with full phase out at $250,000.

The legislation also provides tax credits to individual affected by the marriage penalty, which occurs when a married couple pays more as a couple than they would as individuals.

Finally, the legislation creates a new type of Individual Retirement Account (IRA) which would permit individuals with any income level to contribute up to $2,000 per year ($4,000 for married couples) into a new IRA, called the American Dream Savings Account (ADSA). These new accounts differ from conventional IRAs in that individuals would pay income tax on contributions to the accounts, but would be able to make withdrawals tax free. Current IRA participants would be allowed a two-year window to roll over existing IRAs into an ADSA.

I strongly support these provisions. As you may know, the Republican Budget Alternative for fiscal year 1995 (FY 95), written by the Republicans on the Budget Committee, included provisions providing for expanded IRAs and a $500 tax credit per child. Our alternative budget not only provided for greater deficit reduction in FY 95 than the President's budget but also paid for the tax incentives. It is equally important that the tax provisions in H.R. 6 and all the tax provisions within the Contract With America be paid for. Tax provisions will not help if ultimately they contribute to the federal budget deficits.

II. THE JOB CREATION AND WAGE ENHANCEMENT ACT

H.R. 9 is an effort to do just what its title states -- help create jobs and enhance the wages of American workers.

Small business continues to be the job creator in our economy, but federal taxes and regulations have stifled small business creation. While the United States and the Soviet Union were fighting the Cold War, our trading partners in Europe and Asia have been fighting an economic war. It is essential that we provide ways to help businesses advance in the global market. This bill is an effort to create a better environment for growth in what has become a very competitive global economy.

I support the tax provisions in H.R. 9, which include: cutting the capital gains tax; increasing capital investment depreciation; raising the estate tax exemption; providing greater expensing on equipment for small businesses; and restoring the deduction for individuals who work out of their homes.

One of the ways we can help businesses is by reducing the burden of

taxes. As you know, the bill provides a 50 percent capital gains tax rate cut and prospectively indexes capital gains to account for inflation. It will reduce the current tax rate from 39.6 percent to 19.8 percent. It also allows those who lose money on the sale of their home the ability to deduct the loss from their taxable income.

The neutral cost recovery system allows businesses to depreciate the original cost over the life of the equipment, plus inflation, plus 3.5 percent each year. This provides the opportunity for businesses to deduct the true value of this investment by factoring in the effect of inflation.

Accordingly, businesses that invest less than $200,000 in depreciable property each year will be able to receive an immediate $25,000 deduction on the purchase of new equipment, which represents an increase of $7,500.

Also included in the bill is an increase in the exemption of the estate tax from $600,000 to $750,000. The increase in the exemption is phased in beginning at $700,000 in 1996 and increasing $25,000 over the next two years.

H.R. 9 also clarifies current regulations concerning the deduction of home office expenses by allowing those who perform essential administrative and managerial duties of the business in their homes to take these costs as a business deduction.

Under the Taxpayer Debt Buy-down provision, taxpayers could designate up to 10 percent of their taxes to reduce the federal debt. Congress would be required to reduce government spending by the amount in the Public Debt Reduction Fund or mandatory sequestration would take effect. The Congressional Budget Office (CBO) has calculated that if all taxpayers checked off the maximum level of 10 percent, and Congress was then forced to make the reductions in spending necessary to comply, the federal budget deficits would be eliminated by the year 2000. While I cosponsored the Taxpayer Debt By-down last Congress when it was introduced as a separate bill by Congressman Bob Walker of Pennsylvania, I believe this provision of H.R. 9 should not be included if the balanced budget amendment is ultimately ratified.

The Taxpayers Debt Buy-down provision is a tool to force Congress to reduce our annual federal budget deficits, but in my opinion, the constitutional amendment is a far stronger tool. I believe it might be ultimately harmful to our economy if both the Taxpayer Debt Buy-down and the balanced budget amendment were in place.

While I support many of the provisions in this bill, I have concerns with Title IX: Private Property Rights Protections and Compensation. As you know, under this provision private property owners would be compensated by the Federal Government if the use of their property is limited as a result of actions taken by the Federal Government.

I agree private property owners should be protected from undue financial harm caused by an overzealous federal government. But the Fifth Amendment of the Constitution provides this protection and the courts have, in most cases, been an appropriate forum to address these issues.

Title IX raises several questions that I would like to share with you. One question I have is related to retroactivity. I am unclear as to whether people would be able to receive compensation for property depreciation as a result of a regulation that is already in place. If this is the case, it seems the bill would open up the possibility for people to apply for compensation above and beyond what was paid for the property.

It is also unclear whether H.R. 9 would apply to potential loss of property value, or just actual loss. For example, suppose an individual planned to build an apartment complex on a piece of property, but then found out that an endangered species lived on the land. It is not clear to me if property owners would be compensated for the potential increased revenue that might have

been gained had the apartment complex been built. It seems it would be difficult to determine the amount of compensation due a property owner under this type of scenario.

Another issue raised by the bill's provisions is that of direct versus indirect loss of property value. Most property value is in some way linked to other nearby property. If a wetlands regulation meant that an amusement park couldn't be built in a particular community, I am unclear whether a neighboring property owner could receive compensation because his plans to develop the land based on the development of the neighboring amusement park were no longer economically viable.

I recognize that regulations sometimes result in decreased property value, but they also can result in increased property value. The federal government does not expect to be compensated for such "givings," and it seems to me this understanding should be a part of the debate on "takings."

Clearly, compensation under this bill could be extraordinarily expensive. By requiring agencies to use their own appropriations to fund the compensation, the intent seems to encourage agencies to loosen regulations. But we, as lawmakers, must hold ourselves accountable for making good laws that make sense. If we feel a law does not make sense, we should change it.

Finally, I wish to express my concern about how this law might affect our environment. Our nation's environmental laws and regulations were created to protect the health, lives and safety of American citizens. In addition, they aim to preserve and protect our natural resources for future generations to use and enjoy. This lofty goal should not be taken lightly and we must take responsibility for achieving and maintaining it. Environmental laws and regulations need to be debated, and at the end of that debate some laws might need to be strengthened, and others weakened. But they should be assessed based on the merits, and not on the broad ramifications that could result if Title IX of H.R. 9 became law.

My staff and I have spoken with many people and organizations who have brought up these and other questions regarding possible scenarios under which people could be compensated under Title IX.

These concerns, among others, lead me to believe that the issue of federal takings is best left up to the courts. Every claim will be different, and should be decided on a case-by-case basis, not on a sweeping law open to wide interpretation.

If we decide that Congress, not the courts, is that best forum for deciding the issue of "takings," I hope some changes will be made to the pending legislation. I support raising the percentage of property loss meriting compensation. In addition, I hope that any "takings" legislation passed by Congress is more narrow in scope, so the ambiguities such as the ones I have outlined are made clear.

III. THE FAMILY REINFORCEMENT ACT

I would also like to thank you for allowing me to testify on H.R. 11, I am proud to be a cosponsor of this important legislation.

The Family Reinforcement Act, of which I am a cosponsor, offers tax relief for an already overburdened middle class by providing credits in two areas which have previously been overlooked. The $500 per person eldercare credit will give needed assistance to families who are caring for the elderly, and the $5,000 credit for adoption expenses will help find new homes for displaced children.

Another area which needs strengthening is child support enforcement. H.R. 11 includes provisions that help prevent non-custodial parents from turning their backs on their children. Given the fact that child support payments often determine whether a family remains financially stable or is reduced to poverty, it is imperative our government actively and vigorously enforce child support regulations.

A third provision of the Family Reinforcement Act which I believe is extremely important is the increase in sentences for sexual offenses against children. I am glad the bill also provides for a minimum three year sentence for anyone who forces children into prostitution, a provision I strongly support. It is about time criminals who commit such horrific acts on our children begin to pay for their crimes.

It is my hope the passage of H.R. 11 will be a major step in ensuring that the interests and needs of our children are protected. This bill will offer a better, brighter future for the families of our great nation.

IV. THE SENIOR CITIZENS EQUITY ACT

I would like to express my support for the provisions of the Senior Citizens' Equity Act which would raise the earnings limitation on older Americans, and commend the Ways and Means Committee for acting so promptly in the 104th Congress to correct this injustice.

I believe Social Security recipients who want to continue working should be able to earn outside income without being penalized. Senior citizens, like any other group of Americans, have a right to work to achieve financial independence without being penalized by the federal government.

Unfortunately, that is not currently the case. The earnings test imposed on senior citizens, taxing their Social Security benefits if they earn more than a certain amount, is an unfair punishment for those who wish to stay productive and contribute to our economy.

Persons aged 65 to 69 can receive full benefits as long as they earn no more than $11,160 in outside income. Benefits under this category are reduced $1 for every $3 earned above this amount. For those citizens 70 years old or older there is no earnings test.

The Senior Citizens Fairness Act, of which I am a cosponsor, would phase in an increase of the earnings limit over five years, raising it to $15,000 in 1996, $19,000 in 1997, $23,000 in 1998, $27,000 in 1999 and $30,000 in 2000.

Support for this change is strong, both from the public and here in Congress. We cannot afford to ignore the experience and professionalism older Americans bring to our workforce. In addition, these older Americans will be working longer and paying more taxes.

The earnings test, developed during a depressed economic environment, was designed to drive workers out of scarce jobs. Its repeal is long past due as a recognition of the changing needs of businesses struggling to find qualified workers and remain competitive.

V. THE PERSONAL RESPONSIBILITY ACT

As this committee knows all too well, many welfare recipients view employment as a threat to their standard of living. We have created a culture of dependency where getting a job may actually result in a decreased income. This must end. We must change the welfare state so that people are encouraged to work and save in an effort to become self-sufficient.

In a perfect world, certain provisions of H.R. 4, the Personal Responsibility Act, could be seen as outdated, but unfortunately we do not live in a perfect world. When you have 12 year-olds having babies, 14 year-olds selling drugs, 15 year-olds killing each other, 18 year-olds who can't even read their own diplomas, and 30 year olds who have never held a job, you see that measures such as orphanages and foster homes must be considered as possible solutions in reforming the existing welfare system.

We also need to encourage our young people to focus on moral living. Government legislates immorality when it encourages our children to have babies out of wedlock rather than in wedlock and doesn't hold the fathers accountable.

H.R. 4 contains provisions, which I support, that reform our welfare system and provide greater control to the states in the use of federal welfare funds.

The legislation will terminate Aid to Families with Dependent Children (AFDC) payments to unwed mothers under age 18 and their children, while allowing the states to have the option to extend payments between the ages of 18-20. The savings from these programs will then be given to the states in the form of block grants. These block grants may be used to establish orphanages or group homes for unwed mothers. Also H.R. 4 requires paternity to be established to receive full benefits.

The Personal Responsibility Act also will eliminate welfare benefits to legal permanent residents. I support placing this limitation on federal assistance programs because it will preserve the original intent of social service programs -- to protect citizens of our country -- and discourage immigrants who come to the United States intending to apply for benefits.

There is one element of H.R. 4, however, that gravely concerns me. I am opposed to any provision that would silence health professionals from advising their clients about abortion services. I believe the government has no business interfering in the relationship between a doctor and their patient. The "gag rule" denies all women, especially those less fortunate, information about the full range of available medical options. This could cause them to make uninformed decisions and deprive them of needed medical services. I have always voted against the "gag rule provision" and will do so again should this language remain in H.R. 4.

A fifth provision of the Personal Responsibility Act is the consolidation of 10 nutrition programs such as food stamps, Supplemental Nutrition for Women, Infants and Children (WIC), and the school lunch and breakfast program into 1 block grant. I support this idea because I believe each state and town should be able to decide where it can best use the money. For some it may be in the schools, while others may desire to utilize the moneys to strengthen the food stamp program. I also believe competition is important and only those programs which truly need the funding will receive them under this proposal.

Thank you for your consideration of this testimony.

STATEMENT OF HON. LOUISE M. SLAUGHTER
A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to be here today to testify on what is shaping up to be the Agenda for the 104th Congress. I am pleased that the Committee will be hearing from both Democrats and Republicans on the "Contract with America."

I have closely studied the Republican "Contract with America," and I have serious concerns about the short and long-term implications of this framework. While I do not deny that there are several appealing aspects of the proposal, I must challenge you to ensure that we do not jeopardize our long term financial stability.

We have heard a great deal about the "Family Agenda," and I have consistently supported policies and programs aimed at helping working families who are struggling to raise children and plan for their future. We must continue this effort in the future, and not turn our backs on our children and grandchildren. One key area in which we can dramatically affect our children's economic future is by further reducing the federal deficit. Congress and this Administration have worked hard to bring spending down and lower the deficit. We must not abandon this effort. For the past three years, the deficit has declined; it is estimated that the deficit for fiscal year 1995 will be significantly lower than original projections. As a percentage of GDP, the deficit has been cut in half in less than four years. This was not an easy task and we all made some tough decisions. But, if we have learned nothing, we have learned that fiscal responsibility and discipline is critical.

As I look at this Contract with America, I am deeply troubled by conservative estimates of cost. I have seen reports that claim that all the provisions of the contract will add another $1.4 trillion dollars to our debt. This is staggering. Can this amount be off-set with cuts? Can we protect the integrity of Congressional scorekeeping? Can we guarantee that the actions we take now will not force future generations into bankruptcy? All of these questions must be addressed, and we need solid projections and specific answers. Unfortunately, for some of the provisions of the Contract, there are no simple methods available for determining costs.

Take unfunded mandates; if we act to delay or eliminate key mandates in the Clean Air Act, for example, what will be the financial implications and how will we score these costs? The unhealthy carbon dioxide level in the air in our major cities contributes significantly to the cost of health care and declining productivity of urban residents. Will these increased costs be included in our deficit calculations? Additional respiratory illnesses for senior citizens will increase the cost of Medicare. Will we factor this into the equation?

I have always been a strong supporter of government incentives for business, as is illustrated by my authorship of legislation (which became law in August 1993) to make the tax exemption of industrial development bonds (IDBs) permanent. And I am extremely interested in the capital gains tax reduction, called for in the Contract. However, it should be noted that the Joint Tax Committee has estimated that a 50% reduction in capital gains tax could ultimately cost tax payers $56 billion. I realize that there is an effort to change the way we determine the budgetary impact of tax cuts, but we must be careful to avoid budgetary gimmickry. We can change the calculations, but we will still face deficit problems.

As a result of OBRA 1993 and serious budget discipline, our economy has improved. More jobs have been created and investments are improving. Drastic reductions in federal spending, including the mandated 272,000 reduction in the federal work force, have contributed to the strengthening of the economy. I support the argument that American families and senior citizens should be the first to see benefits from this reduction in government. But we still have an obligation to pay for any tax cuts. I am willing to continue to support tough deficit reduction. In fact, at this very moment I can suggest at least $30 Billion in spending cuts. These include a $1 billion reduction in the Intelligence budget; $24 billion from slowing the development of the F-22 fighter to meet actual need; cancelling funding for the two Milstar II satellites which would provide a long-term savings of $2 billion; and cancelling the Space Station, with a long-term savings of close to $50 billion. I would be happy to share with the members of the Committee additional recommendations.

But I must caution the committee that I will not support major cuts in investment spending -- for effective and necessary programs in education, Women and Infant Children nutrition, Head Start, and health care research. Nor will I ask senior citizens who depend on Social Security, Medicare , Veterans benefits, and nutritional assistance to bear the brunt of the sacrifices we intend.

Neither can we afford to mislead the working families we represent. We must be honest and tell them that they will be hurt, rather than helped by a $500 tax cut, if the cost of education and health care increases by $1,000 to $1,500 a year. And it would seriously hurt the health status of American women if we were to enact across-the-board cuts in federally funded medical research. This is not the time for cutbacks on research, with the incidence of breast cancer on the rise and with progress being made on so many fronts.

As one who has worked in this House for years to ensure that research into diseases affecting women gets its full share of federal research funds, I will not stand by and watch our small advances be destroyed. 46,000 women will die from breast cancer this year; the federal government must not back out of its commitment to improve treatment and prevention for this and so many other deadly and disabling diseases.

I pledge my support for maintaining budget discipline and hope to work with you in moving forward, building on the progress we have already made.

STATEMENT OF
THE SMALL BUSINESS COUNCIL OF AMERICA, INC.

BEFORE THE COMMITTEE ON WAYS AND MEANS
OF THE UNITED STATES HOUSE OF REPRESENTATIVES

ON
TAX AND REGULATORY STRUCTURE TO
MAXIMIZE ECONOMIC GROWTH AND DEVELOPMENT
February 2, 1995

SBCA is a national nonprofit organization which represents the interests of privately-held and family-owned businesses on federal tax, health care and employee benefit matters. The SBCA, through its members, represents well over 20,000 enterprises in retail, manufacturing and service industries, which enterprises represent or sponsor over two hundred thousand qualified retirement and welfare plans, and employ over 1,500,000 employees.

It is time to focus on simplifying the tax and regulatory structure that is strangling economic growth and opportunity. We believe your Committee and Congress should have a special interest in focusing on the need to create a tax system geared to maximizing economic growth, business development, and self-sufficiency.

THE CONTRACT WITH AMERICA

The SBCA supports most, but not all, of the Contract with America, and other simplifying issues. We support:

1. Increasing the estate and gift tax exemption from $600,000 to at least $750,000. This limit should also thereafter be indexed for inflation. This will assist in preserving business, including the family farms, by reducing the need to sell them to pay estate taxes.

2. Expanding the Individual Retirement Account, creating a new American Dream Savings Account (ADSA). The ADSA is "back-loaded" --- meaning taxes are paid on amounts deposited, but not on amounts withdrawn for qualified purposes. Amounts escape taxation if withdrawn for: (1) retirement income, (2) purchase of first home, (3) college tuition, or (4) medical expenses.

3. Correcting the "marriage penalty", which presently taxes married couples at a higher rate than unmarried couples. For example, married couples are penalized by a standard deduction which is $3,900 for singles, but only $6,550 on a joint return. They're also hit by higher rates. Two singles with income of $50,000 each are in a 28 percent tax bracket. A married couple with $100,000 is in the 31 percent bracket.

4. Creating tax-exempt "Medisave" accounts through which the uninsured could pay for health insurance and medical care.

As to health policy, SBCA supports 5 goals and several specific actions:

1. Universal Private Insurance Access

2. Incentives for Private, not Public, Buying Alliances

3. Medi-Save Accounts and Tax Incentives

4. No Employer or Employee Mandates

5. No Global Budgets or Price Controls

SBCA's PLAN:

A. A Moratorium on Piecemeal Reform

B. Private, Not Public, Management

C. Preservation of Small Business Incentives

D. Clear Antitrust Guidelines and Employee Tax

E. No Price Freezes that Cause Shortages

F. A "Sunshine Law" for Health Care Data

G. National Awareness and Education

H. Preservation of Out-Of-Panel Physician Choice

We believe that Congress should convene its own blue-ribbon panel to work out an incremental health care policy which will provide a safety net for those who cannot afford coverage, but not bankrupt the small businesses in our Country. This blue-ribbon commission should include the experts involved in the health care industry.

5. Creating a tax credit of $500 per child for families with earnings under $200,000. However, we would not favor those between $200,00 and $250,000 getting a reduced amount.

6. Excluding 50 percent of longterm capital gains from tax, and index the basis of most capital gain assets for inflation.

7. Clarifying, and liberalizing the home office deduction. Start up companies and individuals, especially those with small children, should be allowed to have the same office deductions for

home offices as other offices.

8. We support an increase in allowable business write-offs for new equipment. Contract With America would increase the current $17,500 write-off to $25,000.

9. Simplifying our tax system by eliminating special definitions for special types of organizations or industries to provide flexibility for businesses and their accountants. Specifically eliminate all definitions of "personal service corporation" except as required by the accounting rules of Code Section 448. Eliminate the other six different definitions of "personal service corporations" contained in 10 Code sections as follows: 441(i) , 444, 11(b) , 269A, 414(m) (3) , 535(c) (2) (B) , 469(j)(2), and 263A(h)(3)(D). This will eliminate the silly and burdensome requirement of forcing most of these entities on calendar years, which is detrimental to clients and their accountants, and will eliminate treating architects, engineers, physicians, veterinarians, etc. differently from other types of business entities.

10. Allowing employee stock ownership plans to be established by subchapter S corporations. Presently they are not allowed because the employee stock ownership plan is not a "qualifying shareholder" under Internal Revenue Code Sections 1361, et seq.

11. Simplifying our pension and ERISA system and begin to deal honestly with the overburdening deficits that are robbing our children and grandchildren of their futures. More detail on this issue, which we believe is the most important, is enclosed hereafter.

ENTITLEMENTS, THE DEFICIT, AND A SECURE FUTURE

We do not support reducing taxes on Social Security, however, as proposed by the Contract. Social Security taxes mask the true nature of the deficit and are already making it very hard for "boomers"and "Generation X" to save for retirement. Social Security also needs funding help to remain viable financially.

1. **Entitlement Growth** - The Bipartisan Commission on Entitlement and Tax Reform, appointed by President Clinton, and headed by Senators Bob Kerrey (D-Neb) and John Danforth (R-Mo) issued its report in December 1994. Our country has major problems to which Congress must immediately turn its attention:

- **Entitlements will soon be 70% of our federal budget.** In 1963 we spent 71% of every federal dollar for education, technology, roads, bridges, defense and other productive programs. Now we are looking at spending that much in the

year 2000 on interest on the federal debt and entitlements alone. Something has got to change!

The six largest entitlements are as follows:

Federal programs	Projected cost in 1994
Social Security	$317 billion
Medicare	158 billion
Medicaid	84 billion
Other Retirement/Disability	72 billion
Unemployment Compensation	27 billion
Food Stamps	26 billion

2. The Role of the Unfunded Public Pension Plans.

Private pension contributions have been restricted and discouraged by Congress in the 1980s because of its voracious need for more tax revenue. The potential unfunded liability, if all companies in the USA were to quit funding their plans, would be **38 billion dollars.**

But the unfunded liability benefits promised for **federal pensions as of the last available statistics, was over 1.1 trillion dollars -- nearly forty times the 38 billion of the private sector.** These pensions are not funded.

Just like Social Security, the federal government pays as it goes. There is no separate trust fund set aside for federal pensions. They are funded by promises and can only be paid by our taxes on a "pay as you go" basis. The largest components of the unfunded federal pension deficit are as follows:

Military Retirement System Civil Service Retirement System Federal Employees Retirement

Military Retirement System	513 billion
Civil Service Retirement System	600 billion
Federal Employees Retirement	5 billion
Total	$1.1 trillion

The federal unfunded liability is not potential, as in the private sector, but actual.

In addition, public employees have a pension indexed for inflation, with cost of living adjustments ("COLAS"). Thus, with the leveraging of fact of higher pay, plus more generous formulas, which are index for inflation, the average public employee is in much better shape than the average private employee. In addition, they have a lower retirement age (55) than many private pensions.

3. The Federal Deficit -- Recent Events have Lulled Us

Into a False Sense of Security. The Congressional Budget Office projections show the deficit hitting a seven year low of 166 billion in fiscal year 1996. However, its CBO estimates show a deficit growing quickly and reaching a record high of $324 billion by the year 2003. Remember, the aggregate national deficit has increased from $.5 trillion in the late 1970s to $3 trillion today, and could be $6 trillion by the year 2000.

4. **The Real Federal Deficit**. If the federal government had to account for pensions the same way it requires private business to do, the formal U.S. debt would increase 32% from $4.7 trillion to $6.2 trillion. Social Security funds are loaned to the U.S. and mask another $60 billion or so in the deficit.

Entitlements need to be reduced, so as to stop robbing our children and grandchildren. Our retirement system, ERISA, needs to be repaired and restored to its former health.

We have had change after change, which has really been more and more taxes in the guise of fairness. It isn't just budget balancing. This is budget balancing in the guise of improving the system. In the late '80s and the 1990s, those years showed that nothing based on tax incentives will ever work well within an unmanageable deficit and ERISA was no exception, particularly without strong and knowledgeable backers in the legislative and executive branches or elsewhere. The pension system when under budget pressure has begun to collapse.

The other bad thing that's happened in the post-1974 years when ERISA was ended has been Congressional staff takeover in the wake of over-complexity. ERISA was not a simple bill, but it was understood when it passed in 1974. Since then, Title I of ERISA and its corollary sections in the Internal Revenue Code have become so complex that hardly anybody understands it. The result has been an abdication by members of their true legislative duty in favor of staff control. The result is an irresistible engine of complexity compounding itself to the detriment of retirement income security.

In the 1980s and '90s, therefore, we have ERISA amendment after amendment purporting to make the system fairer when in fact these amendments simply make the system less attractive to plan sponsors, thereby deterring plan establishment and growth, thereby increasing taxes, which is what these amendments are really about.

In other words, many of the things that have been done have occurred in the name of non-discrimination. If you're against them, you're for discrimination. Well, that simply is not true. The change in the IRC Section 415 limits, from $45,000 in 1982 to $30,000 in 1984, the change in the total compensation that can be taken into consideration ($200,000 for "top-heavy" plans in 1984

and then again $150,000 in 1993, despite inflation), a whole host of these changes have been detrimental to participants as well as plan sponsors and administrators.

But the complexity of ERISA and the Tax Code makes it rather difficult to generate the kind of interest that would get the general public or substantial elements speaking out.

Private pension plans cover about half of full-time workers. When you look at that overall coverage more closely you will find that the reason 50 percent are covered at this point is because of the rapid growth of the 401(k) plans. From 1983 to 1993, coverage under the more traditional other types of plans actually decreased from 47 percent to 33 percent.

Why has this erosion occurred? Because pension have been viewed as fair game for meeting revenue needs. It has become a creature of tax policy. Elitist tax economists, and government and IRS bureaucrats, principally Stanley Surrey but also his legion of followers, have succeeded in fixing the pension law with the label "tax expenditure." So this has not only provided the justification for continual retinkering of the rules to implement a host of policies that are constantly changing. This onslaught has left the pension system defenseless against the demands of the constant budget deficits of the past 15 years that have damaged the pension system for no policy purpose whatsoever than the need to raise revenue.

Is it any wonder that we have a pension law today that is largely dysfunctional? In the words of the New York State Bar Pension Simplification Committee, ERISA is now, after all these changes, a hodgepodge of conflicting goals, policies and overburdens. We had a remarkable pension system in this country. It began after World War II and it grew to the presence that it enjoyed until the turnaround that began in the eighties when we got these excessive series of law changes: ERTA, TEFRA, DEFRA, REA, OBRA, TRA86, etc.

The key social goals, funding, vesting and benefit accrual, have been well met under ERISA. But from the perspective of the employers who want to provide good benefits, the question is whether the cost is worth playing the game.

It is entirely possible that the private pension system is going to collapse of its own weight while we're waiting for simplification. Particularly now, where we are in the process of sending plans into the Service, sometimes for the first time since REA, that employers, not the ones who are most actively involved but the ones who do the minimum necessary, are flabbergasted by the amount of information that is required and the number of hoops that

they have to jump through to do a simple submission.

The SBCA knows from the experience of its Advisory Boards that most employers really want to provide good benefits, but the cost of compliance both in fees and in employer time can outweigh the benefit. Since ERISA, there have been nearly thirty new laws affecting plans, an average of nearly one every nine months. This one every nine months rubric has been around for a long time.

The focus seems to have shifted from providing a tax based incentive to serve a broad public policy to viewing qualified plans as a tax loophole which needs to be shut down to avoid exploitation by unscrupulous employers. The sheer volume of statutory and regulatory material has exploded. When the author graduated from law school, the Internal Revenue Code, the paperbound version, was one volume and the regulations were two volumes. The number of pages of statute governing pensions totaled sixty-five, whereas, in 1992 there were 699 pages. Regulations in the same time period have expanded from 306 pages to 3,627 pages.

The IRS has now actively begun to disqualify plans. The regulators, both the IRS as well as the Labor Department, who now come in and audit plans and say, well for the last ten years you should have been doing it this way, never mind that we didn't tell you, you should have known. Your plan is now disqualified and you owe all of it in taxes. If you think this is not true, look at the 1994 case of John U. Fazi, and the other adverse developments not reported in that case.

The 1993 tax change to reduce compensation that can be counted in funding a retirement plan from $235,840 to $150,000, has had a profoundly negative impact on the ability of small firms to maintain pension plans for their owners and employees. Described as another tax on the rich, it actually works to reduce the pension of employees earning as little as $35,000. Since pensions are eventually taxed when distributed, the economy is hurt in two ways. First, the pool of investible capital is reduced, and second, future tax revenues are reduced as new pressures are added to our long term deficit outlook. For the owners and employees, it means a less secure retirement.

Unlike larger firms, the realities of the tax laws make it nearly impossible for a small firm to provide nonqualified pension benefits, stock options and other PERKS. Most small firms cannot now plan to use a defined benefit pension plan due to the impossible complexities of one specific 1994 GATT change on calculating lump sum distributions. This one change should be repealed!

The provisions in Internal Revenue Code Section 415 limit the

maximum lump sum benefit allowed to be paid to a participant. This lump sum removes the individual participant from the protection of a pool of funds and places all the risks squarely on the shareholders of one life. In order for that lump sum to produce an annual pension for the life of that individual, many risks must be balanced. These would include investment volatility, expenses and cash flow as well as the possibility of living much longer than the average. It is possible that if the annual benefits were being paid from a large plan with many participants and a huge asset pool, the lump sum needed by that plan may be properly determined using a 30-year Treasury rate, as required by the 1994 GATT change. However, once the lump sum amount is separated from that pool and given to an individual, the proper interest rate for determining the lump sum payment could arguably be much lower than the 30-year Treasury rate which would result in a much greater Single Sum Distribution.

This change is a clear benefit cut back for those participating in a small pension plan. For the participant in a large plan, this change could simply result in a decision to take the annual payments instead of the Single Sum Distribution, but for the participant in the small pension plan where plan maintenance after retirement is less likely, GATT has just cut the benefit allowed by over 20%. This is clearly a step away from the Tax "Equity" between participants in small plans and participants in large plans.

Not only have maximum benefits been cut significantly, but the new limits are based on a market rate that changes every month. The fact that the maximum Single Sum Distribution was based on a fixed interest rate was extremely practical for plans covering a small number of participants. By having a fixed rate (5%), the plan could fund for a fixed funding goal. As a result, the required contributions were relatively stable and consistent from year to year.

Now that the limit will be based on a fluctuating market rate, this stability will be lost. For example, suppose that the GATT bill provisions for maximum benefits has been in effect since 1980. If the maximum annual pension had remained fixed at say $90,000 per year age at 65, the maximum Single Sum Distribution at age 65 would have varied from $587,720 to $1,042,250 during that period (the 30-year Treasury rate has ranged from 5.94% to 14.68% in the past 15 years). If a participant was age 50 in 1980 and the $90,000 annual benefit was projected for that individual at age 65 in 1995, what Single Sum Distribution amount should have been targeted?

This kind of moving funding target becomes very disconcerting when we add the 50% excise tax for reversions due to overfunding on one side and the 10% to 100% excise tax for failing to meet minimum

funding requirements on the other side! Because of these penalties, it is even more difficult for the small plan sponsor to fund for and receive maximum allowable pension benefits, whereas these potential penalties would not be an issue for recipients of maximum pensions from large pension plans.

Anyone who earns a maximum pension under a defined benefit plan where single sum distributions are offered will be affected. This could include outside directors who participate in a 100% of pay pension plan for directors, highly compensated employees from any sized plan, mid-level management in plans offering subsidized early retirement with lump sum settlement, and employees at any level who participated heavily in both a defined benefit plan and a defined contribution plan and whose pension maximum is reduced by special combined plan limits. See Klingler, RIA, Pension & Benefits Week, Dec. 12, 1994, p. 9.

THE $150,000 COMPENSATION CEILING TRAGEDY

For small business, the qualified defined contribution pension plan is their only real option for retirement savings. But the uncertainty of their economic survival may delay instituting a plan until key employees and founders had reached an age at which standard benefit formulas would not provide a sufficient retirement income. With the $150,000 compensation rollback, much of their current compensation would be excluded. Enriching the benefit formula is not an option since the cost would be prohibitive. Faced with this dilemma, the fear is that owners might choose to abandon the plan. This is not an unreasonable fear as the enclosed chart reveals that the tax advantages of pension plans for small business owners is shrinking significantly.

The problem with the rollback in compensation to $150,000 is not limited to defined contribution plans and the owners of small businesses. Defined benefit plans and the pension security of younger, low wage participants in these plans will also be threatened because of the limits placed on actuarial funding contributions. For example, using reasonable actuarial projections about future salary growth, an employee expected to retire in 30 years need only be making $35,000 today to be impacted by this rollback since the projection shows that at age 65, this 30 year old will be making $165,000. Because this exceeds the new limit, the funding contribution of his employer would not cover the entire benefit being projected. When a plan has many employees in this group, its funding would be severely impaired, posing risks for the employees as well as for the PBGC.

Another problem presented by the rollback of covered compensation to $150,000 arises for the popular 401(k) plans offered by both large and small employers. Because these plans

have nondiscrimination tests which they must pass, it is quite likely that the limit will force a reduction in the percentage amount of compensation that higher paid individuals can contribute on a pre-tax basis. If historical experience is a gauge, the reductions in contributions will fall most heavily on those employees earning $60,000 to $75,000 a year. These and many others are not within the class of highly compensated that the proponents of this rollback said should lose the benefits of tax deferral.

The consequences of this cut are predictable, although not readily discernible. The slowdown in funding, the reduction in tax deferred retirement savings for employees earning $60,000 and up, the potential threat of losing a pension promised by a non-qualified plan, and the likelihood that a small plan might be terminated are real risks that are being sacrificed on the altar of deficit reduction. When this government is outspending its ability to collect revenues by more than $200 billion a year, it seems to us that the $500 million a year that this rollback gains could easily be offset by minor reductions in government spending that would have far less impact on far fewer Americans.

REGULATORY COMPLIANCE BURDENS AND THEIR IMPACT ON RETIREMENT PLANS SPONSORED BY CLOSELY-HELD AND FAMILY BUSINESSES

Today, closely-held businesses employ approximately 60% of all employees in the Nation. Providing fringe benefits and retirement plan coverage for these employees has been greatly hampered by extraordinary compliance burdens imposed by the Congress and the Internal Revenue Service. The costs of maintaining a retirement plan for a small business on a participant to participant basis is as high as 10 to 1 (Mitchell & Andrews, 1981). These costs are largely the result of complex administrative requirements imposed by too many legal changes and the accompanying regulation.

For whatever reasons, there has been for years a belief that employers can absorb the costs of whatever increasing administrative burdens are thrust upon them. In our opinion NO cost should be thrust upon an employer that can possibly be used more profitably by that company elsewhere (including additional benefits for its employees) unless it is clearly demonstrated that the administrative burden is necessary for the proper and effective working of the plan.

Six years ago, Congress recognized this problem and repealed the onerous Section 89 fringe benefit rules. However, a series of laws since ERISA was passed on Labor Day, 1974, have crippled our nation's retirement system for private employers. During the last decade the cost/benefit ratio of sponsoring a retirement plan has gone out of whack because costs have increased significantly while benefits have declined dramatically. Data derived from Internal

Revenue Service determination letter requests indicates that new retirement plan establishments have declined by at least 70% in the last 9 years. The decline for new defined benefit plans is even more precipitous - a drop greater than 80%. Conversely, termination of plans has increased markedly - more than 100% in the last 9 years. This decline is due in large part to the additional costs and complexity injected into the private retirement system over the last decade by Congress and the Internal Revenue Service while at the same time the benefits which can be provided by a retirement plan have been severely curtailed.

Today the laws governing the retirement plan system confound the "best and the brightest." By this, we mean even the elite of the pension world - the practitioners who work exclusively in this area as well as the people at IRS and Treasury working at the very highest levels. Few, if any, of these practitioners, can honestly say that they completely understand the ERISA and pension law in its present state or that the plans they represent are operating fully in compliance with the law at this time.

NEEDLESS COMPLEXITY AND CHANGE IN THE PRIVATE RETIREMENT SYSTEM AND ITS NEGATIVE IMPACT ON PENSION COVERAGE

One of the outstanding tax practitioners in the country, Mr. Harold Apolinsky, from Birmingham, Alabama, wrote to Mr. Kenneth Gideon when he was Assistant Secretary of Tax Policy at the Treasury Department, "You may recall that Wilbur Mills insisted that there be 15 years between major tax laws. We had the 1939 Code, the 1954 Code, and what we thought (erroneously by today,s standards) was a major tax bill in 1969. Such a time frame aIlows the taxpayers, their advisors, and those of you in tax administration to become comfortable with the system. It is constant change which is the problem."

Mr. Apolinsky **has determined that there have been over 10,000 changes to the Internal Revenue Code sections since 1980.** The frequency and complexity of these changes in the retirement plan area is greatly exacerbated by IRS regulations which can be any or all of the following; untimely, effective retroactively, or difficult to comprehend even by specialists. Often needed regulatory guidance is not issued until after a qualified retirement plan has had to comply with the law change. In some cases, the change is so incomprehensible that IRS basically suspends operation of the law until it can figure out what to do with the change - for example, the changes made to the integration rules by Congress.

Ten years ago, when the voluntary retirement system was stable and the rules were clear, the system was flourishing and retirement plans were being established by privately held companies in record

numbers. We know from tax advisors from all over the country that retirement plans for small businesses were being established in record numbers. Stable small businesses were adopting plans because it became evident to the owners of these businesses that a qualified retirement plan was the best way to save for retirement and to retain good staff employees. Costs of the plan were in a good balance with the benefits to be derived from the plans - so plans were being adopted.

Data which supposedly shows the opposite is flawed - the data is based upon a time period that precedes the boom period of the late 70s when plans were being adopted in record numbers. Costs to administrators and pension specialists were reasonable and companies were able to take actions knowing what the results would be. The system was working.

If the law returned the system to its prior relative simplicity, reliability and clarity even while retaining the reforms that have been injected into the system during the last several years, the voluntary private retirement system would become rejuvenated. The second step in restoring the system to its prior viability would be to restore retirement benefits to the level they were at prior to the onslaught of legislation.

THE ROLE OF SIMPLIFIED EMPLOYEE PENSIONS (SEPs)

SEPs have not been utilized to any meaningful extent by small business. This may be because an SEP is antithetical to small business management. Money contributed to a retirement plan by small business is money that would otherwise have gone back into the business or the owners could have taken out themselves as income. Most owners are only willing to enter into a retirement plan if it is perceived as a true benefit by the employees and the owners. It appears that at least some employees (and our guess is more than some) do not even view an SEP as a retirement plan but instead see it as a bonus program. Unfortunately, the lack of governmental regulation and supervision allows the SEP plan to be a target for abuse.

We understand from bankers, attorneys and advisors throughout the country that many, if not most, non-highly compensated employees immediately take the money out of the SEP. In contrast, with a retirement plan, the company only pays out the retirement benefit to an employee when the employee terminates employment, dies or becomes disabled. When the check is paid over, it is clear to all parties concerned that the employee has received a real benefit from the company. And many employees of small businesses receive very good retirement plan benefits, which because of plan design are almost always portable. The benefits are good because they must be good in order to provide the key employees with

meaningful retirement benefits. Remember in the small business context, the retirement plan is the primary method available to owners to fund for their retirement. And the law ensures that plan contributions for all employees, key or otherwise, must be non-discriminatory. Simplification of the underlying system is the answer - not enhancing or expanding a program which is not really a part of the retirement plan system and considered by many small business employees as merely a bonus plan.

Another proposed solution is to have IRS model or prototype plans which would allegedly increase retirement plan coverage. There is little reason to think that an IRS prototype would afford a small business any more than a brokerage or insurance company prototype. The rules that are necessary to properly design, implement and operate a retirement plan are what are so complex, not the underlying plan document. Thus, this approach would do nothing to entice small business to sponsor retirement plans.

SIMPLIFY THE SYSTEM: OUR PROPOSALS

The following proposals are respectfully offered, for changes to the present law which could simplify the administration, and thus, the costs of maintaining retirement plans. These changes would be a necessary first step to revitalizing the system for small business. As retirement plan experts, we believe these simplifying proposals would retain the underlying change effectuated by Congress over the last ten years.

- **Eliminate the Top-Heavy Rules under Code Section 416.** The American Bar Association Tax Section recommended this years ago. These rules provide for accelerated vesting, minimum benefit accrual and a limit of $200,000 on the amount of compensation that can be taken into account under a qualified plan if more than 60% of the benefits under the plan are payable to key employees. Because of many of the changes enacted under the 1986 Tax Reform Act, including the new coverage and participation rules, new vesting standards, strengthened integration requirements, the top-heavy rules are unnecessary.

- **Repeal the family aggregation rules**, which discriminate unfairly against spouses and children employed in the same business.

- **Delete the $150,000 Compensation Ceiling.**

- **Delete the definition of key employee and replace it with the definition of highly compensated employee.** All retirement plans should be able to utilize the same vesting schedules regardless of size.

- **Adopt the design based 401(k) safe harbors of former H.R. 13, which has been passed by both House and Senate.**

  Many companies would choose to stay outside the safe harbor because it is more cost-effective to stay with their current system. On the other hand, particularly for small employers, a voluntary safe harbor that does away with costly complex testing which entails significant cost may prove to be enough of an incentive for the company to go ahead and sponsor a §401(k) plan.

- **Repeal, or modify Code Section 401(a)(26) to apply only to defined benefit plans.** The reach of the proposed regulations is so broad that almost all plans, except the most elemental, will be subjected to this code section. These proposed regulations are the antithesis of simplification and can be expected to waste taxpayer and IRS dollars.

- **Simplify the definition of Highly Compensated Employee.** The definition of highly compensated employee which applies a number of highly complex rules to four basic definitions should be streamlined to a single rule that says that any employee who earns over $75,000 (indexed) is a highly compensated employee.

- **Repeal the GATT change on lump sum distributions from defined benefit plans.**

- **Modify the full funding limitation.** Code Section 412(c)(7) was amended to prohibit funding of a defined benefit plan above 150 percent of current "termination liability." This is misleading because termination liability is often less that the actual liability required to close out a plan at termination, and the limit is applied to ongoing plans which are not terminating. In effect, current law inappropriately mortgages benefit promises by prohibiting the level funding that is the reasonable way for plans to fulfill benefit obligations and, instead, requires plans to be funded with payments which escalate in later years. Instead, the full funding limitation should be based on ongoing (projected) liabilities, and not on termination liability.

- **Simplify the rules on affiliated service groups and leased employees under Code Section 414.** Overbroad language in the statute and overbroad regulations issued in proposed form have combined to create artificial affiliations which do nothing to promote the integrity of the retirement plan system. Solution: Have Congress give greater direction to the IRS on the types of abuses to be covered.

- **Eliminate the excise tax on excess distributions.** The rationale for maintaining such taxes, the prohibition against excessive accumulations, is outweighed by the complexity of the provisions. This provision was initially intended to take the place of the complex §415(e) calculations. However, since §415(e) was not repealed, the excise tax is unnecessary. Alternative: repeal the absurdly complex Section 415(e) fraction. Actuaries report that the calculation of the §415(e) fraction to be extremely complex. Rumors persist that this fraction is only reviewed by IRS in the context of privately held companies.

- **Repeal new Code Section 401(m) and the multiple use limitation.** Subjecting matching contributions to the §401(a)(4) rules and defining voluntary after-tax contributions as annual additions for purposes of the §415 limits provides sufficient restrictions on the use of such Contributions. The new voluntary designed based safe harbors set forth under the Tax Simplification Bill should greatly assist small plans which provide employer matches in their §401(k) plans as an incentive to increased employee retirement savings.

- **Eliminate Code Section 414(o).** This section provides a broad grant of regulatory authority to the IRS to deal with business arrangements which would allow circumvention of the qualified plan requirements. This section should be eliminated because it has made it virtually impossible for a sole proprietor and other small businesses to determine eligibility for plan contributions when it is involved in any way with another entity.

- **Simplify notices for required annuity distributions.** Solution: Notices of such annuities should only be required upon commencement of employment and when requested thereafter.

Finally, the IRS must halt the overt discrimination which is occurring in the so-called small defined benefit plan audits and it should never undertake an audit where it is applying new standards retroactively on a group of taxpayers that are perceived as "too small" to litigate. The Administration must not be allowed to dictate to IRS how much it is to receive from a targeted audit group - in this case IRS was to collect $660 million in 2 years from small business defined benefit plans. This is, plain and simple, reprehensible. To go after a class of taxpayers because it is known they do not have the deep pocket necessary to litigate cannot be tolerated. This program is unseemly - secret memos requiring agents to impose retroactive guidelines on small plans, key officials at IRS and Treasury publicly stating they know

nothing of the program, and forcing the public to obtain the data through Freedom of Information. Even though justice prevailed in the Tax Court and at the Appellate level - this program has not only hurt the small businesses involved financially and the actuarial community who were forced to defend prudent actions, but in the long run it will also hurt the Service.

Even now taxpayer dollars are being expended in the continuation of Appeals. Of great concern is that the taxpayer may begin to see the Internal Revenue Service as an unfair and unprincipled entity. This is disastrous for a tax system that largely relies upon voluntary compliance. It will not be enough to simplify the system if companies know that by sponsoring a retirement plan, they are basically "buying" an audit.

CONCLUSION

The private retirement system has been in a decline for the last several years. This is the result of (1) additional and largely unnecessary costs and complexity injected into the private retirement system over the last decade, (2) a concomitant reduction of benefits to retirees, and (3) a dramatic downturn in the economy. It is not clear how much the system has been harmed by the cutback in benefits as compared to the increased costs of complexity. It is clear, however, that the needless complexity is a real threat to the continued health of our private retirement system and that the system can be simplified without adversely impacting revenue or the underlying policy of the changes.

Voluntary design based safe harbors are the most effective way of truly simplifying the complexity inherent in the retirement plan system. This is the solution advanced in the §401(k) area. The §401(k) plan is an exceptionally popular plan with both employees and employers. The Tax Simplification Bill set forth two design based voluntary safe harbors in the §401(k) area. These safe harbors promote this popularity by making the administration easier. A company can elect to fall within a safe harbor or not. This is a novel and sound approach to simplification which should be utilized in other complex areas of the retirement plan system.

The voluntary retirement system was healthy and growing before the onslaught of constant changes in the law and regulations. New plans were being established by small businesses in record numbers. Simplification of the underlying system, particularly by the use of voluntary safe harbors, will go a long way towards reviving the system.

Last year, the National Institute on Aging (NIA) reported that millions of Americans in their 50s face an uncertain future, lacking health insurance or pensions, or fearing that they will

lose the benefits they do have. The survey by NIA found that a substantial number of people -- especially minorities -- lack pension coverage that may rob them of a satisfying and successful retirement.

The findings, while shocking, do not come as a surprise to benefits professionals. Most of us are aware that in recent years the focus of America's retirement and employee benefits policy has shifted dramatically for the worse. Those of us concerned about the viability of the private benefits system know all too well that the budget deficit and not retirement and savings objectives, has driven almost all debate on important national issues, including retirement matters.

In March of 1993, the American Academy of Actuaries reported that since 1988 at least 50,000 of America's small business firms -- those with less than 25 employees -- have eliminated their defined benefit pension plans leaving their workers without retirement plans. An equal number of small firms, according to the Academy, chose to replace their defined benefit plan with a defined contribution plan. The Academy's data is confirmed by the U.S. Department of Labor which reported in its initial Private Pension Bulletin that defined benefit plans had decreased by 24% between 1983 and 1989. The DOL reported that the trend shows that we are no longer seeing a growth in the number of plans nor is the percentage of the workforce with pension plans growing. Indeed, while the workforce grows, the percentage of covered workers falls (albeit, there was a small increase in 1992).

This drop in pension plan coverage could not come at a worse time. The graying of America, and the burden that it will place on future generations, can not be ignored. The American Council of Life Insurance reports that from 1990 to 2025, the percentage of Americans over 65 years of age will increase by 49%. This jump in our elderly population signals potentially critical problems for Social Security, Medicare and our Nation's programs designed to serve the aged.

While we must assure our citizens that Social Security and Medicare will remain strong and stable, private pensions, savings and private Sources for retiree health care will have to play a more significant role for tomorrow's retirees. The savings that will accumulate for meeting this need will contribute to the pool of investible capital that will provide the economic growth needed to finance the growing burdens of Social Security and Medicare. But such savings will not be forthcoming in the face of the kind of policy directions reflected by the Administration proposal.

While many factors can be cited for the crisis, two stand out -- DIMINISHING TAX INCENTIVES and INCREASED COSTS DUE TO

OVERREGULATION. The loss of tax incentives appears to be directly related to our nation's budget deficit problems. Reducing the tax incentives for pensions is destructive of our goal of having an adequate retirement savings system.

Frequently, the case for reducing the incentive is premised on dubious assumptions that the current incentives are not functioning as expected. Often times, advocates for reducing tax incentives employ the politics of envy. Both the Association of Private Pension Plans and the Employee Benefits Research Institute have recently published treatises that punch holes in the logic of those advocating reduced tax incentives for retirement savings. While defending current tax incentives is commendable, what's really needed are new tax incentives to overcome the losses of the past decade.

The other factor that is contributing to the stagnation of private pension and welfare plans is the unrelenting drive to suffocate our private benefits system with questionable costs due to increased burdens imposed by regulation. In the above mentioned American Academy of Actuaries study the reason most given for abandoning a pension was the growing burden to comply with government regulation. Nearly 60% of small employers in the Academy cited the cost of compliance as the primary reason for their decision to terminate a defined benefit plan. Almost 30% of large firms cited this factor also.

Despite the increasing evidence that we are drowning employers in regulations, the push for more regulations and laws appears unrelenting while the drive to simplify compliance is locked up in legislative stalemate as is the case for the laudable Pension Simplification Bill.

This statement was largely prepared by Al Martin, Esquire, the President of the Small Business Council of America, ("SBCA"). He is also a practicing attorney in Kansas City specializing in tax, business and pension law. Much of his work is spent with family business as well as privately-owned, closely-held businesses.

STATEMENT BEFORE
HOUSE COMMITTEE ON WAYS AND MEANS
BY GERALD B.H. SOLOMON

Mr. Chairman and members of the Committee:

I appreciate the opportunity to testify in support of those areas of the Contract With America which fall under the jurisdiction of this Committee.

As a Representative of the State of New York which has one of the highest per capita tax burdens in the country, I am well aware of the disastrous impact heavy taxation and regulation can have on families, businesses and local economies. I applaud those proposals of the contract which seek to alleviate these tax burdens, stimulate investment and free up capital.

However, as both a deficit hawk and a fiscal conservative I am concerned that corresponding measures to reduce spending, restructure the government, and balance the budget may take a back seat in priority to those proposals to cut taxes. I believe they both can and must be done simultaneously. My rational for this position does not come from my view of the relationship between tax cuts and their impact on the economy.

Let me assure my Republican colleagues on the Committee that I do believe a smaller tax burden on both business and families will result in stronger economic growth and hence greater federal revenues. I particularly favor reducing the capital gains tax rate, increasing the estate tax exemption, and expanding Individual Retirement Account rules.

Nevertheless, I am reminded of what this Congress did back in 1981 and 1982. I am not referring to the alleged claim that President Reagan's tax cuts caused today's high deficits. A thorough and honest examination of the facts shows these subjective accusations to be completely unfounded. As a matter of fact, I still consider my "yea" vote for that tax cutting package to be one of the most important decisions and votes that I have cast since becoming a member of this body. Consequently, I do not believe that passing tax cuts now will inevitably result in higher deficits. However, my memory is plagued by the Congressional promises given President Reagan in 1981 and the revocation of those promises in 1982. In negotiations, the Democrat leadership of this Congress and President Reagan made a deal to cut taxes in 1981 and to cut spending in 1982. Unfortunately, the promised spending cuts never appeared. I firmly believe we must ensure that both occur now.

Many of you are aware of my efforts to balance the budget through a fundamental restructuring of the federal government. By consolidating similar programs, eliminating obsolete functions and privatizing certain services, government actions can be pared back to a size closer to a level of government revenues that is less restrictive and burdensome. I realize that reducing spending for various programs does not necessarily fall under the jurisdiction of this Committee but we all favor a government that costs less and yet does what is constitutionally required of it. Furthermore, as this Committee is tasked with the job of determining how best to generate adequate federal revenues while also ensuring long term multi-sector economic growth, it is imperative that this Committee do its part in assuring that spending and taxes be reduced correspondingly.

One area of the Contract under the jurisdiction of this Committee which I believe can result in a smaller and yet more efficient government is H.R. 4, "The Personal Responsibility Act of 1995." Our nation's current welfare system is wrought with waste, fraud, and abuse as welfare has become a way of life for many people. For over forty years the welfare system has been paying for non-work and single parenthood at increasingly alarming rates. Examine these revealing statistics.

Twenty-seven million American families presently collect food stamps. A record high of 5 million families (with 9.6 million children) are currently enrolled in the AFDC program - up from 3.7 million families in 1988. 92% of the children on AFDC do not have a father in the home. Fewer than 1% of AFDC parents are now required to work. Out-of-wedlock births among children 15-to-17 years of age have more than doubled since 1965. Funding for the twenty-five major social welfare programs doubled from $132 billion in 1975 to $277 billion in 1992. These facts are the results of a system that subsidizes out-of-wedlock births, penalizes marriage, creates dependents out of able-bodied citizens, and discourages recipients from breaking out of this detrimental cycle. Rather than alleviating social pathologies such as crime, drug abuse and academic failure, the current welfare system has contributed to them.

I believe a fundamental approach to welfare reform must address three major areas: it must end the subsidy of illegitimacy, enhance work requirements, and impose concrete spending control measures. I believe H.R. 4 meets this criteria.

Consistent with the taxpayer's demands for lower taxes and cuts in spending are their demands for time limited welfare benefits, stricter spending enforcement mechanisms, an end to illegitimacy and a rededication to the principles of family, personal responsibility and a work ethic. Many Americans work diligently eight to ten hours a day for five and six days a week, giving large sums of their income over to the federal government only to watch how it is wasted and pilfered on the evening news. The taxpayers desire fundamental change and not merely a reform of the status quo. For example, if a program designed twenty years ago to assist unwed mothers has not worked, it should not merely be fixed. It should be abolished and a new program that recognizes root causes and the role of the federal government in meeting those challenges should be erected instead.

I applaud those portions of H.R. 4 which correctly recognize the state as the primary entity to fight poverty. Resurrecting the timeless principle of federalism will enable individual states to determine for themselves how best to approach the welfare dilemmas indigenous to their state. Again, representing the state of New York with one of the largest welfare roles in the nation, I believe both the state and the nation would be best served if New York were allowed to devise its own programmatic solutions.

A one size fits all approach to poverty and illegitimacy as currently exists with Food Stamps and Aid to Families With Dependent Children clearly has not worked. I believe the bold approach of capped block grants with specific but limited strings attached offered by H.R. 4 is the answer.

Furthermore, I also strongly support the cap on the aggregate growth of welfare spending. As this Committee is well aware, the total cost of the "War on Poverty" has been enormous. From its inception in 1965 to the present, welfare spending has cost the taxpayers $4.9 trillion in constant 1992 dollars. This is even greater than the entire national debt. Total welfare spending now absorbs 5% of the Gross National Product, compared to 1.5% in 1965. In 1992 welfare programs alone cost $305 billion and this number is projected to increase by $510 billion by 1998. With welfare spending rising significantly from year to year and the welfare dependency roles rising as well why does the federal government continue to pour more money into a program that clearly has not stemmed the tide of poverty?

Mr. Chairman, the Bible tells us that the poor will always be with us but that we should care for them. Despite this truth, the government should focus its limited resources on those programs which truly make life in poverty shorter and more reasonable.

Capping the growth of welfare spending at an amount equal to the sum spent the preceding year, adjusted for inflation and a tight poverty population index is consistent with our fiscal realities and our duties to community and society.

Reforming government through reducing taxes, spending and eliminating the deficit while promoting individual responsibility, civic duty and limited government is the recipe for real change.

I commend this Committee for the laudable work I am confident it will do.

Mr. Chairman, I believe you described our task as the People's Congress best when you wrote "Our obligation to the American people remains the same today as when it began - asking the people for the strictest minimum taxes so that the smallest government possible can help people do what they otherwise cannot do for themselves."

I thank the Committee for its time and consideration.

TESTIMONY OF THE HONORABLE BART STUPAK
Before the House Committee on Ways and Means
January 10, 1995

Chairman Archer, Ranking Member Gibbons, and Members of the Ways and Means Committee:

I appreciate being given the opportunity to appear before you today to share my thoughts on our great national debate over the role of government and on the Republican "Contract with America."

I welcome the opportunity to give my thoughts on proposals contained in the "Contract." My constituents and I support many of the points outlined in the plan, and I look forward to working with you in the days ahead on this package.

There is much promised in the "Contract with America" which I like. Tax relief for middle-class families and senior citizens. Welfare reform. A balanced budget amendment and reduced federal spending. All of these measures are things which I have long-supported.

While I support many of your ideas, I am deeply concerned over the financing measures -- or lack of financing measures -- contained in your plan. In reading the "Contract with America," I am reminded of the lengthy Christmas lists which my two sons used to put together when they were younger. These lists sounded great, and like all parents, my wife and I would have liked to have been able to fulfill every Christmas wish our kids had. But as adults, we knew that giving a child every toy he wants isn't responsible or possible. As Members of Congress, we are in that same position today.

Mr. Chairman, the people of Michigan's First Congressional District didn't elect me Santa Claus. They elected me their Representative in Congress. With that election, I signed my own contract -- a contract with the people of Northern Michigan. I promised my constituents that I would come here to represent their best interests with every vote I cast. I vowed that I would make the tough decisions needed to get our economic house in order and relieve the crushing burden of debt and deficit that threatens our nation and our children and grandchildren's future.

The Balanced Budget Amendment portion of the "Contract" alone will mandate $1.2 trillion in budget cuts by the year 2002. The Personal Responsibility Act will cost $12 billion. The Family Reinforcement Act will cost $8.9 billion. The American Dream Restoration Act will cost $112.3 billion. The Senior Citizen's Equity Act will cost $25.1 billion over five years. The Job Creation and Wage Enhancement Act adds up to $46.5 billion in spending. Mr. Chairman, that's some Christmas list -- $204.8 billion for just these proposals.

Keeping these concerns in mind, I would like to take a moment to relate some of my thoughts on the specific portions of the "Contract" within your Committee's jurisdiction:

The Fiscal Responsibility Act

We all share the desire to balance the federal budget. Deficit reduction has been a common goal. Realizing that we did not get into our economic mess overnight and that, according to the bill, we have only seven years in which to balance the budget, it is apparent that we will be faced with very difficult spending choices. If our experience with the Penny-Kasich plan forwarded in the 103rd Congress is any indication, it will be difficult enough to "finance" a balanced budget amendment without all of the other

tax breaks included in the "Contract." While I am pleased that the Fiscal Responsibility Act will also provide a line-item veto to allow for further reductions in wasteful and unwarranted spending, it is difficult to fathom how we will reach a balanced budget in seven years while also providing billions of dollars in tax cuts with sharp increases in defense spending. In fact, it sounds a lot like the failed trickle-down economic plans I heard about in the 1980's. Finally, and for the record, I will only support a balanced budget amendment that takes Social Security off budget. The Republican amendment does not do this.

The Personal Responsibility Act

Shrinking the size of federal bureaucracy and reform of the welfare system are bipartisan goals which I support. While the federal government may be bigger than the framers of the Constitution envisioned, the role of the American government remains the same: to protect and better the lives of the people who live within its borders.

The PRA is a departure from the principle of "mutual responsibility" that should guide bi-partisan welfare reform efforts. Under this principle, which I support, welfare recipients are expected to move toward self-sufficiency by participating in education and/or training, by working, or by looking for work while the government agrees to maintain a basic safety net beneath poor children and families. While our current system is certainly partially to blame for creating a class of dependents, the PRA abandons the government's side of this important mutual responsibility.

I fear that the bill could deny basic income support to numerous families in the Michigan's First Congressional District. This will include many families where parents are complying with the law, and are willing to work, but cannot find a job. Representing the district with one of the highest unemployment rates in the State of Michigan, this is obviously a concern.

I am also concerned with how the PRA deals with food assistance programs. According to the Michigan Department of Social Services, the PRA would cut an estimated $18 billion over four years from food assistance programs. Virtually all domestic food programs, including food stamps, WIC, Senior Nutrition Programs under the Older Americans Act and the school lunch program would be consolidated into one block grant. In FY 94, roughly $835 billion in federal food stamp dollars came into Michigan. As of September 1994, 977,728 people in 411,257 households received food stamp assistance. Furthermore, persons over 60 years old accounted for 42,601 of total food stamp households. I wonder what effect the consolidations of these programs will have on these vulnerable populations. The proposal may also have the unintended result of harming small businesses whose clientele use foods stamps.

We must be careful in our struggle to reform the welfare system not to dismantle the safety net that provides vital support. To throw thousands of people into the street without some assistance to help them stand on their own two feet is immoral and penny-wise. We must also be careful not to adversely affect hard working men and women whose businesses don't differentiate between a dollar and a food stamp. While I strongly support making all able-bodied people work, we must accomplish these goals in a way that is both tough and smart.

Family Reinforcement Act

Many of the components of this proposal are sound. I have long supported adoption as a means to curtail the use of abortion as a form of birth control. However, like many provisions in the contract, it is replete with tax deductions and credits. It is estimated that enactment of this provision could cost $8.9 billion dollars, yet it fails to provide the corresponding spending cuts necessary to pay for it.

American Dream Restoration Act

Mr. Chairman, on May 25, 1993 on the floor, you said, "Most economists say the biggest problem in the United States today is a lack of savings."[CR, 5-25-93, pg. H2784] I fully agree. The theory behind tax free IRA's is sound, and will inevitably provide some measure of relief for the greatest number of taxpayers. I would go further and ask the Committee to look into provisions that could allow those without IRA's a targeted tax break by not taxing earned interest on basic savings accounts. In this way, we reward not just those who are fortunate enough to have IRA's or those who play the stock market, but those working men and women that are just getting by.

I am, however, concerned that provisions like $500 tax credit per child for families that make $200,000 is unnecessary and costly. Furthermore, those living below the poverty rate, with no tax liability, would receive no benefit.

Again, Mr. Chairman, dollars are scarce. We should not be frivolous in opening up the treasury to the wealthiest taxpayers in the country at the expense of working and middle-class families.

The Senior Citizens Equity Act

I have in the past and will continue to support efforts to raise the "earnings test" threshold which discourages seniors who collect Social Security from working full time. Social Security is a sacred compact and seniors should not be penalized from working as much as they are able simply because they are receiving Social Security benefits.

In regard to provisions in the "Contract" to repeal the 1993 increase in the portion of Social Security benefits subject to taxation, I fear that we may be taking a step backwards. Only 13% of all Social Security beneficiaries were affected by this change. The tax code needs to remain progressive and based on "ability to pay." Whether the filer is single, married, or a senior, everyone must share the burden of deficit reduction. While that may not be politically popular, it is the truth.

The Job Creation and Wage Enhancement Act

I agree with many of the components of this bill.

I have long been a supporter of mandatory cost benefit analysis and risk assessment in the federal regulatory and rule-making process. I voted against legislation to elevate the EPA to a cabinet position, not because I believe the EPA is unworthy of cabinet status, but because significant "cost" and "risk" language was left out of the bill.

Furthermore, I have always supported private property rights whether in regard to "takings" legislation or legislation designed to protect against other instances of government intrusion.

Finally, as a former state legislator, I am well aware of the problems facing state and local governments in regard to unfunded federal mandates. In the 103rd Congress, I strongly supported H.R. 140, legislation to require the Federal government to include a funding mechanism in any legislation that mandates state or local compliance with Federal laws. I fully believe that Congress must act more responsibly when imposing spending mandates to predetermine any adverse effects they might have on the states.

I must express concern over the scope and cost of the proposed fifty percent exclusion from the capital gains tax. I do support the indexing provision, however, it has been estimated that the exclusion could cost up to $56 billion dollars over five years, and like many proposals in the contact, there is no indication of how this cut will be paid for. While I understand that such a cut is not simply a give-away to the wealthy, I also understand that this provision will not pay for itself. As previously noted, I would be far more inclined to support a cut that benefits many Americans, like a cut in taxes on interest, than one that benefits such a narrow band of taxpayers.

I have many other thoughts on the Republican "Contract with America," and look forward to discussing them in further detail as the package makes its way through the legislative process. The days ahead will hold many difficult choices and countless painful decisions. I appreciate the opportunity you have given me to testify here today, and would like to leave you and the members of the Ways and Means Committee with one assurance and one pledge. I assure you that I will put aside party politics in a spirit of bipartisan cooperation to work with you in these coming weeks to pass those portions of the Contract with America that will benefit the people of my district, and this nation. But above all, I pledge to remain true to my own Contract with Northern Michigan, and oppose at every turn any part of your package which passes the buck to my constituents and their children or dodges the tough choices that I was sent here to make.

Mr. Chairman, postponing these hard choices until another day may be easy and politically safe, but <u>my</u> contract simply won't allow it.

Testimony of U. S. Rep. C. W. Bill Young
before the House Ways and Means Committee
on the Contract with America
January 10, 1995

Mr. Chairman and members of the Committee. Thank you for the opportunity to appear before you to testify in support of the Ways and Means portion of the legislation that comprises the Contract with America. The members of this Committee have a historic opportunity to deliver the kind of genuine change the American people asked for in November, and I look forward to working with each of you to implement key legislation before your committee that I have long supported.

As the Congressman from Florida's Tenth Congressional District, a Congressional District which is home to a large population of senior citizens, I am pleased to be testifying in favor of the Senior Citizens' Equity Act. One of the first bills I ever introduced in Congress was to repeal the Social Security earnings limitation, and I have consistently cosponsored legislation that would overturn the unfair limit on outside income which penalizes older Americans for working. While the former House Leadership failed to allow us to debate this legislation on its own in the House, and prohibited us from raising it as an amendment to any other pending legislation, I am pleased that the Committee has committed to raising the earnings limit from $11,160 to $30,000 over the next five years. I will actively press for this legislation because I firmly believe our nation can benefit greatly from the skills and experience of older employees. Another portion of the Contract that I strongly support is the repeal of the 1993 Clinton tax increase on Social Security benefits. I opposed the original legislation that required senior citizens who earn more $34,000, or couples earning more than $44,000, to pay income taxes on 85-percent of their Social Security benefits. I cosponsored legislation in the 103rd Congress to repeal this onerous burden, and I will support the current legislation to roll this tax back over five years to the pre-Clinton levels.

Mr. Chairman, you are well known for your work to cut the capital gains tax rate, and I have long been supportive of these efforts, so I am pleased that a capital gains tax cut has been included in the Job Creation and Wage Enhancement Act. Also included in this legislation are changes to increase the current estate and gift tax exemption from $600,000 to $750,000, which I also strongly support. I am pleased that the Act would index these levels for inflation, so the Congress will not have to continually amend these levels. Another component that I strongly support is the clarification regarding the home office deduction for those taxpayers who conduct significant administrative business task at their home.

The Contract with America embodies the sentiment of the new Congress that Washington is no longer the only solution to our nation's problems. The most well-intentioned, broad-brush, national solutions from Washington, D.C., cannot hope to address the specific, unique problems of St. Petersburg, Florida. Instead, by passing this Contract, Congress can help individuals and states help themselves, and free them from the restraints imposed by past attempts by Congress to run their lives for them.

The Personal Responsibility Act exemplifies this change in priorities. By giving states the flexibility and funding to design welfare systems that meet the needs of their residents, instead of their resident federal bureaucrats, Congress will offer hope to hundreds of thousands of Americans currently receiving funds from AFDC, SSI and other federal programs. I endorse the bill's provisions to reduce illegitimacy, stimulate employment, and restrict the alarming growth of welfare spending, a funding explosion that has failed to achieve its goal. I have supported legislation in the past to provide comprehensive welfare reform, and I look forward to working with my colleague from Florida, Chairman Clay Shaw, in his historic redefinition of government's role in American society.

It encourages me to see the trust we grant states to reform their welfare systems will extend to other issues as well. For too long, Congress has micromanaged state behavior with onerous environmental, transportation, labor, and other regulations that demand compliance, yet refuse them the funding to enable it. State and local governments have been forced to divert their own scarce, public funds into the enforcement of federal policies. I wholeheartedly endorse efforts to eliminate these unfunded mandates, by federally funding legitimate regulations or terminating unnecessary burdens.

Often, the states most affected by these mandates operate with a level of fiscal discipline the Congress has been unwilling to match. In this Congress, however, we have an opportunity to emulate them by enacting a Balanced Budget Amendment to the Constitution. As a consistent cosponsor of similar legislation in past Congresses, I have watched our nation become so numb to our fiscal plight that we treat a reduction in the size of the annual increase in the deficit as a success. This is like lifting our foot just a little off the gas pedal of a car heading over a cliff. We need to hit the brakes. By requiring a balanced budget and giving the President a line-item veto, the Fiscal Responsibility Act will force future Congresses to control government spending, and protect the economic rights of generations to come.

Finally, the Committee will take up key portions of the American Dream Restoration Act. I have long been a critic of the so-called "marriage penalty", and believe that the government should not punish people for getting married. The family is the core of our society, and the Congress should be approving legislation that supports our nation's families, not penalizing them. I support the reform of the marriage penalty, where married couples pay more in taxes than they would as two singles. Also contained in this legislation is a $500 per child tax credit for families with annual incomes up to $200,000. Last, but certainly equally important, the American Dream Restoration Act creates the American Dream Savings Account (ADSA). I know the members of this Committee are as concerned as I am about our nation's low savings rate when compared to the rest of the world. By allowing individuals to contribute up to $2,000 a year into an ADSA, our nation can increase its savings rate and enable more workers to plan for their retirement years. Individuals can make tax-free withdrawals if used for retirement income, for a first time home purchase, for post secondary education expense, or for medical emergencies or purchasing long-term care health insurance. While the initial deposit is taxed, by allowing these accounts to accrue tax free for these purposes, we will foster the American dreams of home ownership, a better job, and retirement security.

Mr. Chairman, I thank you for the opportunity to testify in support of all these programs, and I look forward to working with you to bring these changes to the American people.

ISBN 0-16-052057-6

90000

9 780160 520570

TAX PROVISIONS IN THE CONTRACT WITH AMERICA DESIGNED TO STRENGTHEN THE AMERICAN FAMILY

HEARINGS

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JANUARY 17, 18, AND 19, 1995

Serial 104–16

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

92–792 CC WASHINGTON : 1995

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-052001-0

COMMITTEE ON WAYS AND MEANS

BILL ARCHER, Texas, *Chairman*

PHILIP M. CRANE, Illinois
BILL THOMAS, California
E. CLAY SHAW, JR., Florida
NANCY L. JOHNSON, Connecticut
JIM BUNNING, Kentucky
AMO HOUGHTON, New York
WALLY HERGER, California
JIM McCRERY, Louisiana
MEL HANCOCK, Missouri
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
DICK ZIMMER, New Jersey
JIM NUSSLE, Iowa
SAM JOHNSON, Texas
JENNIFER DUNN, Washington
MAC COLLINS, Georgia
ROB PORTMAN, Ohio
PHILIP S. ENGLISH, Pennsylvania
JOHN ENSIGN, Nevada
JON CHRISTENSEN, Nebraska

SAM M. GIBBONS, Florida
CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
ANDY JACOBS, JR., Indiana
HAROLD E. FORD, Tennessee
ROBERT T. MATSUI, California
BARBARA B. KENNELLY, Connecticut
WILLIAM J. COYNE, Pennsylvania
SANDER M. LEVIN, Michigan
BENJAMIN L. CARDIN, Maryland
JIM McDERMOTT, Washington
GERALD D. KLECZKA, Wisconsin
JOHN LEWIS, Georgia
L.F. PAYNE, Virginia
RICHARD E. NEAL, Massachusetts

PHILLIP D. MOSELEY, *Chief of Staff*
JANICE MAYS, *Minority Chief Counsel*

CONTENTS

	Page
Advisory of January 3, 1995, announcing the hearing	2

WITNESSES

Abaya, Carol, Sandwich Generation	346
Adolf, Barbara P., Towers Perrin, New York, N.Y	352
Adoptive Families of America, Susan A. Freivalds	276
Alstott, Anne L., Columbia University School of Law, New York	82
American Academy of Adoption Attorneys, Samuel C. Totaro, Jr	264
American Association of Retired Persons, Robert Shreve	443
American Council of Life Insurance, Hon. Daniel A. Mica	398
Ball, Hon. Robert M., Washington, D.C	501
Banks, John, Viaticus, Inc	421
Bauer, Gary L., Family Research Council	135
Bloch, Thomas M., H&R Block, Inc	141
Boulter, Hon. Beau, United Seniors Association	490
Burtless, Gary, Brookings Institution	61
Buyer, Hon. Stephen E., a Representative in Congress from the State of Indiana	236
Children's Rights Council, T. Michael Pitts	208
Christian Coalition, Marshall Wittmann	195
Concerned Women for America, Beverly LaHaye	125
Dave Thomas Foundation for Adoption, R. David Thomas	247
Decter, Midge, Jewish Policy Center, and National Jewish Coalition	202
Dignity Partners, Alan B. Perper	420
Dornan, Hon. Robert K., a Representative in Congress from the State of California	226
Doug and Valerie, adoptive parents	271
Eagle Forum, Phyllis Schlafly	120
Entin, Stephen J., Institute for Research on the Economics of Taxation	458
Families for Private Adoption, Mark T. McDermott	285
Family and Child Services of Washington, D.C., Rhoda L. Veney	285
Family Research Council, Gary L. Bauer	135
Freivalds, Susan A., Adoptive Families of America	276
Goodman, John C., National Center for Policy Analysis	471
Grams, Hon. Rod, a U.S. Senator from the State of Minnesota	11
H&R Block, Inc., Thomas M. Bloch	141
Halamandaris, Val J., National Association for Home Care	314
Home Care Coalition, Suzanne G. Mintz	320
Hudson Institute, Alan Reynolds	97
Hutchinson, Hon. Y. Tim, a Representative in Congress from the State of Arkansas	12
Institute for Research on the Economics of Taxation, Stephen J. Entin	458
Jewish Policy Center, Midge Decter	202
Keown, Annette, Birmingham, Ala	372
Kroll, Joe, North American Council on Adoptable Children	291
LaHaye, Beverly, Concerned Women for America	125
Lank, Richard, National Eldercare Coalition	333
Larson, Per, Highland Mills, N.Y	409
Life Partners, Inc., Brian D. Pardo	402
Liska, Elizabeth, Prince William Interfaith Volunteer Caregivers Program, Manassas, Va	345
McDermott, Mark T., Families for Private Adoption	285

Page

McSteen, Martha, National Committee to Preserve Social Security and Medicare 496
Mica, Hon. Daniel A., American Council of Life Insurance 398
Mintz, Suzanne G., National Family Caregivers Association, and Home Care Coalition 320
Molock, Sherry Davis and Guizelous O., Jr., Fort Washington, Md 281
Moon, Marilyn, Urban Institute 465
National Association for Home Care, Val J. Halamandaris 314
National Center for Policy Analysis, John C. Goodman 471
National Committee to Preserve Social Security and Medicare, Martha McSteen 496
National Council for Adoption, Inc., William L. Pierce 248
National Eldercare Coalition, Richard Lank 333
National Family Caregivers Association, Suzanne G. Mintz 320
National Jewish Coalition, Midge Decter 202
National Viatical Association, Brian D. Pardo 402
North American Council on Adoptable Children, Joe Kroll 291
O'Connell, Marjorie A., O'Connell & Associates, Washington, D.C 92
Pardo, Brian D., National Viatical Association, and Life Partners, Inc 402
Paul, Don, Austin, Tex 374
Perper, Alan B., Dignity Partners, and Viatical Association of America 420
Phinney, Paul, Santa Rosa Beach, Fla 378
Pierce, William L., National Council for Adoption, Inc 248
Pitts, T. Michael, Children's Rights Council 208
Prince William Interfaith Volunteer Caregivers Program, Manassas, Va., Elizabeth Liska 345
Progressive Policy Institute, Robert J. Shapiro 129
Queen-Hines, Carmen, Baltimore, Md 351
Rawoot, Teresa Kane, Timberville, Va 386
Reynolds, Alan, Hudson Institute 97
Roth, Hon. Toby, a Representative in Congress from the State of Wisconsin 369
Sandwich Generation, Carol Abaya 346
Schlafly, Phyllis, Eagle Forum 120
Shapiro, Robert J., Progressive Policy Institute 129
Shreve, Robert, American Association of Retired Persons 443
Smith, Hon. Christopher H., a Represenative in Congress from the State of New Jersey 229
Steuerle, C. Eugene, Urban Institute 47
Summerfield, Nancy, Reno, Nev 309
Thomas, R. David, Dave Thomas Foundation for Adoption 247
Totaro, Samuel C., Jr., American Academy of Adoption Attorneys 264
Towers Perrin, Barbara P. Adolf 352
United Seniors Association, Hon. Beau Boulter 490
Veney, Rhoda L., Family and Child Services of Washington, D.C 285
Viatical Association of America, Alan B. Perper 420
Viaticus, Inc., John Banks 421
Vucanovich, Hon. Barbara F., a Representative in Congress from the State of Nevada 235
Weller, Hon. Jerry, a Representative in Congress from the State of Illinois 238
Wittmann, Marshall, Christian Coalition 195
Zelenak, Lawrence A., University of North Carolina School of Law 57

SUBMISSIONS FOR THE RECORD

Affording Care, Thomas P. McCormack, letter 510
Besharov, Douglas J., American Enterprise Institute for Public Policy Research 43
Catholic Charities USA, Carol Peck, statement 513
Child Welfare League of America, David S. Liederman, statement 516
Concord Coalition, Martha Phillips 518
Condit, William & Patricia, statement 519
First Penn-Pacific Life Insurance Co., joint statement and attachment 524
Flemming, Arthur S., Save Our Security Coalition, statement 531
Freeman, William J., National Association of People With AIDS, statement 529
Human Rights Campaign Fund, statement 522
Liederman, David S., Child Welfare League of America, statement 516
Lincoln National Corp., Lincoln National Life Insurance Co., and First Penn-Pacific Life Insurance Co., joint statement and attachment 524

Page
Lincoln National Life Insurance Co., joint statement and attachment 524
McCormack, Thomas P., Affording Care, letter 510
National Association of People With AIDS, William J. Freeman, statement 529
Peck, Carol, Catholic Charities USA, statement 513
Phillips, Martha, Concord Coalition 518
Save Our Security Coalition, Arthur S. Flemming, statement 531

TAX PROVISIONS IN THE CONTRACT WITH AMERICA DESIGNED TO STRENGTHEN THE AMERICAN FAMILY

TUESDAY, JANUARY 17, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 10:05 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

[The advisory announcing the hearings follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
January 3, 1995
No. FC-1

PRESS CONTACT: Ari Fleischer or Amy Tucci
(202) 225-8933
ALL OTHERS CONTACT: (202) 225-1721

ARCHER ANNOUNCES DETAILS ON STRENGTHENING THE AMERICAN FAMILY HEARINGS

-January 17, 18, 19-

Congressman Bill Archer (R-TX), Chairman-Designate of the Committee on Ways and Means, today announced that the Committee will conduct hearings on January 17, 18, and 19, 1995, on the tax provisions in the *Contract with America* that are designed to strengthen the American family. On Tuesday, January 17, and Wednesday, January 18, the Committee will receive testimony on the proposed tax credit for families with children, marriage tax penalty relief, refundable tax credit for adoption expenses, and refundable tax credit for home care of the elderly. On Thursday, January 19, the Committee will receive testimony on two tax provisions in the Senior Citizens' Equity Act: the proposed repeal of the 1993 tax increase on social security benefits and a proposal to allow tax-free accelerated death benefits under life insurance contracts. The hearings will feature invited witnesses from the general public, Members of Congress, and other interested parties. **All hearings will be held in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

BACKGROUND:

The American Dream Restoration Act contains a $500 per child tax credit and a credit to offset partially the "marriage penalty." The $500 tax credit would be available for each qualifying child under age 18. The full credit would be available to families with adjusted gross incomes of $200,000 or less, with the credit phased out for incomes exceeding $200,000. The credit would be effective for tax years beginning in 1996. Also beginning in 1996, two-earner couples who file joint returns would be eligible to claim an income tax credit. The credit would mitigate unfavorable tax consequences which arise when two single workers marry. This latter provision would provide $2 billion of tax relief over each of the first five years.

The Family Reinforcement Act includes a refundable tax credit for adoption expenses and a refundable tax credit for home care of the elderly. Families may claim an income tax credit (up to $5,000) for qualified expenses paid for legal child adoptions. The full credit would be available to families with annual adjusted gross incomes of $60,000 or less, with the credit phased out for incomes exceeding $60,000. Families caring for an elderly member in their home would be eligible for a credit equal to $500 per parent or grandparent who is mentally impaired or disabled and who, without assistance, is unable to perform daily living activities, such as eating, bathing, and dressing. Both credits would be effective for tax years beginning after 1995.

The Senior Citizens' Equity Act includes a repeal of the 1993 tax increase on social security benefits and a provision allowing for accelerated death benefits under life insurance contracts. The 1993 tax increase requires senior citizens who earn more than $34,000 (singles) or $44,000 (couples) to pay income taxes on up to 85% of their social security benefits. The proposed repeal would lower (over a five year period) to 50% the amount of benefits potentially subject to tax, restoring the level of taxation that existed prior to the 1993 tax increase. Beginning in taxable year 1996, terminally and chronically ill individuals would be able to use tax-free distributions from their life insurance policies to pay medical bills and living expenses.

Chairman-Designate Archer stated, "I look forward to hearing what American families have to say about these provisions in the *Contract with America*. There is no question that tax relief is needed. The *Contract with America* shows our commitment to provide lower taxes for hard-pressed and hard-working American families."

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearings must be made by telephone to Diane Kirkland or Traci Altman (202) 225-1721 no later than the close of business, Monday, January 9, 1995. The telephone request should be followed by a formal written request to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Committee will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the staff at (202) 225-1721.

In view of the limited time available to hear witnesses, the Committee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Committee are required to submit 300 copies of their prepared statements for review by Members prior to the hearing. **Testimony should arrive at the Committee office, room 1102 Longworth House Office Building, no later 48 hours before hearings.**

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement by the close of business, Friday, February 3, 1995, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 300 additional copies for this purpose to the Committee office, room 1102 Longworth House Office Building, before the hearing begins.

FORMATTING REQUIREMENTS:

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

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.

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

3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

* * * * *

Chairman ARCHER. The committee will come to order.

I invite our witnesses to move up to the witness chairs. We have your names in front here, Senator, if you would sit right there. Tim Hutchinson, if you would sit right there, we will get your names lined up with your physical beings.

I am pleased to begin the first of 3 days of hearings on provisions in the Contract With America that are designed to strengthen the American family. As a society, we are committed to the well-being of our children for the simple reason that they represent America's future. It is for this compelling reason that the centerpiece of the American Dream Restoration Act is a $500 tax credit for each child under the age of 18 years.

Over 69.5 million children and their families will benefit from the child tax credit, and that relief is long overdue. Over time, we have seen the real value of the personal exemption for dependents erode substantially. In 1948, close to 80 percent of family income was excluded from income tax due to personal and dependent exemptions. Today those exemptions shield only about 20 percent of family income from taxation.

It is essential we recognize the burdens American families shoulder today. According to the Tax Foundation, over 40 percent of average family income is consumed by Federal, State, and local taxes. This is unacceptable, especially when one considers that the average expenditures for rearing a child approach roughly $5,000 annually.

I am particularly pleased that President Clinton has joined our call for family tax relief. Although the President's proposal is less far reaching, nonetheless, it sends an encouraging signal that the administration will work with Congress to provide long-awaited relief, paid for with spending reductions instead of tax increases.

Today's hearing will also address the so-called marriage tax penalty. A perfect example of the marriage tax penalty was raised by Speaker Gingrich when he spoke before the committee. He spoke of two heads of household each earning $11,000 and both eligible for earned income tax credits. Now, to this couple, the cost of getting married is $4,600 each year. We don't think Uncle Sam should charge a fee when people meet and say "I do."

The American Dream Restoration Act also directs $10 billion in tax relief for working couples over the next 5 years. Although this amount will not erase the marriage tax penalty, the proposal represents an important first step to minimize unfair taxes on marriage.

At this point, I would like to recognize the minority for an opening statement. Mrs. Kennelly, you are the ranking minority member today, so I recognize you for an opening statement.

[The prepared statement follows:]

Opening Statement of Chairman Bill Archer
Hearings on Tax Provisions to
Strengthen the American Family
January 17, 1995

I am pleased to begin the first of three days of hearings on provisions of the Contract with America designed to strengthen the American Family.

As a society, we are committed to the well-being of our children for the simple reason that they represent America's future. It is for this compelling reason that the centerpiece of the American Dream Restoration Act is a $500 tax credit for each child under the age of 18 years. Over 69.5 million children and their families will benefit from the child tax credit. This relief is long overdue.

Over time, we have seen the real value of the personal exemption for dependents erode substantially. In 1948, close to 80 percent of family income was excluded from income tax due to personal and dependent exemptions. Today, those exemptions shield only about 20 percent of family income from taxation.

It is essential that we recognize the burdens American families shoulder today. According to the Tax Foundation, over 40 percent of average family income is consumed by federal, state and local taxes. This is unacceptable, especially when one considers that the average expenditures for rearing a child approach $5,000 annually.

I am particularly pleased that President Clinton has joined our call for family tax relief. Although the President's proposal is less far reaching, nonetheless it sends an encouraging signal that the Administration will work with Congress to provide long-awaited relief, paid for with spending reductions instead of tax increases.

Today's hearing will also address the so-called "marriage tax penalty". A perfect example of the marriage tax penalty was raised by Speaker Gingrich when he testified before the Committee. He spoke of two heads of households each earning $11,000, and both eligible for earned income tax credits. For this couple, the cost in getting married is $4,600 every year. We don't think Uncle Sam should charge a fee when people meet and say "I do".

The American Dream Restoration Act also directs $10 billion of tax relief for working couples over the next 5 years. Although this amount will not erase the marriage tax penalty, the proposal represents an important first step to minimize unfair taxes on marriage. At this point I'd like to turn to the Ranking Minority Member Sam Gibbons, for any opening comments he might have.

Let me extend a warm welcome to all of our witnesses. We will begin today's proceedings with a bicameral panel -- Senator Rod Grams and Representative Tim Hutchinson. We look forward to your testimony.

Mrs. KENNELLY. Thank you, Mr. Archer.

I am very pleased that this committee is revisiting the issue of marriage penalty, because this is an issue which many members of the committee have worked on, especially in 1986 when this committee considered major tax reform. Those of us who served on the committee then will recall that I strongly supported the steps we took in 1986 to lessen the tax burden on married couples.

Like my colleagues, I did so because I strongly believe that the Tax Code should not penalize marriage, which is fundamental to our society. I also believe that the Tax Code should not work against those parents who, because of death, divorce, or abandonment, must struggle to raise children by themselves.

For that reason, in 1985, I introduced and the committee adopted an amendment that increased the standard deduction for heads of households from the single rate to a rate much closer to what joint filers receive.

Recognizing a problem exists is not the same as finding a remedy. Generally, fixing the marriage penalty is an extraordinarily expensive proposition. I know that in 1993, when I was concerned about the impact of the President's deficit reduction plan on upper income couples, I asked Joint Tax to estimate the cost. I was informed that merely by not making the marriage penalty worse in that bill would cost in the range of $180 billion.

So my point today is that goodwill and good resolution will only get us so far. The marriage penalty is a multibillion dollar problem and I do not believe any one of us in this room has a multibillion dollar solution.

In fact, I would point out that the proposal in the Contract allocates $2 billion in each of the next 5 years and directs the Secretary of the Treasury to allocate it as a credit to those affected by the marriage penalty. The Secretary is also required to ensure that no couple gets more of a refund in the marriage penalty than they paid. In other words, the Treasury Department is asked to calculate the marriage penalty paid by every couple in America and then divvy up the $2 billion among them.

This will be an expensive and time consuming process. The approach will not end the penalty. At best, it will slightly ameliorate it.

Taking all the problems into account, any benefit received by America's married couples would be at least 1 year late and billions of dollars short. It seems to me that our focus should be on how best to help American families and I can think of nothing more important, including rectifying the marriage penalty, than continuing to reduce the deficit.

When I go home, people aren't asking me to reduce the marriage penalty, though they would very much like us to do that. But they are asking us to be responsible with their money, to restrain spending, and to keep taking a disciplined approach to deficit reduction. The marriage penalty is a fact. The Contract addresses the existence of the marriage penalty. However, it is disingenuous to claim that the problem is resolved by the solution in the Contract.

We must continue to wrestle with this situation but, unfortunately, the deficit reduces our options in this area. So too with the child tax credit.

The election sent many messages, including that Americans want a tax cut. However, as I said, Americans also want the deficit reduced and interest rates held as low as possible.

In Connecticut, we are still fighting a recession. The $10 per week per child would be welcome of course, but we must ask the real price of this benefit. I would hope that this committee would look long and hard at the $500 child tax credit before taking this route and not knowing what exactly it would do to the deficit and interest rates.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF CONGRESSWOMAN BARBARA B. KENNELLY
COMMITTEE ON WAYS AND MEANS
JANUARY 17, 1995

Thank you, Mr. Chairman. I am very pleased that this committee is revisiting the issue of the "marriage penalty," because it is an issue on which many members of the Committee have worked, especially since 1986, when this Committee considered major tax reform.

Those of us who served on the Committee then will recall that I strongly supported the steps we took in 1986 to lessen the tax burden on married couples. Like my colleagues, I did so because I strongly believe that the tax code should not penalize marriage, which is fundamental to our society.

I also believe that the tax code should not work against those parents who, because of death, divorce, or abandonment, must struggle to raise children by themselves. For that reason, in 1985, I introduced, and the Committee adopted, an amendment that increased the standard deduction for heads of households from the single rate to a rate much closer to what joint filers receive.

But recognizing that a problem exists is not the same as finding a remedy. Genuinely fixing the marriage penalty is an extraordinarily expensive proposition. I know that in 1993, when I was concerned about the impact of the President's deficit reduction plan on upper-income couples, I asked Joint Tax to estimate the cost. I was informed that merely not making the penalty worse would cost in the range of $100 billion.

So my point today is that good will and good resolutions will get us only so far. The marriage penalty is a multi-billion dollar problem, and I do not believe that any one of us in this room has a multi-billion dollar solution.

In fact, I would point out that the proposal in the Contract allocates $2 billion in each of the next five years, and directs the Secretary of the Treasury to allocate it as a credit to those affected by the marriage penalty. The Secretary is also required to ensure that no couple gets more of a refund than the marriage penalty they paid; in other words, the Treasury Department is asked to calculate the marriage penalty paid by every couple in America and then divvy up the $2 billion among them. Imagine what an expensive and time-consuming process that would be.

This approach will not end the penalty; at best, it would slightly ameliorate it. Taking all the problems into account, any benefit received by America's married couples would be at least a year late -- and some billions of dollars short.

It seems to me that our focus should be on how best to help America's families. And I can think of nothing more important -- including rectifying the marriage penalty -- than continuing to reduce the deficit.

When I go home, people aren't asking to fix the marriage penalty. They are asking us to be responsible with their money; to restrain spending; and to continue to take a disciplined approach to deficit reduction.

The marriage penalty is a fact. The contract addresses its existence. However, it is disingenuous to claim that the problem is resolved by the solution in the contract. We must continue to wrestle with this situation, but, unfortunately, the deficit reduces our options in many areas.

So too with the child tax credit. The election sent many messages including that Americans want a tax cut. However, as I said, Americans also want the deficit reduced and interest rates held as low as possible. In Connecticut, we are still fighting a recession. The $10 per week per child would be welcome, but we must ask the real price of this benefit. I would hope that this Committee would look long and hard at the $500 a child tax credit before taking this route.

Chairman ARCHER. The Chair will now recognize the gentleman from Minnesota, Mr. Ramstad, for an introduction of one of our witnesses.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Mr. Chairman, it is my privilege to welcome my former colleague and my good friend Rod Grams to the committee today. Although Rod was with us only one term, he certainly made his mark in the House. Along with his other good friend, our other witness today, Tim Hutchinson, they introduced the Putting Jobs and the American Family First Act.

As we all know, the centerpiece of this legislation, the $500 per child tax credit for American families, found its way into last year's Republican budget proposal and into our Contract With America. Should anyone doubt that the American people strongly support family tax reform, I would just suggest they look at the results of the 1994 Senate race in Minnesota. Rod ran a strong campaign centered on the overtaxation of families and was handily elected in a State which had gone Democrat in the last five presidential elections.

But far more important than politics, reducing the tax burden on American families is the right thing to do and I am glad to see both President Clinton and Minority Leader Gephardt have recently agreed.

Rod, we are grateful for your hard work to promote family tax relief and for your willingness to testify before the committee today. Welcome. Glad to have you back.

[The opening statement of Mr. Ramstad follows:]

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON FAMILY TAX REFORM
January 17, 1994

Mr. Chairman, I appreciate you holding this hearing to discuss one of the most important issues in our Contract With America -- tax relief and reform for American families.

Families with children are among the most overtaxed in our country. In 1950, the average American family with children paid only 3 percent of its income in taxes. Today, the same family pays 24 percent of its income in taxes.

It is little wonder that parents are frustrated by the difficulties of providing for their children and their children's future. Deductions for children have simply not kept pace with the rate of inflation and rising taxes.

Even as wages have increased, people find more and more of their hard-earned dollars ending up in the government's coffers rather than their own pockets.

Added to this dilemma is the incredible injustice of the "marriage penalty," which forces many married couples to pay higher taxes than they would if filing as two single persons. The U.S. tax code has no business discouraging the formation of families by unfairly placing married couples at a financial disadvantage.

I am particularly pleased that my colleague from Minnesota, U.S. Senator Rod Grams, will testify before the committee today on his idea to provide a $500 per child tax credit to American families. This proposal in the Contract With America is based on legislation Rod first introduced as a freshman in the 103rd Congress.

And once again, Mr. Chairman, I'm delighted we will be hearing from a range of policy experts whose opinions were rarely heard during hearings in past sessions of Congress. The witnesses before us today hail from a number of pro-family organizations, which represent literally millions of Americans. The membership of these organizations had a powerful impact on the 1994 elections, and they rightly believe family tax relief is long overdue.

I thank you all very much for being here today and look forward to your testimony.

Chairman ARCHER. I join Congressman Ramstad in welcoming both of you warmly to the committee. We would encourage you to keep your oral presentation to 5 minutes and should you have any more lengthy written statement, that would be included in the record without objection.

Senator Grams.

STATEMENT OF HON. ROD GRAMS, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator GRAMS. Well, thank you very much, Mr. Chairman, for this opportunity to testify today before the House Ways and Means Committee to discuss an issue of great importance to me, and that is middle-class tax relief. I want to also thank Jim for his kind words and congratulate him on the committee. I am pleased to be joined this morning by my colleague from Arkansas, Tim Hutchinson, with whom I introduced the $500 family tax credit, the cornerstone of our families first bill.

Mr. Chairman, it was just about 1 year ago that Congressman Hutchinson and I were testifying on this very subject before the House Budget Committee, then chaired by my colleague from Minnesota, Martin Sabo. As you might guess, our bill and our ideas were not very well received. Our arguments then were simple. Taxes were too high. The burden of tax increases fell disproportionately on the middle class and big government was forcing more workers out of the working class and into the welfare class.

Today, those same problems remain and the arguments for tax relief are still the same. Taxes are still too high. The tax burden still falls too heavily on the middle class and the big difference, however, is, in this year, with this Congress, we can do something about it. We promised tax relief, now we have got to deliver. We have got to do it for what Garth Brooks calls the hard-hat, six-pack, aching-back, flag-waving, fun-loving crowd.

In 1993, when Congressman Hutchinson and I introduced the $500 family tax credit, we did so in a tax environment that was not exactly middle-class friendly. Consider the facts. Most middle-class American families pay more in Federal taxes than they spend for food, clothing, transportation, insurance, and recreation combined.

Since World War II, Federal income and payroll taxes have increased from 2 to 24 percent of the median income of a family of four. Despite this, however, while Congressman Hutchinson and I were making the case for tax relief, Congress was in the midst of passing the 1993 Clinton tax proposal, which was the largest tax increase in American history.

Far from providing tax relief for the middle class, the Clinton proposal actually increased their tax burden making it more difficult for the middle class to care for themselves and their children. The message from Congress then was clear. Give us your money and we will solve your problems. But the American voter said no to this message in November and we now have their support to let them keep their money.

Now, it is 1995 and the cry for middle-class relief was taken up last year when House and Senate Republicans adopted the families first $500 per child tax credit in their alternative budgets and that

is spread across this country and across the aisles. President Clinton and Minority Leader Gephardt have offered their own plans for middle-class tax relief and to them I say, Welcome aboard.

When Washington gets serious about getting government off the backs of the American taxpayer, the taxpayers are clearly the winners. We promised tax relief in the Contract With America and we are going to deliver on it. The question is, How much?

I stand strongly behind the original families first proposal for a $500 per child tax credit. It would mean $25 billion annually to families across America and that is $500 million to families in my home State of Minnesota and $2.1 billion in tax relief to the home districts represented by members on this panel. Ninety-plus percent of that tax relief will go to working Americans making annual salaries of $60,000 or less.

Others have proposed means testing in the tax credit reducing the amount of the credit, limiting the ages of the children eligible for the credit, for substituting an increase in the personal deduction for the credit. The families first tax credit, however, is the largest, fairest, most progressive way of providing tax relief for families and lives up to our commitment of reducing the size of the Federal Government.

By cutting government spending to pay for family tax relief, families first is the strongest response we can send to the American people that we have heard their message, we accept their mandate, and we will deliver on our promises.

Mr. Chairman, what we do in this Congress will determine the makeup of the next Congress. Mr. Chairman, what we do in this Congress will be judged by the middle class. We have made a contract with them and I urge this committee to uphold it as we fight for the middle class and as we fight for fairness.

Thank you, Mr. Chairman, and members of the committee. I welcome any questions that you might have.

Thank you.

Chairman ARCHER. Thank you, Senator.

Congressman Hutchinson, we would be pleased to hear your testimony.

STATEMENT OF HON. Y. TIM HUTCHINSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARKANSAS

Mr. HUTCHINSON. Thank you, Mr. Chairman. I appreciate the opportunity to appear before you and before the committee today.

Almost 2 years ago now—Senator Rod Grams, who was then Congressman Grams—and I started talking about drafting legislation that would significantly ease the financial burden on America's middle-class families. We began with the recognition that our Tax Code has become decidedly hostile to families with children. In fact, every study of the American family has concluded that they are more strapped, more squeezed, and more pressured under a heavier tax burden than ever before.

For instance, in 1950, the average American family with children paid only 2 percent of its income to the Federal Government in taxes. Today that same family pays 24.5 percent. When State and local taxes are included, the government now takes 37.6 percent of the income of the average family.

When you look at what has happened over the past four decades, you see that the Federal income tax burden on a family of four has increased by over 300 percent as a share of family income. Tax relief in the past has targeted senior citizens, the poor, single parents, and the business sector. The result has been that a disproportionate share of the increased tax burden has fallen on middle-class families with children.

In addition, rising inflation has eaten away at the value of the standard deduction and personal exemptions. I point out that if the dependent exemption was indexed for inflation, it would be over $8,000 today instead of just over $2,000. It seems to me we have said through our tax policy that children just aren't as important, that children just aren't as valuable today as they were in 1948, and that is the wrong message.

In response to this inequity, in June 1993, Senator Rod Grams and I introduced the putting families first bill. It was introduced in the Senate by Senator Coates and we are delighted that the $500 tax credit is included in our Contract With America. Senator Grams and I believe strongly that parents know best what their children need.

This tax credit will empower parents in the areas of health care, education, and the other necessities of daily life. Currently, we take from families with the left hand through confiscatory taxes and then we give it back with the right hand in the form of middle-class entitlements minus a big Washington surcharge. Let's let families keep more of their hard-earned money.

Family tax relief has had many proponents over the last several years, from candidate Bill Clinton's endorsement of an $800 tax credit back in the campaign, to the National Commission on Children chaired by Senator Rockefeller who endorsed a $1,000 per child tax credit to the Progressive Policy Institute which has advised increasing the dependent deduction for children and/or providing a targeted child tax credit.

In addition, in 1991, then-Senator Lloyd Bentsen introduced legislation which included a $300 per child tax credit. The Family Research Council has supported a targeted child tax credit of $500 to $1,500 per child. But in spite of all this support, nothing has been done. The time is now.

During the 103d Congress, the polling firm of Fabrizio McLaughlin & Associates conducted a survey which found that Americans not only favor family tax relief by a margin of 3 to 1 but they are willing to accept cuts in entitlements to offset the lost revenues.

Mr. Chairman, on November 8, 1994, the voters made sure we got their message. They told us they want less government, less taxes, and less interference in their lives. The American family wants relief. They want their purchasing power restored. They want to be able to spend more of their paycheck as they see fit. Isn't it about time we make the Federal Tax Code family friendly?

Mr. Chairman, this $500 per child tax credit is not a panacea for the family. It will not nearly solve all of the financial problems that the American family is facing today. It will, however, be a step in the right direction. If we say we believe in family values, then we must at least acknowledge the value of families in our Tax Code.

Last week, here on Capitol Hill, mayors and Governors testified before this committee and other committees on the Hill. What their messages seemed to be was this: Give us the resources, no strings attached, and we can do the job better than Washington. Today, on behalf of millions of American families, I say to you, give American families the resources, no strings attached, and they can do the job better than Washington.

Thank you, Mr. Chairman. Thank you, members of the committee.

[The prepared statement follows:]

THE HONORABLE TIM HUTCHINSON

JANUARY 17, 1995

THANK YOU MR. CHAIRMAN. I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU AND THE COMMITTEE TODAY.

ALMOST TWO YEARS AGO NOW, SENATOR ROD GRAMS (WHO WAS THEN-CONGRESSMAN GRAMS) AND I STARTED TALKING ABOUT DRAFTING LEGISLATION THAT WOULD SIGNIFICANTLY EASE THE FINANCIAL BURDEN ON AMERICA'S MIDDLE CLASS FAMILIES.

WE BEGAN WITH A RECOGNITION THAT OUR TAX CODE HAD BECOME DECIDEDLY HOSTILE TO FAMILIES WITH CHILDREN. IN FACT, EVERY STUDY OF THE AMERICAN FAMILY HAS CONCLUDED THAT THEY ARE MORE STRAPPED, MORE SQUEEZED, AND MORE PRESSURED UNDER A HEAVIER TAX BURDEN THAN EVER BEFORE.

FOR INSTANCE, IN 1950, THE AVERAGE AMERICAN FAMILY WITH CHILDREN PAID ONLY 2 PERCENT OF ITS INCOME TO THE FEDERAL GOVERNMENT IN TAXES. TODAY, THAT SAME FAMILY PAYS 24.5 PERCENT. WHEN STATE AND LOCAL TAXES ARE INCLUDED, THE GOVERNMENT NOW TAKES 37.6 PERCENT OF THE INCOME OF THE AVERAGE FAMILY.

WHEN YOU LOOK AT WHAT'S HAPPENED OVER THE PAST FOUR DECADES, YOU SEE THAT THE FEDERAL INCOME TAX BURDEN ON A FAMILY OF FOUR HAS INCREASED BY OVER 300 PERCENT (AS A SHARE OF FAMILY INCOME). TAX RELIEF IN THE PAST HAS TARGETED SENIOR CITIZENS, THE POOR, SINGLE PARENTS AND THE BUSINESS SECTOR. THE RESULT HAS BEEN THAT A DISPROPORTIONATE SHARE OF THE INCREASED TAX BURDEN HAS FALLEN ON MIDDLE CLASS FAMILIES WITH CHILDREN.

IN ADDITION, RISING INFLATION HAS EATEN AWAY AT THE VALUE OF THE STANDARD DEDUCTION AND PERSONAL EXEMPTIONS. IN 1948, THE AVERAGE INCOME FOR A FAMILY OF FOUR WAS $3,468. AT THAT TIME, $2,667 OF THIS INCOME WAS TAX-EXEMPT -- THAT MEANS THAT OVER THREE-FOURTHS OF THE FAMILY'S INCOME WAS TAX-EXEMPT. COMPARE THAT WITH 1983 FIGURES WHERE AVERAGE FAMILY INCOME WAS $29,184, BUT ONLY THE FIRST $8,783 OF THAT INCOME WAS EXEMPT FROM TAX. THAT'S LESS THAN ONE-THIRD.

FINALLY, I WOULD POINT OUT THAT IF THE DEPENDENT EXEMPTION WAS INDEXED FOR INFLATION, IT WOULD BE OVER $8,000 TODAY INSTEAD OF JUST OVER $2,000. IT SEEMS TO ME THAT WE HAVE SAID THROUGH OUR TAX POLICY THAT CHILDREN JUST ARE NOT AS IMPORTANT TODAY AS THEY WERE IN 1948. THIS IS THE WRONG MESSAGE.

IN RESPONSE TO THIS INEQUITY, IN JUNE 1993, SENATOR GRAMS AND I INTRODUCED H.R. 2434, THE "FAMILIES FIRST" BILL. AT THE CORE OF THIS LEGISLATION WAS A $500 PER CHILD TAX CREDIT FOR EVERY FAMILY IN AMERICA. THIS TAX CREDIT WOULD RESULT IN AN AVERAGE OF $59 MILLION BEING RETURNED TO EACH CONGRESSIONAL DISTRICT NATIONWIDE. IT WOULD ALSO BE TRUE MIDDLE CLASS RELIEF WITH 78 PERCENT OF THE TAX RELIEF GOING TO FAMILIES WITH INCOME BELOW $60,000.

THE BILL WAS INTRODUCED WITH 45 ORIGINAL COSPONSORS, MOST OF THE REPUBLICAN LEADERSHIP, AS WELL AS STRONG SUPPORT FROM THE PRO-FAMILY GROUPS AND A NUMBER OF TAX REFORM GROUPS.

IN THE SENATE, SENATOR COATS INTRODUCED COMPANION LEGISLATION, WHICH AGAIN HAD STRONG SUPPORT AMONG SENATE MEMBERS.

WE WERE DELIGHTED THAT THIS $500 TAX CREDIT IS INCLUDED IN OUR "CONTRACT WITH AMERICA." SENATOR GRAMS AND I BELIEVE STRONGLY THAT PARENTS KNOW BEST WHAT THEIR CHILDREN NEED. THIS TAX CREDIT WILL EMPOWER PARENTS IN THE AREAS OF HEALTH CARE, EDUCATION AND THE OTHER NECESSITIES OF DAILY LIFE. CURRENTLY, WE TAKE FROM FAMILIES WITH THE LEFT HAND THROUGH CONFISCATORY TAXES AND GIVE IT BACK WITH THE RIGHT HAND IN THE FORM OF MIDDLE-CLASS ENTITLEMENTS -- MINUS A BIG WASHINGTON SURCHARGE. LET'S LET FAMILIES KEEP MORE OF THEIR HARD EARNED MONEY.

FAMILY TAX RELIEF HAS HAD MANY PROPONENTS OVER THE LAST SEVERAL YEARS FROM THEN-CANDIDATE BILL CLINTON'S ENDORSEMENT OF AN $800 PER CHILD TAX CREDIT, TO THE NATIONAL COMMISSION ON CHILDREN, CHAIRED BY SENATOR ROCKEFELLER, WHICH ENDORSED A $1,000 PER CHILD TAX CREDIT, TO THE PROGRESSIVE POLICY INSTITUTE WHICH HAS ADVISED INCREASING THE DEPENDENT DEDUCTION FOR CHILDREN AND/OR PROVIDING A TARGETED CHILD TAX CREDIT. IN ADDITION, IN 1991, THEN-SENATOR LLOYD BENTSEN INTRODUCED LEGISLATION, S. 1921, WHICH INCLUDED A $300 PER CHILD TAX CREDIT. THE FAMILY RESEARCH COUNCIL HAS SUPPORTED A TARGETED CHILD TAX CREDIT OF $500 TO $1,500 PER

CHILD AND THE COMMUNITARIAN POSITION PAPER ON THE FAMILY HAS RECOMMENDED A $600 PER CHILD ALLOWANCE FOR CHILDREN, WHICH COULD COME IN THE FORM OF A CREDIT OR OTHER TARGETED TAX MEASURE. BUT IN SPITE OF ALL THIS SUPPORT, NOTHING HAS BEEN DONE. THE TIME IS NOW.

DURING THE 103RD CONGRESS, THE POLLING FIRM OF FABRIZIO, MCLAUGHLIN AND ASSOCIATES CONDUCTED A SURVEY WHICH FOUND THAT AMERICANS NOT ONLY FAVOR FAMILY TAX RELIEF 3 TO 1, BUT ARE WILLING TO ACCEPT CUTS IN ENTITLEMENT SPENDING (OTHER THAN SOCIAL SECURITY) NEEDED TO OFFSET THE REVENUES LOST TO THE FEDERAL TREASURY FROM A $500 PER CHILD TAX CREDIT.

LAST YEAR, SENATOR GRAMS AND I WORKED WITH JOHN KASICH, BUDGET COMMITTEE RANKING MEMBER, AND THE FAMILY GROUPS TO INCORPORATE THE $500 TAX CREDIT IN THE FY 1995 REPUBLICAN BUDGET.

DESPITE THE HARD WORK DONE BY THE FAMILY GROUPS AND A NUMBER OF MEMBERS, WE FELL SHORT IN GETTING THE MESSAGE TO THE MAJORITY OF OUR COLLEAGUES THAT AMERICAN FAMILIES WANT SOME RELIEF.

WELL, MR. CHAIRMAN, ON NOVEMBER 8, 1994, THE VOTERS MADE SURE WE GOT THEIR MESSAGE. THEY TOLD US THEY WANT LESS GOVERNMENT, LESS TAXES, AND LESS INTERFERENCE IN THEIR LIVES. THE AMERICAN FAMILY WANTS RELIEF. THEY WANT THEIR PURCHASING POWER RESTORED. THEY WANT TO BE ABLE TO SPEND MORE OF THEIR PAYCHECK AS THEY SEE FIT. ISN'T IT ABOUT TIME WE MAKE THE FEDERAL TAX CODE FAMILY FRIENDLY.

MR. CHAIRMAN, THIS $500 PER CHILD TAX CREDIT IS NOT A PANACEA FOR THE FAMILY. IT WILL NOT NEARLY SOLVE ALL OF THE FINANCIAL PROBLEMS THAT THE AMERICAN FAMILY IS FACING TODAY. IT WILL, HOWEVER, BE A STEP IN THE RIGHT DIRECTION AND WE OWE IT TO THE AMERICAN FAMILY TO DO EVERYTHING WE CAN TO MAKE IT EASIER FOR PARENTS TO RAISE THEIR CHILDREN IN OUR SOCIETY TODAY. IF WE SAY WE BELIEVE IN FAMILY VALUES, THEN WE MUST AT LEAST ACKNOWLEDGE THE VALUE OF FAMILIES IN OUR TAX CODE.

LAST WEEK YOU HAD MAYORS AND GOVERNORS TESTIFYING BEFORE YOU. THEIR MESSAGE IT SEEMED TO ME WAS -- GIVE US THE RESOURCES -- NO STRINGS ATTACHED AND WE CAN DO THE JOB BETTER THAN WASHINGTON. TODAY, ON BEHALF OF MILLIONS OF AMERICAN FAMILIES I SAY TO YOU -- GIVE AMERICAN FAMILIES THE RESOURCES -- NO STRINGS ATTACHED AND THEY CAN DO THE JOB BETTER THAN WASHINGTON.

THANK YOU MR. CHAIRMAN.

Chairman ARCHER. Thank you, Congressman Hutchinson.

Very briefly, let me ask both of you, why did you elect to push a tax credit rather than an increase in the personal exemption?

Senator GRAMS. I just think the credit is a good, fair way of doing it rather than trying to put it into increasing the exemption. I think it sends a real clear message that as Tim mentioned, and I mentioned in the opening statements, children are important and if we would have just kept pace over the last four decades, the child credit today, if you put it in terms of the tax deduction, would have been over $8,000.

So to put a $500 per child credit on the tax forms to help support this and to really give support to the American family I think sends a good, clear message.

Mr. HUTCHINSON. I would agree. I don't really quibble which way you go on it. I think if you do the calculations and numbers on it, you probably come up with a little more relief for the middle class with the credit than you would with increasing the exemption. I think 90 percent of this relief falls to people making less than $75,000. It is a very fair way of doing it.

Chairman ARCHER. Would it not be true that an increase in the personal exemption or, in effect, a tax deduction helps the wealthy a lot more percentagewise than the tax credit?

Mr. HUTCHINSON. I think if you do the figures on it, that's exactly right, that higher income people benefit more from increasing the exemption while the middle class benefit more from the tax credit.

Chairman ARCHER. Thank you very much.

Mr. Gibbons.

Mr. GIBBONS. I don't know of a Member of Congress that won't advocate a tax cut for somebody. I never in my 34 years here found a Congressman that would say no to a tax cut.

Let me ask you, you say your tax cut goes to the six-pack, fun-loving crowd. Is it more important to give the six-pack, fun-loving crowd a tax cut than to continue reducing the Federal deficit by $25 billion a year?

Senator GRAMS. In the same respect, you haven't seen a Member of Congress who wouldn't want to give a tax cut. We haven't found too many Members of Congress who haven't advocated tax increases over the past four decades. When we are talking about the hard-hat, six-pack, aching-back, fun-loving crowd, we are talking about average Americans, family people out there who, over these last four decades, have seen their tax burden go up.

Now, to say that we can't have tax relief would be to buy into the assumption that we are not already paying too much in taxes. I believe American families are overtaxed and do need relief, and we can do that but at the same time, we can't ignore the problem of having spending cuts to go along with this. We can't give tax cuts without looking at the spending side, as well. So we do have to do it.

I think the main thrust of this is to make sure that we leave American taxpayers with more of their money in their pocket. I disagreed with one statement that was made recently that said we will allow the taxpayers to keep more of their money. Who are we to say that we should take more of their money? I am a strong sup-

porter of the philosophy that Americans today are paying too much in taxes.

We need tax relief to start with and then we have to back that plan up with the spending cuts that are going to allow us to balance the budget and reduce the deficit at the same time.

Mr. GIBBONS. You would rather give the tax relief before you get the spending cuts?

Senator GRAMS. No, no. It has to go hand in hand.

Mr. GIBBONS. That is what you said.

Senator GRAMS. I said these go hand in hand. You can't escape one without the other. The tax cuts have to go hand in hand with the spending cuts or we will have deficit spending, there is no doubt about it. So we have to have the spending cuts first.

Mr. GIBBONS. We tried that in 1981 and all we got were the tax cuts. We never got the spending cuts.

Senator GRAMS. That is why it is incumbent upon this Congress to make sure that those spending cuts go hand in hand with the tax cuts.

Mr. GIBBONS. Don't you think we ought to do the spending cuts first?

Senator GRAMS. I will take the spending cuts first if the tax cuts are very close behind them.

Mr. GIBBONS. We are right on the edge of inflation, although no one likes to talk about it. It is not popular to talk about it. We are at full employment, we are at full industrial capacity. The next step, unless we rein ourselves in, will be inflation.

Which do you think will be the most important, to give $25 billion extra to spending or to avoid inflation?

Senator GRAMS. I think the bottom line is they are both very important, but I think it is best to leave that discretionary decision up to average Americans to make those cuts rather than the government. So the money and the dollars are out there and they are going to be spent in some way. Let's leave the taxpayer to decide how best to spend their money.

Mr. GIBBONS. How about your priorities. Is your priority first to cut inflation or to cut taxes?

Senator GRAMS. Right now, I want to cut taxes and that is not to say while cutting taxes that we are advocating that we would support inflation or that inflation would be the result.

Mr. HUTCHINSON. If I might just comment. I don't think that they are mutually exclusive. What we are talking about is not some kind of profligate tax break to go out and do consumer spending. What we are talking about are middle-class families that are already overburdened, strapped, and need some relief. This is essential tax relief. It is—I don't think essentially inflationary.

Mr. GIBBONS. Well, as I read the statistics, we are right on the verge of inflation. It seems to me the most damaging thing for the American middle class is inflation. They cannot cope with it. They are always the big losers. You are sending $25 billion out to who you call the six-pack, fun-loving crowd. I just think cutting inflation is more important than pandering to the six-pack, fun-loving crowd.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman.

I thank you both for your testimony. I think it is important to keep in mind, if you are talking about freeing up $25 billion, that that money is going to be spent by responsible parents, as opposed to being spent by irresponsible bureaucrats down here. I would infinitely prefer to see it spent back home.

My wife and I had eight children, and believe me, it was a struggle. I was just calculating if that personal exemption had been indexed through the years, that today that would be about $7,500 at least or close to $8,000, which with my wife and myself and my eight kids, we would have had about an $80,000 personal exemption rate.

That sounds staggering today, I am sure, to many people. But the fact of the matter is, that is the equivalent of what it was back then after World War II. Even when I brought up my kids—and that was mostly in the decade of the sixties and seventies, there had been no indexation and it was a struggle, a major struggle. Our Tax Code has been biased, profoundly biased against families.

So I salute you both for what you have done. This is a good first step as far as I am concerned. We have a long way further to go down that pike. Keep up the good fight.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman.

I would like to ask both Senator Grams and Representative Hutchinson, isn't it true that Federal, State, and local taxes add up to about 40 percent of our income and all other things, housing, food, transportation, health care, clothing, recreation, all eventually get to 100 percent and that we had tax-free day last year on May 5, 1994?

This proposal, in my opinion, would have a direct impact on the middle class, the average family that has children. I don't want to one-up Congressman Crane at all, but in raising nine children, the deduction that I got on my Federal income tax didn't even come close, didn't come close to taking care of the expenditures for those children.

With a tax credit, you impact your tax returns directly. If these changes were in effect when I was raising my children—now they are all raised and have families of their own—don't you believe that it would have made the Tax Code a heck of a lot more family friendly than it is presently?

Mr. HUTCHINSON. Absolutely. I couldn't agree with you more, Mr. Bunning. I think the figure I have is 37.6 percent of the income of the average family is taken in taxes at some level now, and I was amazed back in the district this past weekend how many people walked up to me at the mall or on the street and said, please fight for that tax credit for children, that we forget—it is very easy for us to lose touch with what clothing costs and how that is hitting the family, and the automobiles and tuition and food costs and everything else and how that has squeezed the middle-class family.

We do the EITC (earned income tax credit) for the low-income people and we try to target tax relief. The middle-class family just gets hit over and over again. This is the first step toward providing

some real relief, leaving the money back in the pockets of those parents.

Mr. BUNNING. Senator Grams, could you possibly answer the critics which say, you are only giving the tax relief to married couples who have children? I would like to know how you would answer those critics of this tax relief in regard to that.

Senator GRAMS. Well, basically the families have been the ones most under attack in the Tax Codes over the last four decades going from 2 to 24 percent. I would say that if we added in all the taxes, property, sales, Social Security, income taxes, we are at close to 50 percent—49 point some percent of money made by Americans today goes to some form of supporting government, which is 2 percent growth over the last 2 years, by the way, from 47 to 49 percent.

But to the critics who complain, I think families are the ones that need the relief. Where would that $500 per child go? Would some of it go to savings? Yes. The rest would go to help support the child in food, clothing, shelter, a better education. Those are a lot of the services now that government wants to offer.

The only thing is they want to take the money, send it to Washington, then send it back to provide the services that the individuals can provide for themselves. But on the other hand when the critics would say only families would benefit, as we begin to reduce the deficit, reduce the role of government, everybody in society is going to have some benefit from that. So there are also other benefits to other people who do not have children or who have children now that have left home.

Mr. BUNNING. One last thing. According to the information I have, over 50 million families would be included. Do you know how many would be left out?

Senator GRAMS. The vast majority of people in this country are family people or have children, and, as I said, they are the ones that even if you look at just the Tax Code and the child credit from 1940 till now, as Mr. Crane mentioned a short while ago, that it is only about 25 percent of what it could have been if it would have just kept pace with inflation.

So I think to put more emphasis on giving these credits, as you said, helps families to raise their children without having to rely more on government. So in this respect, I think we are putting responsibility and also accountability back to families and taking some of it away from the Federal Government.

Mr. BUNNING. Thank you, Mr. Chairman.

Chairman ARCHER. Mrs. Kennelly.

Mr. Coyne.

Mr. COYNE. I have no questions.

Chairman ARCHER. No questions.

Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman.

Gentlemen, thank you very much for being here with us. I am in general agreement with what you are trying to do. I have got a couple of questions, though.

The first—I am a little confused why you don't do all this through the earned income tax credit. Maybe it touches a little bit on what Mr. Archer was saying. But you have a cap on claiming

the credit. You have your income tax liability, your total payroll tax and then that is offset by EITC (earned income tax credit), and I just don't know how those two things interact. So that is one thing.

Another thing is, I don't know how this helps, specifically, the people in need in my district. Let me just give you some figures. Of the three largest towns—and this again is in a rural area, the average annual income goes from $18,500 to $24,100. So really, in effect, about 40 percent of the people who really need help can't get it through this process. If it will work through an earned income tax credit, they might be able to do it.

Mr. HUTCHINSON. Mr. Houghton, I am not a tax expert and I will leave that to you all. I think that this is only going to minimize the impact of the ITC which is currently available, that what we are really doing is playing catchup. We are trying to level the playing field on how we have, over the last 40 years, gradually made the Tax Code more and more hostile to the family.

People say, well, why are you picking families with children? Why are you giving them the special benefits? It is not a special benefit. We are just trying to catch them up with where they should have been had we indexed things back since 1948. They are the ones being squeezed. They are the ones being hard hit.

I really think that it will hit the vast majority of middle-class Americans, that it will leave that money in their pocketbooks, allow them to make the choices that we currently are making with that $25 billion and the numbers are there for how it will impact each congressional district in this country, how much will be returned to middle-class families. I think it is a good way.

Mr. HOUGHTON. Congressman, I agree with the basic thrust here. There isn't any question about it. But you know, what is middle class? It goes anywhere from $15,000 to $115,000 in terms of how you ask. But the people who are closer to $15,000 are the ones that need it, don't quite get it the same way. They might have gotten it through a different process.

Senator GRAMS. Right now, most of those with earned income tax credits are getting that type of relief. Those are built into the Tax Codes. But it is the families over that poverty level or over that amount, the $20,000 and up, as you talked about.

Mr. Houghton, in your district alone, you would get about $60.7 million a year in tax relief just in your district. I think if you went and asked the average family if $500 or $1,000 or $1,500, depending on the size of the family, wouldn't mean something to their bottom line or their quality of life, I think you would have some strong arguments.

That, again, is not the cure-all. It is not the panacea for the problems, but it is a good start and it is a way of emphasizing support for those who I believe have been shouldering the burden. We have offered so much in government programs and cuts and programs for those below the poverty line. We seem to have forgotten the middle class. What we have asked for them to do is pay the tab and not get any relief. So this is strictly, or one of the areas pointed at, those above that line.

Mr. HOUGHTON. Thanks very much.

Chairman ARCHER. Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman. I will be extremely brief.

Thank you for your testimony. I support you all the way. I have ever since you started the idea. I just hope that we can—in addition to this, come up with incentives for savings that will apply to everybody, rather than just concentrating on the middle-income members that have family only, because we have got to come up with some tax relief to encourage the savings programs that the Tax Code has stopped middle-income people from being able to utilize.

Thank you very much for your testimony, gentlemen.

Mr. HUTCHINSON. Mr. Hancock, I appreciate those comments. I think all of us ought to be concerned about the low savings rate in the United States. I think we have the lowest savings rate in the world. That needs to be addressed.

But I think also that if a family has two children, they have $1,000 more disposable income because of this tax credit, they are going to have something to put in that savings account or in that savings bond and start setting it away for college tuition so it is at least a step in the right direction.

Mr. HANCOCK. But you do agree we have to make those savings plans available and give the citizens an incentive to put them into effect. Thank you.

Chairman ARCHER. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman. I want to thank my colleagues for their testimony today.

Senator Grams, congratulations.

Senator GRAMS. Thank you.

Mr. PAYNE. My question really goes back to what Congressman Gibbons was asking about earlier, and that has to do with this whole notion of responsibility and fiscal responsibility, which is something that this committee is charged with and something that we certainly take a great deal of pride in.

As we have learned in terms of the balanced budget amendment, which we will be voting on next week, in order for us to successfully find a way to a balanced budget by the year 2002, we know that we will have to find $1.2 trillion of reductions in cost between now and the year 2002. That is a very substantial number and it is a very substantial undertaking to accomplish.

We are now proposing in the Contract as we—as one of the first things we do—to add to that $1.2 trillion through various tax cuts. This, of course, is the one that is viewed by the Treasury as the most expensive. Those tax cuts cumulatively add about four-tenths of a trillion dollars, which is $400 billion. So we are now talking $1.6 trillion.

I know you have thought about this in your proposals last year as you thought about how we would find our way to a balanced budget, because I believe you both support that notion. My question is: What specific recommendations do you have or what can you say about reducing the cost of government that would offset numbers such as $1.6 trillion between now and the year 2002?

I think that is where we are headed some time during this Congress as we begin to make these decisions. Tim, maybe you could just comment on that.

Mr. HUTCHINSON. OK. Thank you for the question. Let me just say, in my view, deficit reduction and family tax relief are not mutually exclusive, that we can do both. We must do both. In the Republican budget which was submitted last year, we had the $500 tax credit. We also had the spending cuts to offset it. I don't want to face the American people and say we can't—because we can't control our spending, we can't afford to give you tax relief. I think we have got to do both.

In our Contract With America, there is a commitment that the specific spending cuts will be there to offset the tax relief. But too often these things are presented like they are new spending programs. This isn't a spending program that is costing the Treasury more money, it is leaving money in the pockets of hard-working Americans where it ought to be, letting them make the decisions. They are going to spend some of that. It will be good for the economy. Most of all, it will provide some much-needed relief. I think we can do both. We must do both.

We have a big job between now and the year 2002. I hope we put the disciplinary mechanism of the balanced budget amendment in place and then set about the hard task of doing some entitlement reform and identifying specific spending reductions. I am willing to make those hard votes but I think we have to look at the eyes of the American people and say you deserve this relief and we are going to do it.

Senator GRAMS. Mr. Payne, I would just like to briefly add to that, when we talk about $1.2 or now $1.6 trillion in spending cuts over the next 8 years, you have to put that in the context where this government is going to be spending over $13 trillion at the same time. What we are looking at is an 8-percent or less than 8-percent cut in the budget over that period of time.

Now if we, in our own private lives, had to make an 8-percent reduction in our spending habits to ward off a catastrophe that our family was facing, we would do it. In the private sector, General Motors has done it, IBM has done it, Sears is doing it to try to stay profitable and in business. The Federal Government has no less of an obligation.

When you are talking about tax cuts, you talk about productivity. We did double revenues in the eighties with the tax cuts proposed under President Reagan. President Kennedy knew the value of tax cuts that he offered in the early sixties. We didn't get the high deficits in the sixties because we didn't increase spending at as foolish a rate as we did in the eighties.

So, again, I go back to Mr. Gibbons and his remarks about how we need the tax cuts, which I believe are better for families. It is going to increase productivity, and can even increase revenues to the Treasury. But we have to have, on the other hand, the spending cuts to balance them and then use them for deficit reduction. I think we can do both.

Mr. PAYNE. I do appreciate your comments. I would say two things. One is that certainly we have to offset these costs and we all recognize that. But second, we are also on another track and that is a track to balance the budget that says not only do we offset these costs, we have a lot of other costs we are looking at as well.

I think we always need to keep that in mind as we are making these decisions.

Two, I think that we can say in general that there will be cuts. You have mentioned 8 percent and I have heard other numbers, as well. But when we begin talking specifically about how is it that we are going to achieve those $1.2 trillion in cuts, it seems that is where we have much less discussion about the specifics. But I know we will be getting into more detail later.

I too support the middle-income tax cuts, but I am really concerned about how it is that we maintain fiscal responsibility, because I think that is very, very important as well.

Thank you.

Chairman ARCHER. The gentleman's time has expired.

Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Mr. Chairman, just a followup comment. I like the way our distinguished colleague put it yesterday on one of the talk shows, or rather Sunday, when he—when Chairman Kasich said we are not cutting anything. Instead of increasing spending over the next 7 years by $3 trillion, we are going to increase spending over the next 7 years by $2 trillion. I think that puts it in perspective.

I am glad to hear both of you talk about doing it right this time, unlike the eighties when the commensurate spending cuts were not made during the go-go years. Things were fine. Congress kept spending the money like there was no tomorrow and, of course, we saw the results in the deficit. But I am glad that both of you talk about the need to make the commensurate spending cuts.

As an economist who sat in that chair last week put it, "As long as the spending cuts are real, then it will be a wash from a macroeconomic standpoint and the standpoint of the deficit."

My question is this to either or both of you: In looking at the Clinton tax cut proposal that was recently put on the table, which cuts off the child tax credit after age 13, would you care to comment on that proposal as contrasted to yours?

Mr. HUTCHINSON. I will just comment briefly that I think it is too little and it is spread out over too long a period of time. It does not provide the kind of relief that is necessary. As a father of three teenagers, I can tell you that the highest costs in child rearing occur after they reach the age of 13, not before. I really think that it is phased in over too long a period of time. It is not a sufficient amount. The cutoff is too early at the age of 13.

Senator GRAMS. I agree, too. I don't think we can just pay lip service to this or bite around the edges or make it look good and go in the back rooms and say what can we do to fool the American public into thinking that some kind of tax cut or tax relief is enough. I think we have got to provide tax relief and cuts that are meaningful and that when they open their wallets at the end of the month, they can see that there is a difference. Not just to have the headlines read that there was a tax cut and it doesn't show up at the kitchen table when they are figuring out their budget.

So, I think it is too little, and I think we have got to make a meaningful statement and that is a minimum of $500 per child.

Mr. RAMSTAD. I thank you both for your responses. I must say I am not surprised by them but I concur with them. Thank you very much.

Chairman ARCHER. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. I guess I snuck in before the gavel went down. I appreciate that. I thank my colleagues present and former for being here this morning for your good testimony.

I really enjoyed that dialog you had with the Members of both sides of the aisle here this morning. I think it has been interesting. I think there is a general consensus we need targeted relief. I think middle-class families need the relief. It is interesting, to just reiterate, that there are other proposals on the table. There is a Gephardt tax credit for children, as well. The Clinton administration advanced its own proposal. The question is not so much do we do this but how we do it and how we pay for it.

I think there is also a consensus this morning that we do need to pay for it. For that reason, I have a couple of questions. One is, do you think the $124 billion figure is a sound one? This gets into the dynamic versus static scoring issue, and I have been instructed this morning by hearing both of you say at different times that people will use this money in part to increase their savings. I think, Mr. Hutchinson, you mentioned at one point the benefits to the economy. So it seems to me there would be some increased revenue.

Do you have a comment on that $1.4 billion figure?

Mr. HUTCHINSON. I think economists differ on the economic impact of family tax relief. They would probably say a capital gains tax relief would have more economic stimulus than the family tax relief. It has been so long since we did it, I don't know if anybody can really project what the impact will be.

I am more optimistic. I think we have to have more spending cuts to balance it. I don't think you can go to dynamic scoring on family tax relief. We have to assume it is a genuine loss to the Treasury. But I am more optimistic about what the real impact of the economy would be and that consumer spending, investment in savings, all of that would result from leaving more money in the pockets of American families. I think it would have a beneficial impact and the numbers will not be as bad as what we have seen.

Senator GRAMS. Also, Mr. Portman, I agree with Mr. Hancock that Tax Codes can be written to encourage savings. If you give people an incentive, they are more likely to do something than if you provide the hammer. But also, I think when we are talking about $24 or $25 billion, putting that into the pockets of parents to make those decisions, I think they are going to make decisions closer and better to their family needs than a bureaucrat in Washington. So if the money is going to be spent, I think the decisions for the family are best made by the parents, rather than in Washington.

So to say that we are going to cut this money loose and give to it a bunch of irresponsible Americans to spend at will rather than having a smart government tax it away from them and spend it in their best interest, I would opt for the former and let the parents make the decision.

Mr. PORTMAN. The second question I have relates really to Mr. Gibbons' comments with regard to the current economy. I think he described the economy as being in full employment and full capacity, and he questioned whether there was a need for tax relief at this point and even questioned the potential inflationary impact.

I guess my question to you is: When would these tax credits begin to affect the economy? When would they kick in?

Senator GRAMS. Well, I think by the time you get them into your pockets. I mean, when you have either in your paychecks reduced withholdings or the refund that you get in 1996, I think would be the earliest. But I still think it is important that we look at this as not hurting programs or people who need it. It is just to add extra relief, an extra spending discretion to those people who earn that money.

Mr. HUTCHINSON. I think that is a good point that you are making that in fact those refunds will not come for some time. So to speculate now as to what the impact may be in the next few months on inflation is almost a moot point.

But I don't want to face the American people and say we are afraid it may be inflationary so we can't afford to give you a tax break at this time. We can always find an excuse if we don't want to give tax relief. So to speculate on how it might impact inflation down the road seems to me to not be a good basis for not passing them.

Mr. PORTMAN. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Levin will inquire.

Mr. LEVIN. Thank you, Mr. Chairman. Good morning.

Senator GRAMS. Good morning.

Mr. LEVIN. I believe there is some strong general agreement on letting the individual family make the decision. Let me ask you, if there weren't the savings to pay for the $125 billion, somewhere between $120 and $125 billion and we had to choose between reducing the amount of the credit or reducing income eligibility for the credit, which of the two would you choose? Which course would you select?

Senator GRAMS. Well, I think we are looking at a scenario that you are saying "what if" or maybe we don't want to give this tax credit for some reasons.

Mr. LEVIN. Let's assume that when you put all the tax proposals together that there has to be some give, that the amount simply can't be found and there have been increasing statements that we have to end up with a balanced budget here. Let's assume that the scoring—there is agreement on the scoring and it doesn't meet some of the expectations and a choice has to be made between reducing the credit or reducing the amount of income for which there is eligibility.

Which of the two would you choose?

Mr. HUTCHINSON. Mr. Levin, I don't want to climb into that box. I heard that word "assume" several times. If you are in a ball game, you are playing to win. You don't assume a loss. I think right now we have to find the spending cuts. We have to determine that this is something worthwhile doing, that the middle-class American family needs relief and we are going to find the money

to do it. That is the approach I would take on it. Let's do what we promised we would do for the American people.

Mr. LEVIN. Because I think it raises the question why you go up to $200,000 and phase it out at $250,000, rather than a lower figure. So let me ask you, Representative Hutchinson, you said the public says that they would prefer entitlement cuts to sustain a middle-income tax cut. Which entitlements do you favor cutting?

Mr. HUTCHINSON. I don't know if I am in the position to make that decision. But the poll that I quoted said that the American people support middle-class tax relief, family tax relief by a 3 to 1 margin, including the necessity to make entitlement cuts. I don't know that they were listed, given a list of what potential cuts would be.

Mr. LEVIN. What would your preference be in terms of entitlement cuts?

Mr. HUTCHINSON. I don't think that that is a proper thing for me to respond to. I am not going to present a budget today. I am committed to make the kind of votes that are necessary to find the spending reductions to allow us to give tax relief to American families. I am willing to do that. But for me to sit here and say that I have made some kind of evaluation, I made some kind of study as to where the most abuse and fraud is or where the most waste is or where we can hurt people the least by making the reductions, I am not in the position to do that.

I am in the position to say I will make the hard votes to find the spending cuts to give the middle-class families the tax relief. I think we have to keep the focus in mind. The focus is the American family deserves tax relief. They need tax relief. They are burdened and they are stretched and we have got to find a way to do it.

Mr. LEVIN. Well, I agree with that sentiment. I do think that each of us has to begin to figure out what cuts we would be willing to vote for. That day is pretty imminent, thank you.

Senator GRAMS. I think we have to set goals, Mr. Levin, and follow it up with action. We might run into some of those tough questions. I think if we go without answering those tough questions, we are going to face more retribution from our children and grandchildren for not having done what is fiscally responsible and not to pass these debts and burdens on to them.

Mr. LEVIN. I couldn't agree with you more.

Senator GRAMS. All cuts have to be across the board. All entitlements have to be across the board. I think what Mr. Ramstad said, quoting Mr. Kasich, "We are not talking about cuts in a lot of programs. We are not talking about endangering the lives of many individuals or a lot of the programs, only the growth of those programs. We are not going to spend $3 million or billion or trillion in increases, only $2 trillion in increases."

So a lot of the question is going to be how much do we increase spending, not how much do we cut. So I think those assumptions are going to be the hard questions and the hard votes that you said are coming in the very near future.

Chairman ARCHER. The gentleman's time has expired.

Ms. Dunn.

Ms. DUNN. Thank you, Mr. Chairman, and welcome, gentlemen, Congressman Hutchinson and Senator Grams, and congratulation

on your ascension to the other body. My background is as a single mother, and I raised two boys from the ages of 6 and 8, and they are in their early twenties now. I must say it was at a rate of income far below any of the limits listed on any of the options here. I would like you to explain to me, both of you, how this child tax credit would affect a single parent. What would be the requirements?

Senator GRAMS. There would be no differences between a single parent or a two-family, two-parent household. But the thing is, for many single parents that face a lot of these problems and are trying to make ends meet, the $500 per child credit could mean maybe not having to take in the second job for that single mom or single dad and being able to spend more time with their children, rather than having to meet the obligations of not only having one full-time job, but maybe having to take on a second job.

So this is where some of the relief really comes in, that it allows the single person not to have a part-time job in order to try to provide what he or she feels is necessary for the family. Or maybe in a two-parent household, that maybe the second parent doesn't have to work or maybe only work a part-time job. Again, allowing more time for the family to be together. Those are really some of the trigger mechanisms and the goals behind this program.

Mr. HUTCHINSON. I think, Jennifer, in a sense that it is going to be more beneficial for the single parent, because they are so strapped now. My sister is a single parent and she said pass that. I asked her what $500 more disposable income would mean, and she has one child, and it would mean a great deal, she made it very clear. So I think the principles are the same. The impact will be at least as great for the single parent.

Ms. DUNN. I certainly feel it would have been in my case. You have talked about some of the incentives, some of the goals behind the $500 tax credit for each child. Could you summarize those so that we have a good clear view on how the ramifications would work from this tax credit? What are we trying to do, what is behind it?

Senator GRAMS. Well, I think the goal is to really put support into the families, and again to go back to the wage earners that when you have husband and wife working, that means less time to spend with the child or the children in the home.

This way, maybe one of the family members can stay home or only work a part-time job or in a single parent's instance, maybe only a part-time job rather than two. So it is trying to strengthen the family, provide them money where it is needed the most, and that is for food, clothing, shelter, and in the education of our children. Rather than looking to the government for a program that is going to provide me some assistance, when we have the money to begin with, why send it to Washington and then go begging to get some of it back to help? So really it is to put discretionary spending back where I think the best decisions are made and that is to the closest point, that is the family.

Mr. HUTCHINSON. I agree. I think we need two things. For one thing, we put the U.S. Congress and the Federal Government on record as being in support of the family. So often, our policies have

indicated that we are hostile to the traditional American family. So we do that.

It is certainly an empowerment bill. It empowers the American family. Where now we take through confiscatory taxes on Friday and give it back to them in a middle-class entitlement of one sort or another which Washington, D.C., has made the priorities, and we have made the decisions as to what is the best way for them to spend it. We are saying you have the wisdom to make those kinds of decisions and those kinds of choices, whether it is education or whether it is the priorities for their own family. So it is very much an empowerment bill.

Ms. DUNN. Also, that choice could be to save that money, so that it would take us a step further toward one of our goals here in this congressional term of increasing the ability of families to save.

Thank you.

Chairman ARCHER. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman, and thank you for your testimony. I find it both very interesting and very informative. Both of you mentioned time and time again about the fact that this could not only help accrue money in the family's budget for spending purposes, but also for savings purposes.

We heard testimony last week about the fact that the savings rate in this country has really dropped. There is also mention of the fact that for those who don't have children—what type of relief are we going to be giving them? Is it not true that the repeal of the marriage penalty would help many families, couples who don't have children? Is it not true, too, that if we put in place the deductibility of the IRA at the beginning or end, that will help families who do not have children?

Also, will the repeal of the Social Security tax increase of 1993 help families who do not have children, as well as the earnings limit? The question too was posed about whether we should go with a credit route or exemption route or increase the exemption.

Is it not true that in order to reach a $500 credit based on a 24-percent rate of family income, that we would have to increase the dependent deduction to $2,000 to reach that $500 credit? Also, the question has been posed about the earned income tax credit. The earned income tax credit was passed in 1975, I believe it was, with a twofold purpose. One was to offset Social Security tax deductions for those of low income, and the other purpose was to encourage people to work and keep them off of welfare.

But recent reports have shown that those who do work and receive the earned income tax credit have a tendency to work 2.1 hours less each week than those who don't receive the earned income tax credit. These recipients slow down their work rate when they reach the phaseout threshold. They understand that if they continue to work and accrue hours, the value of the credit decreases. So they try to hold the credits as high as they possibly can.

Is it not further true that any type of tax credit given to any one individual becomes a tax liability for another individual or another family to cover those credits? It has been mentioned about entitlements and what entitlement programs that you would like to see cut or abolished. I believe I understand the fact that if we go to block grants to States, we in effect will be abolishing a lot of enti-

tlement programs and making the Congress come back and address those proposals each year in the budget process.

Again, I appreciate your testimony. Thanks again for the work you have done. Hopefully, this Congress will give the people and the families of this country a $500 tax credit per child.

Thank you. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman. I just want to understand. First of all, I want to offer my condolences to you, Senator Grams, having to go over to the Senate. Everybody's making that out to be a good deal, but I can't see what the good deal is, really.

I want to understand that the idea of this is that you think that the people at the bottom who would not receive a refundable credit because they haven't paid any income tax, they already have it made so we don't need to think about them anymore. It is the people above them that you are worried about.

Is that a fair statement of your fundamental underlying principle under which you propose this?

Senator GRAMS. No. My belief is that under past Congresses we have offered some form of relief or help in the earned income tax credit area to those people making under $16,400 a year, but, at the same time, we have forgotten those who make $16,401 and more a year.

Under this plan, over 90 percent of it goes to middle-class Americans making under $60,000 a year. They are going to get this. So this is for those making between the $20,000 and the $60,000 wage or combined income for a household, that we have forgotten and have not offered any tax relief.

All we have asked them to do is to continue to pay more in taxes. So this was an effort to make sure that there was some tax relief across the board that was going to include millions and millions of Americans. It is not to say that we are going to ignore them.

Mr. MCDERMOTT. OK.

Senator GRAMS. It is not at their expense that this program is being implemented.

Mr. MCDERMOTT. Let me ask another question, because I think it is an interesting proposition you have here, as you have already heard. There isn't anybody up here who is going to say we don't want to give a tax cut. I mean there isn't anybody that stupid in the Congress, right? It is a question of priorities.

If you take the $500 a year tax credit, and I figure, you know, $5 for a bottle of wine, that is 100 bottles of wine for a family, or I guess you think that that is what people pick up in a second job, but when you look at it as $83 a month that that family's going to get, if you put a vote to the American people, do they want this tax cut or would they like to have guaranteed health benefits, which do you think they would take?

Senator GRAMS. How much are those guaranteed health benefits going to cost them? That is not free either, Mr. McDermott. But you ask them if $83 isn't going to make the difference.

Mr. MCDERMOTT. No, we are talking about money you are going to cut from the budget somewhere. Someday you are going to tell us where from. OK. So we got that money. Now we have to lay it

on the table. Your decision is to hand it back to people as a $500 tax credit that they can do whatever they want with. You cannot buy a health benefit package for $500 a year for a family of four. It isn't worth a thing.

So the question is, wouldn't they rather have that money used for the funding for a guaranteed health benefit package? Because you have got half the people who are out there working full time—half the people who don't have health insurance are working full time, and they can't get into the insurance market. So you are taking this money and saying the priority that we think is appropriate is just hand it back to them. They can't buy what they really need.

Mr. HUTCHINSON. Let me just cite, first of all, the family of four, if I figure correctly, there is $1,000 available for them, not $500.

Mr. MCDERMOTT. OK. But that $1,000——

Mr. HUTCHINSON. What we are saying is that is $1,000 they ought to make the decisions about, not us. I think in the elections this past year, in my opinion, they spoke about what they wanted on tax relief. They made their will very clear on that. I think that——

Mr. MCDERMOTT. So you would be willing to offer that as an alternative?

Mr. HUTCHINSON. I don't think you need to offer that as an alternative. I don't think the American people see it in that kind of stark this-or-that terms. But I do——

Mr. MCDERMOTT. You are not selling the idea that you, for $1,000 for a family of four, could go out and buy a meaningful health care package?

Mr. HUTCHINSON. I don't think anybody's saying that. What we are saying is right now we are a taking the $1,000 and deciding how it will be spent.

Mr. MCDERMOTT. But these people are working full time and they can't get health insurance. So why take that money and just cut it out of the budget and give it to them in a way that they can't—they can't individually buy?

Mr. HUTCHINSON. Because they know better how to use this than we do, and whatever they do with that $1,000, whether they apply that toward their health care premiums or whether they decide they are going to use it in savings or some other way, that ought to be their decision and not ours.

Mr. MCDERMOTT. I would disagree with you. I think that we have a responsibility, when we are setting priorities, to deal with the problems that really face the American people, the debt on their kids, continued debt reduction, and providing health care benefits for all the middle class who work. Nobody in this country should work 40 hours a week, full time, and not have health care benefits. Nobody should be threatened by any kind of——

Chairman ARCHER. The gentleman's time has expired.

Mr. HANCOCK. Would the gentleman yield?

Chairman ARCHER. The gentleman's time has expired.

Senator GRAMS. I just wanted to quickly say that I held about 100 town meetings over the last 2 years during the campaign. Most meetings would start out by saying keep government out of my health care.

So I think by advocating that government can provide a better service—and I disagree that the government is smarter and should tax the dollars away and spend it in their best interest. I think it is not what most Americans agree with. If we are going to make mistakes, let us make them, rather than taxing that ability away from us.

Mr. MCDERMOTT. The cutting of Medicare to get this money is going to be a real problem for you folks.

Senator GRAMS. Nobody is advocating that. You are right, we have got to set a list of priorities. That includes everything on the table.

Chairman ARCHER. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman. Senator, Representative Hutchinson, thank you very much for appearing before us today to shape the discussion here and offer your views. You have clearly played a very significant role in this debate.

Last year one of the things I found in my district was that working families were paying substantially more for the operations of the Federal Government than their parents had. This was a powerful issue in my district. What I discovered as I campaigned was there was a real demand for middle-class tax relief and tax equity. As a result, I adopted your proposal as one of the planks of my platform and found that it was extremely effective.

One of the things that I think we have touched on in this discussion, and I would like you to amplify in your testimony on, is the fact that the traditional mold for families was that there was one earner. What we have seen is a dramatic shift to two earners. Part of the equity argument here, I think, is that many things that were traditionally done in the household off the tax rolls will now have to be paid for out of a two earner's income.

As a result, there has been an artificial expansion in the tax base, working families are paying a lot more in taxes, but they are also paying for child care, they are also paying for other household activities, and they are taking a substantial tax bite on it.

As a result, I think this has made a significant contribution to the perceived problem, and I think it is a real one, that people are earning more in some respects but have a lower standard of living than the prior generation.

I was wondering if you could speak to the effect of your credit in your view on how this problem would be addressed through your proposal.

Senator GRAMS. I would just like to say that is why the tax cut or benefit has to be substantial and really make a difference. The $500 is a minimum that we would advocate. I think we go bipartisan, when you look across the aisle, and Senator Lloyd Bentsen a number of years ago had advocated a $1,000 per child tax credit.

When you look at numbers, and they could be debated, but 90 percent of the second income, to maintain a standard of living that we don't want to slip below or that a family has been used to, 90 percent of that second income has gone to pay the additional tax burden and the additional cost associated with that job, whether it is child care, transportation, or clothing.

So basically that second job has meant trying just to keep pace, to pay the burdens of the increasing taxes and associated costs. So

that is why if you have three children and a $1,500 credit, it might be very appealing to a couple to have the second wage earner stay at home, rather than going out for that second job. So it can make a big difference. It can make a big difference in the quality of life.

Mr. HUTCHINSON. I certainly agree. Every family ought to have the right to make the choice as to whether both parents are going to go into the marketplace and work. But they also ought to have the choice to have a single wage earning family. Most families today don't have that choice. They both have to go out and work. And for two children at $1,000, or three children at $1,500, with everything else that is impacted by what they pay in child care and additional taxes, that $1,000, $1,500, could be the difference between the mom being able to stay at home or the mom having to go out into the workplace.

Mr. ENGLISH. That has been my experience as well. I wanted to leave you with one last question, because I see our time is running low. In my own experience on the election trail last year, I found that this particular plan was criticized by some as tax cuts for the rich because of what is viewed as the comparatively high threshold.

My concern is that by phasing down that threshold there might be an increase in the work disincentives at an area of say $75 to over $1,000. Could you please comment on that and suggest a way around that?

Senator GRAMS. Well, again I agree because more than 90 percent of the credit goes to families making $60,000 a year or less. To say that there should be a cutoff, you are advocating then that those of higher incomes aren't taxed enough. I think all Americans are paying too much in taxes and all need some relief.

Mr. ENGLISH. So your proposal will improve the equity of the system?

Senator GRAMS. I think it will. It also provides the incentive. It doesn't penalize somebody for working harder and trying to earn more money than under some of the other proposals.

Mr. ENGLISH. Thank you, gentlemen.

Chairman ARCHER. The gentleman's time has expired. Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman. I just want to make a comment, I want to congratulate the gentleman from Minnesota in your election win. It is great to have you on the other side. Mr. Hutchinson, I want to thank you also for your work in this area.

I really feel that the last comments are really the basis of the importance, really get down to what you are doing is all about. I think about when I was growing up during the fifties, late forties, very early sixties, very few mothers worked at that time. I was blessed, my mother did not work, she was home taking care of myself and my three sisters. There was someone there when I left for school, there was someone there when I returned. I believe that there are so many, and I don't just believe, I hear it as I go out, as I campaign, as we have just finished an election, as the two of you have, as each of us have, there are so many mothers there who would like to be home just as my mother was. There are many who want to work and by choice they should be allowed that opportunity.

But the point again, getting down to the real basis and the real crux of why your legislation is so very important, I believe gets down to what we have just been talking about, allowing us an opportunity to go back to that point where we were during the fifties or early sixties in which at that time each personal—the value of each personal tax exemption was about 25 percent of their personal income.

Today it is only—or in the early eighties, it was only about 9 percent. Again, as you mentioned, that second income really is not for helping the family live better. It is for paying for the cost of government. What you are proposing certainly is not going to put us back to that point where the mother really has the choice again. It at least makes it a little bit easier for that mother to have the choice of whether or not she is going to work and be away from her children when they come home or whether she is going to be there or not.

So for that major reason, I thank you for what you are doing. I commend you. You certainly have my support. Thank you very much.

Senator GRAMS. Wally, I would just like to comment that I agree with you, because back at that time, 20, 30 years ago, if a woman decided to go to work, a lot of times it was to provide the washing machine that they wanted or maybe go on a family vacation, or something that they could add or a benefit to the family.

Today so many are forced into the workplace in order to try and maintain a standard of living that is being taken away from them through higher taxes. So again, it has taken some of those options away. I agree.

Mr. HERGER. Thank you.

Chairman ARCHER. Mr. Stark.

Mr. STARK. Thank you, Mr. Chairman, and welcome to the witnesses. I am sorry I missed the beginning of your testimony. But I have had a chance to review it and the testimony of others who will follow.

I notice that Mr. Burtless, from the Brookings Institute, is concerned that your idea is good in the abstract, but it creates $100 billion deficit over the next 5 years. I am not hearing very great specificity, as to how you would tend to that. Mr. Burtless says it makes no sense to saddle future generations with heavier bills for interest on a larger Federal debt. There is a sound case, as you so eloquently make it, for tilting the income tax more in favor of families, especially those with limited incomes, but he goes on to say that tax relief for families with children only makes sense if it does not reduce the overall revenue collected under the personal income tax, not from other cuts, but under the personal income tax.

Then Mr. Zelenak from the University of North Carolina Law School is going to talk to us, and he is going to raise the issue that is of some interest to Mr. Crane and me, and that is the question of limiting this adjustment to only those with two children. Mr. Crane gets gypped by three-quarters, me by half.

Now perhaps there is a credit implied for birth control devices, which I would support, and training to get families to plan. Why did you determine that you should encourage smaller families, Mr. Hutchinson?

Mr. HUTCHINSON. I am not sure I understand—why did——

Mr. STARK. Why are you limiting this to only two children? You have something against big families?

Mr. HUTCHINSON. We don't limit it to two children.

Mr. STARK. Oh, yes you do.

Senator GRAMS. There is no place in our proposal that says only two children.

Mr. STARK. I believe that you will find that the credit disappears after two children. You are not in favor of that, huh? It should be for all children?

Mr. HUTCHINSON. I think, yes, it should.

Mr. STARK. Senator, would you agree?

Senator GRAMS. Yes.

Mr. STARK. All right. Now, you see, we have got some of the bipartisan changes here, Mr. Chairman. I agree, and I am sure Mr. Crane will introduce the amendment, as the most experienced father I think on the committee.

But getting back in a more serious note, the marriage penalty is something that has troubled us on this committee for a number of years. Quite frankly, it is like a teeter-totter. You aren't going to help one group of people even it out, you are going to penalize the other. You just can't—unless you spend an awful lot of money and cut taxes for everybody.

I wish that you wouldn't just kick it back to us. I wish you would come up with a way within the Tax Code so that we could keep everything nice and neat in this committee as to where we should raise a little more revenue to direct it to families. That would be of great help to us.

Senator.

Senator GRAMS. You are assuming then that you have to raise revenue to do this and implicating that you are going to have to make cuts. Let's leave that to the Budget Committee and not take so much on your job then because I don't think that the Federal Government has to continue to grow as fast as it has, and I don't think we need a Federal Government as large as it is today.

Mr. STARK. We need more defense you have told me.

Mr. GRAMS. We can use more defense, but that will be set on a list of priorities, and then the committees are going to have to make that decision. The defense will be on the table with everything else, but I think if we put defense in a list of priorities, the safety of my children and not having to send my sons or daughters to war is a high priority of mine as well.

Mr. STARK. Who are you worried about attacking us? Do you have news I don't have? Are you worried about anybody attacking us? You think Canada's going to come across Lake Superior?

Senator GRAMS. No, but I don't want to send my sons or daughter to the Persian Gulf or Bosnia if we don't have to.

Mr. STARK. Unless we go to three-fifths majority vote on that, that is not likely to happen.

Thank you.

Chairman ARCHER. Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman. Well, I was glad to hear your comments about $500 being a minimum, because I agree that this is just a good start. We certainly need to go further.

I would like to get your comments. I have read various studies that since the early fifties, late forties, if you compare the amount of money that people pay for staple items, milk, bread, the various things around, housing, cars, whatever it is, if you adjust that for inflation, people are actually paying around the same or maybe even a little less for most of the items that we use to determine what the standard of living is.

But when you take into account the amount of money that they are paying in taxes, that is the difference in their standard of living. We talk about the American standard of living, it should be much higher because technology, for instance, in farming allows costs to come down to the average American person, average American person when adjusted for inflation. So I would like your comments on how you think that we could go back to giving people more freedom, whether to work or not work as far as a two-parent family is concerned, and when we can adjust this tax credit for inflation.

Mr. HUTCHINSON. Well, I think—Mr. Ensign, I think you are right, that the reason that the middle-class American family's standard of living has stagnated is because of the growth of government and the burden, the taxation burden that has been placed upon the middle-class family.

I think that this is how the middle-class family under this legislation is being targeted for some kind of special benefit when, in fact, what we are doing is recognizing the disproportionate burden that they have shared over the years and that while the tax burden has increased, their personal tax exemption for their dependent children has not increased.

We are trying to do some catchup, and, as you said, the $500 is merely a first step toward that, but it begins to balance, level the playingfield some.

Senator GRAMS. It also could reduce their dependency on the Federal Government for programs. I mean maybe more young families could afford that first home without having to go to a government program if they had more disposable income. Maybe they wouldn't need school lunch subsidies if they were allowed to keep another $500 in their pocket where they could pay for their own child's lunches. So it would really—basically it is trying to reduce the dependency on the Federal Government and put more of the discretion back into the pockets of individuals.

Mr. HUTCHINSON. Fewer of them would need the student day programs if they could begin to set aside some tuition savings earlier when their children are young. So Rod's right, there are so many of these programs that we will lessen the demand and the utility of them if we will give more of the money for the American family.

Mr. ENSIGN. We hear, obviously this committee is also dealing with welfare reform, about illegitimacy in this country as being one of the biggest problems that we have; single-parent families have a very difficult time. Do you think that our tax system has led or at least helped with the breakdown of the American family?

Mr. HUTCHINSON. I don't think there is any doubt that our welfare system has a kind of insidious incentive built into it that encourages out-of-wedlock births and has contributed to, not the sole

cause obviously, but has contributed to the incredible explosion of out-of-wedlock births in our country. That the ending of the welfare system as an entitlement, the cutting off of cash benefits to moms with out-of-wedlock children——

Mr. ENSIGN. Obviously, it is much harder to have a successful marriage when both parents work. I don't think there is any question that the financial strains are much greater, the time away, it is just much more difficult.

It seems to me that the Tax Code has basically forced, in a two-parent family, both parents into the workplace. It should be their choice about which parent works or which parent stays home, but I don't think that we as a government should be forcing both parents into the workplace.

Senator GRAMS. I would say, Bob, it would be hard to debate how much it has been detrimental, but it would be very clear to say that it has not helped to promote family in any way.

Mr. HUTCHINSON. Excuse me, Rod. Marriage counselors say the No. 1 cause of divorces is financial pressures. There is no doubt our Tax Code, our antifamily Tax Code, has contributed to the kind of financial pressures that lead to family breakup.

Mr. ENSIGN. Thank you, Mr. Chairman.

Chairman ARCHER. Less there be any lingering question as to the provisions in the Contract relative to the per child credit, there is no limit as to the number of children who are eligible for this credit, nor should there be. Because of the cost——

Mr. STARK. Mr. Chairman.

Chairman ARCHER. The cost of——

Mr. STARK. At that point, he is quite right. It is the current credit that limits it, it is not this new credit and I misspoke.

Chairman ARCHER. The next gentleman for inquiry is Mr. Rangel. Mr. Kleczka.

Mr. KLECZKA. No questions.

Chairman ARCHER. Mr. McCrery is recognized to inquire.

Mr. MCCRERY. Thank you, Mr. Chairman. Thank you, gentlemen, for your excellent testimony.

One thing that continues to come up, though, that I am curious to hear your views on, is the question of why we extend this child tax credit to taxpayers making up to $200,000 a year. Let me first hear your views, and then I will respond with maybe some of mine.

Senator GRAMS. I will just go back again to quickly say this: They need tax relief, all Americans are overtaxed. When you are talking $200,000 a year incomes, you are talking less than 1 percent of the population. So you are talking a very small number compared to the vast majority, being 90-plus percent of this going to incomes of $60,000 or less.

So while that can be an argument, it might be thrown as a roadblock. If we are going to look for ways to obstruct this tax cut or this credit, there are going to be a lot of proliferous arguments to obstruct that type of movement. But I just think if you look at it in the context of all Americans can stand some tax relief, no matter what income, the majority of this has got to be focused on where it is going to do the most good and the majority is covered under this plan.

Mr. HUTCHINSON. We have all of these debates that go on about what middle class really is. I think we need to make this as broad as possible to ensure that the middle class, where there is no doubt that the vast—the overwhelming majority of this 90-plus percent will go to middle-class families under $60,000 per year.

We hear this class warfare thing that keeps coming up where we try to pit one class against another in our society. If anything, this ought to be broader, but certainly people, even though they may be making more money, they still have faced the same kind of increased costs in rearing children that lower middle-class families have faced.

Mr. MCCRERY. So you are suggesting that we take off the cap at $200—I mean just say you make $10 million a year?

Mr. HUTCHINSON. I suggest that we pass the Contract bill. The American people gave us a clear mandate to provide tax relief.

Mr. MCCRERY. Well, what is the purpose of the child tax credit?

Senator GRAMS. Well, just briefly, I think we can go over it real quickly again, but trying to emphasize the importance of families and to keep them together. Also, just the fact that Americans are overtaxed, but again, a decision may be able to be made where there is only one wage earner instead of two in the family, where one can spend more time, as Wally mentioned, was so important.

I grew up, too, where my mother was always in the home and it was great to come home smelling that baked bread or to know that she was going to be there, rather than going to a day care in the morning and being dropped off at a day care at night until my mother got off from work. So it is really I think to help rebuild some of the binds that have been cut because of the families being forced to have two wage earners or maybe a single mom having to have another part-time job, just to try to maintain some kind of a standard of living that we want for our families.

Mr. HUTCHINSON. I see the tax credit as a first step toward empowering American families in restoring their ability to make choices that have been eroded through the years because of the increased tax burden that they face.

Mr. MCCRERY. Well, I agree—you stated the purpose, and I am not sure that that purpose really fits the family making $200,000 a year or $150,000 a year. The purpose for the child tax credit is a very worthwhile purpose, and I understand that, and I am for it.

I am also for reducing the overall tax burden on all income earners, no matter what they make, because I think that is going to contribute to a more robust economy and a more protective economy. But I am just wondering if we ought not consider the purpose of the family tax credit, the child tax credit, and satisfy that purpose in the most efficient way, and then take what is left, if it is only $5 billion, I don't know what it is, I think it is 95 percent of the total revenue goes to families under $75,000, so we are not talking about a lot of money, but if it is only $5 billion, why not add that to the capital gains give-back? That is a more targeted tax credit, if you will, for productive investment to create jobs and so forth.

I am just thinking through this. I am not saying that I disagree with the $200,000 or the $150,000, but I think it is something we

ought to think about and think through before we actually put it in the Tax Code.

That is all I am saying and I appreciate your comments.

Senator GRAMS. Thank you.

Chairman ARCHER. Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman. I am appalled by the way this questioning has gone to you, gentlemen, because it is the same old routine we hear all the time. Let's take the money away from the individual taxpayer and bring it to Washington and spend it any way we want to.

I know one of our Members has said that no one Congressman can say that they would never be for a tax cut, but I will tell you, the administration is not for a tax cut. In fact Secretary Reich said that yesterday. I think that we have got to get the money back in the people's pockets, in the pockets of the citizens, and that will strengthen our families. I think that is what your proposal is all about.

Would you like to comment, Senator, or Representative?

Senator GRAMS. I agree with you, Sam. If you lined 100 families up in this room today and asked each one of them, would $500 a year make a difference to you or could you use that money in some way, whether it is even just to take the family out for a pizza once a month or something, I think you would hear a resounding yes, that it is going to make a difference. I think Mr. Reich should ask that question, not what is good for the Federal Government or how is it going to limit the Federal Government in spending as it wants to, but how is it really going to benefit the families, no matter how small a scale. This is not going to be the panacea or the answer to all of our problems, but it is a good first step.

Mr. JOHNSON. The other question that keeps coming up is that we know how to manage the money better than the people do. I don't think that is true, and the fact that we are going to create "a deficit." Nobody's talking about a deficit here.

We are talking about putting more money in every citizen's pockets, and we are talking about not increasing the increase at the same rate it has been going up in Federal spending and we then will balance the budget.

Go ahead, Tim, excuse me.

Mr. HUTCHINSON. Well, exactly right, Sam. I think the American people on November 8 rejected the notion that Washington, D.C., is the fount of all wisdom. The question in this legislation is whether or not Washington is going to continue to set the priorities for the American family or whether we are going to let mom and dad set the priorities for their own family.

Mr. JOHNSON. I tell you something I would like for you to think about that has been brought to my attention. Mrs. Dunn and I agree that if we get the families down to the point where you don't have to have both of them working to maintain a quality of living, that the parent who is not at work can get out and volunteer. Perhaps the volunteer force will improve our relationship with the poor and help the American economy overall.

Mr. HUTCHINSON. Well, this legislation already at least makes those kinds of choices a little more feasible than they are now.

Mr. JOHNSON. Thank you. I appreciate what you are both doing.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman. I didn't intend to ask any questions of the panel, but based on some of the comments made to Congressman McCrery, I am compelled now to do so.

The panel indicates, and, gentlemen, you have indicated that you believe Americans are overtaxed and the tax relief proposal should be as broad as possible. Senator, you indicated that if we lined 100 families up in this room, that all of them would agree that we should have a tax cut akin to what you are proposing here. But know full well that if you had 100 families in this room, two-thirds of them under your proposal would get zero, since one-third of the families in this country have children and it is geared to only children.

Why not provide this relief to all families, whether or not they have children? How about the newly married couple who are trying to save a couple bucks for the downpayment on a home, and eventually planning a family? You can make the case that they are overtaxed also, but they get nothing.

I think of the proposal, as it stands now, wherein only one-third of the Americans will receive this tax benefit, is ill conceived, and the fact that it goes up to $200,000 and phased to $250,000, in my estimation, is a heck of a lot higher than middle income. I think this committee will have to look long and hard at making that more responsible and maybe use a $60,000 or $70,000 cap on that, versus your new definition of middle-American incomes, which is now $200,000 plus a year.

Senator GRAMS. Well, again, I would say to that young family, it might provide a tax credit for them in the future, because for most, and I am a grandfather of three, and I sure would like to see my son-in-law and my daughter have that tax credit so they could pay for things that they do, like right now, send their children to a private school. So that gives them that type of an opportunity. So overall, you can say one-third, I think it covers a broader base than that. Maybe not today, but tomorrow or the next day.

So again, why argue about tax cuts or how they are going to come about? Let's look and focus on the goal of reducing the tax burden.

Mr. KLECZKA. Well, then let's do it for all, let's be fair and do it for all Americans and not for only a select few, and especially those $250,000 wage earners in this country.

Mr. HUTCHINSON. If I might add, I think there is a misimpression. In 1948 our government said that we want to recognize that there is a cost, an expense that goes with rearing children. Because our government said we want to be profamily, we want to be on the side of families with children, they granted an exemption, a deduction for those children.

Mr. KLECZKA. Which is current tax policy.

Mr. HUTCHINSON. But we have not kept pace at all. If we had, it would be over $8,000 instead of a little over $2,000. So while costs have gone up, the burden has gone up, the squeeze has gone up, the tax burden has increased enormously. We have said your children aren't worth as much as they were a generation ago. That is what—we are playing catchup. This isn't some kind of special

break for families with children. It is saying we need to again recognize what we recognized in the forties.

Mr. KLECZKA. But if you are sincere in what you say that all Americans should share in this tax relief, then make sure all Americans do. Your proposal, my friends, does not.

Thank you very much.

Mr. GRAMS. Well, this could only be part of one. There are other means here that you can put into practice as well in addition to this. Is this the only tax cut on the table? I don't think so.

Mr. KLECZKA. Well, for those same families you are talking about, your capital gains proposal surely won't touch them to any great degree. So it is sort of slanted.

Chairman ARCHER. Has the gentleman completed his inquiry?

Mr. KLECZKA. Yes, sir.

Chairman ARCHER. Mr. Christensen.

Mr. CHRISTENSEN. Morning. My hats are off to you for introducing this legislation because I truly believe it is needed. I agree with my colleague earlier who said we are giving money back to responsible, hard-working middle Americans, versus letting more irresponsible bureaucrats spend it. I find it hard how some people this morning have stated that we are pandering to the six-pack crowd, when in fact, it is rightfully their money and not the government's. I would like to know where your proposal differs from the Clinton administration's proposal, and does it help families more?

Senator GRAMS. Well, basically it doesn't have an age cap on children or the number of children. It is, I think, a better proposal across the board because it does provide more dollars in tax relief for middle-class families. About $25 billion a year compared to somewhere around $10 or $12 billion a year.

So if we have got to set goals, let's try. These are the contracts that we made with Americans. This is what Americans made a loud and clear decision about in November. To break that or to come tinkering with something that looks like a tax cut but offers no real tax relief or will not make the difference that it should, I think that is breaking the Contract.

Mr. HUTCHINSON. John, I would add that not only does the Clinton plan cut it off at age 13 for the children, but the $300, if I understand correctly, they are recommending a $300 credit, is below what every study dealing with the family has recommended, whether it was the Rockefeller Commission, whether it was the Family Research Council, or whether it was the Bentsen proposal or the Clinton proposal during his campaign in which he advocated a $3,500 tax credit, that to drop below that $500 credit, you really make it less than meaningful.

Mr. CHRISTENSEN. As I understand it, the Clinton administration considers a family consisting of a $40,000 bricklayer and say a $35,000 public schoolteacher, a rich family. Is that correct?

Mr. HUTCHINSON. The cutoff is much, much lower, you are exactly right. So it would impact far fewer families.

Mr. CHRISTENSEN. Your proposal would not consider that family rich, but more middle income?

Mr. HUTCHINSON. Exactly.

Mr. CHRISTENSEN. Thank you.

Chairman ARCHER. Gentlemen, thank you for spending the time with us this morning and giving us excellent input by your testimony and responses to the questions. We are very grateful to you.

Mr. HUTCHINSON. Thank you, Mr. Chairman.

Senator GRAMS. Thank you, Mr. Chairman.

Chairman ARCHER. Thank you. The committee will stand in recess for 5 minutes until the next panel is seated at the witness table.

[Recess.]

Chairman ARCHER. Will our next panel of witnesses please take their seats at the witness table. This panel was supposed to have four witnesses. Dr. Besharov unfortunately could not stay, and we did not anticipate the length of inquiry for the previous panel. So without objection, Dr. Besharov's statement will be inserted in the record at this point.

[The prepared statement and attachment follow:]

American Enterprise Institute for Public Policy Research

DOUGLAS J. BESHAROV

STATEMENT BEFORE

WAYS AND MEANS COMMITTEE

U.S. HOUSE OF REPRESENTATIVES

January 17, 1995

Mr. Archer, members of the committee, it is my great pleasure to come before you today to discuss the important topic of tax relief for families with children.

My name is Douglas Besharov. I am a resident scholar at the American Enterprise Institute for Public Policy Research where I conduct research on issues concerning children and families. I am also a visiting professor at the University of Maryland School of Public Affairs where I teach courses on family policy, welfare reform, and the implementation of social policy.

There are other people here who have much more technical expertise on this matter. Therefore, in the time I have, rather than discuss the technical details of your proposal, I will address the conceptual issues surrounding it.

Over the last 30 years, a greater portion of the federal payroll and income taxes has been shifted to (1) low- and moderate-income workers and (2) families with children. As you know, one of the main reasons for this shift has been the decline in the relative value of the personal exemption. Gene Steuerle, who is also on this panel, has provided some of the best analysis of this issue. Rather than steal his thunder--and his data--I will let him detail this 30-year decline.

As I described in the attached article from the Wall Street Journal,[1] this greater tax burden on lower-income workers and families puts added financial stress on them--and creates more pressure in two-parent households for both parents to work.

Some experts justify this shift in tax burden on the basis that low- and moderate-income families now receive additional benefits from the federal government. But why do we need to take money from families in order to give it back to them? Although many reasons are offered for why we do so, when you get right down to it, the answer is simple: social engineering.

Taking money from families (or all taxpayers, for that matter) and giving it back to them in the form of categorical assistance is a way of controlling their spending decisions. So, for example, when tax funds are used to provide student loans to middle-class families, we are taking money from

---

[1]Douglas J. Besharov and John C. Weicher, "Return the Family to 1954," Wall Street Journal, July 8, 1985, Op Ed page.

one pocket and putting it into another--because we do not think that parents can (or will) save the money themselves.

This kind of forced saving, or inter-temporal redistribution of wealth, sometimes makes good policy sense. But we do it far more than we should.

In fact, the process can easily get out of hand, and can hook Americans on a never-ending upward spiral of tax increases to pay for programs designed to relieve the very burdens created by those taxes.

Lest you think I exaggerate, let me remind you of what almost happened two years ago with the original Clinton proposal to expand the Earned Income Tax Credit (EITC). If you remember, the administration proposed providing a welfare-like "benefit" to families earning almost $30,000--even as we tax the same families to help pay for the benefit. The administration quickly withdrew this proposal, although I must add that the current EITC has many problems that should be addressed.

So, I am a strong supporter of the kind of tax relief that you have proposed because--besides aiding families--it comes with no strings. It empowers families to decide how best to use their own money.

That, by the way, is why I would be concerned about the president's proposed tax deduction for college and other post-secondary tuition. As the parent of a child about to enter college and another about to enter graduate school, I suppose that I have a real interest in seeing his proposal become law--and soon.

But his proposal has many technical drawbacks which others have cited. For example, it is regressive and will likely result in higher tuition charges. More importantly for me, it is a form of social engineering that tries to control how families allocate their own resources.

Some experts object to your proposal because, even assuming deficit neutrality (which I take to be an economic and political necessity), they think any tax cut should go to reducing marginal tax rates. I, too, believe that lower marginal tax rates could be an engine for great economic good. Nevertheless, I think that you can pursue both goals--given the beating that low- and moderate-income families have taken in the last three decades.

Before closing, I would like to make three subsidiary points. First, given the current tax structure, I think that budgetary prudence and political sensibility argue for a cap or phaseout of the credit. I leave to you the decision of where to draw the line, but I would note that many families earning $100,000 are comprised of two hard working parents each making the less grand sum of $50,000. They do not feel rich at all. Instead, they feel stretched in time and finances.

Actually, again given the current tax structure, you might consider phasing out the credit at the same rate as the personal exemption. This is not a perfect solution but it at least avoids creating yet another phase out rate--and utilizes a politically acceptable precedent.

By the way, the tax distribution tables have always been the enemy of thoughtful decisions about where such credits and other tax provisions should be phased out. I recommend that you present the distributional effects of the credit on a per capita basis or by family size.

Second, if you have the money, I hope that you will not limit the credit to younger children. Children do not suddenly become less expensive after age thirteen, although there is a difference in costs between children who require day care and those who are old enough to be left alone. Your objective should be to return decision-making to families.

Third, I do not think that you should not make the credit refundable to families with no income tax liability. Such families are in great need, but, as I mentioned, there are enough worries about the operation of the EITC to pause before creating even greater reason to file false claims while also further distorting work incentives.

I hope that you will start thinking about the long-term problem of marginal tax rates for workers and families near the poverty line, which Gene Steuerle has studied extensively. But this is a complex problem involving the interaction of a number of tax and welfare programs.

Finally, even though I am an amateur in these things, I would like to make one more political point: There will likely be great opposition to the cuts that you plan to make in the funding of various programs--many of which provide benefits to lower- and moderate-income families. I hope that, as you propose these cuts, you show their connection to the tax credit that you have also proposed. For, as I have tried to describe, they really are two sides of the same reform agenda. If you succeed, more of the money that now goes from one pocket to the other will stay where it belongs--with America's families, who will use their own good judgement about how to spend it.

Thank you.

THE WALL STREET JOURNAL MONDAY, JULY 8, 1985

Return the Family to 1954

By Douglas J. Besharov
And John C. Weicher

President Reagan proudly describes his tax-reform proposal as "pro-family." And the substantial tax relief for families with dependent children that it would provide has gained wide support. But there is another "pro-family" element of his proposal: It would reduce the present tax benefit to mothers in middle-income families who decide to work. Advocates for working mothers have mounted a campaign against this aspect of the plan, and the administration is reconsidering it. The administration was on the right track in the first place; the plan need not be changed.

First, the noncontroversial part. By almost doubling the personal exemption from $1,080 to $2,000 and by raising the Zero Bracket Amount (the minimum standard deduction) for married parents from $3,670 to $4,000, the president's proposal lowers the tax rate for all families with children. Families at or below the poverty line, about $12,000, would pay no taxes. Under present law, a typical family of four at the poverty line pays about $450 in taxes.

Exempt From Income Tax

Half of all of poor families are headed by single parents, whether widowed, divorced, or unwed. By raising the minimum standard deduction for heads of households from $2,480 to $3,600, the proposal also exempts these families from the income tax. When it comes to child care, the proposal makes no attempt to legislate morality.

The president's proposal would reverse an almost continuous postwar increase of the tax burden on middle-income families with children, caused by the failure to index the personal exemption and the standard deduction. At the end of the war, the $500 personal exemption was the equivalent of $3,000 in today's dollars. It was increased to $600 in 1947, then left unchanged for the next 20 years. By 1967, its value had eroded to about $2,000 in today's dollars. Over the next few years, it remained roughly constant, as Congress periodically raised it about enough to offset continuing inflation. But since 1973, its value has fallen steadily. The 1980 increase to $1,000 ($1,300 in today's dollars) did not offset the high inflation of the late '70s, and the 1981 tax cut did not increase the exemption, so that its real value declined still further. Right now, it is as low as it has ever been.

As a result, there has been a major shift of the tax burden onto families with children. According to an American Enterprise Institute study, over the last 30 years, the average effective tax rate on middle-income married couples with two children nearly tripled, while that for single people and married couples without children increased only by one-sixth.

Over the last 30 years, the average effective tax rate on middle-income married couples with two children nearly tripled, while that for single people and married couples without children increased only by a sixth.

Thus, the president's proposal would return families to the position they enjoyed until the ravages of inflation devalued the personal exemption. In 1954, typical married couples with two children paid about 4% of their income in taxes. By 1980, they paid 14%. Under the president's plan, assuming average deductions and both spouses taking full advantage of the IRA deduction, their tax rate in 1986 would again be about 4%.

The redistributive effects of the tax plan have won support across the political spectrum. For example, Marian Wright Edelman, president of the Children's Defense Fund, described them as "a giant step toward providing poor working families with children desperately needed federal tax relief."

The proposed tax treatment of a working mother's earnings is another matter. By reducing overall tax rates and by raising the personal exemption, the president's proposal would lower the tax on the prime earner's income, usually the husband's, whether or not the other spouse works. On the other hand, by repealing the "marriage penalty" deduction (the 10% deduction for the second earner's income), by changing the child-care credit to a deduction, and by allowing a full IRA deduction for non-working spouses, the proposal in effect raises the tax on the wife's income.

In upper-income families, the overall reduction in tax rates is large enough to offset this effect, so that their tax rate declines. But for families with incomes between $20,000 and $35,000, with the wife earning from $5,000 and $10,000, the tax on her earnings would rise by between $100 and $500, and her take-home pay would decline by between 2% and 20%, depending on the deductions taken.

Consider one "typical" middle-income family: both spouses working, two children, a combined income of $27,500, with the husband earning 70% of the total and the wife the rest. Under current law, if this family takes full advantage of the IRA deduction and receives the maximum child-care credit, they pay no income tax on the wife's earnings. Her net income, after subtracting her Social Security tax and child-care expenses, is around $2,900 for the year. Under the president's proposal, there would be a $550 tax on her earnings, and her net income would be reduced to around $2,350.

These are extreme assumptions. But even if the family claims the average child-care credit and takes no spousal IRA at all, taxes on the wife's income would still go up, from about $950 to $1,025, and her take-home pay would fall from about $5,300 to $5,200. For many middle-income married mothers, then, the proposal reduces the financial rewards of working.

There are two ways to view this aspect of the president's tax proposal. Its opponents see it as a new penalty on working mothers, designed to encourage them to stay home and care for their children. As evidence, they point to the president's emphasis on "traditional family values" and the New Right's intensive lobbying in favor of this aspect of the plan.

The work-force participation of middle-income mothers would undoubtedly decline under the president's plan. Research has shown, not surprisingly, that wives' decisions about working are affected by the net wages they earn. Estimates of the wage elasticity vary. A reasonable estimate is that for every 1% reduction in after-tax earnings, they would reduce hours of work by the same percentage. Thus, the president's tax plan could reduce the amount of time a middle-income married mother works by up to 20%, depending on the deductions taken by the family. In some families, the effect would be enough to cause the mother to stay at home, rather than work at all.

As It Should Be

It is more accurate, however, to view the proposal as remedial. Between 1975 and 1981, responding to widespread recognition that marginal tax rates on working wives were too high—in 1975, a typical wife was in the 20% bracket—their tax rates were progressively lowered. However, many would be surprised how far this much-needed reform was taken. Remember that in our hypothetical, extreme case, there was no income tax on the wife's earnings. The proposal would raise her tax rate from 0% to 7%. For the family claiming the average child-care credit and no spousal IRA, the wife's tax rate merely rises from 11% to 12%.

By fairly taxing a mother's earnings, the president's proposal more nearly neutralizes the tax code's impact on her decision about entering the work force. This is as it should be. A mother's working should be a personal choice, not affected by tax incentives.

Mr. Besharov is an adjunct scholar at the American Enterprise Institute, where Mr. Weicher holds the Weyerhaeuser chair in public policy research.

Chairman ARCHER. We are pleased to have the other three of you here this morning. You are well known to this committee and well known to many people in this country. We would like to recognize you for your input on this part of the Contract With America.

We would like to start off with Dr. Steuerle, please, if you will.

STATEMENT OF C. EUGENE STEUERLE, PH.D., SENIOR FELLOW, URBAN INSTITUTE

Mr. STEUERLE. Mr. Chairman and members of the committee, providing a credit for children is at its heart an issue of how the tax system should be adjusted for family size, and how to treat individuals who move beyond welfare by working or marrying someone with income.

In that regard, the simple notion of providing tax relief to the middle class by itself is not adequate to tell us how to provide such relief. For example, the case for relief for a family with children is compromised substantially if increased debt burdens are left to those children to pay off in the future.

Fortunately, as I understand it, almost everyone is committed to ensuring that deficits do not rise and that debt does not increase. Given that commitment toward a more fiscally responsible budget, I would like to outline to you the primary cases for a credit.

The first case is restoring the value of the dependent exemption. If the dependent exemption had been adjusted since 1948 to grow at the same rate as income per person, today it would be about $9,600 per person, and next year, in excess of $10,000, rather than the $2,500 being provided in the Tax Code today.

The value of a dependent exemption in excess of $9,600—that is the value if converted to a credit—would also be in excess of $1,500 per child. Far from being radical, therefore, proposals being considered today do not even come close to restoring the types of adjustments that used to be made for the presence of children.

The income tax is meant to adjust for the ability to pay of households. Ability to pay, in turn, is affected by the size of the household. An adjustment for dependents can be made either through credits or exemptions. If this year's dependent exemption of $2,500 were adequate, then in theory it would imply that a couple with two dependents and $50,000 of income, that is with $12,500 per person, had the same ability to pay taxes of the family with half as many members, that is a couple with no dependents and $45,000 of income.

Now, it doesn't take much reflection to realize that most families are required to spend more than $2,500 per year on the food, clothing, housing, education, insurance, and health care of their children.

In this regard, Mr. Chairman, I hope the committee will give special attention to the presentation of distributional tables on tax burdens. These tables can be very misleading unless adjusted for family size. There is substantial evidence that the failure to make family size adjustments in the design of itemized deduction phaseouts, the earned income tax credit, and many other tax items and phaseouts, are driven in part by distributional tables that often do not adjust for family size. A great many decisions made by this Congress will depend significantly upon whether a family of four

with $50,000 of income is compared with a household of one with $50,000 of income, with the household with per capita income of $12,500, or something in between.

The second major reason for favoring a credit for children is that as long as we live in a society that is going to provide some minimum amount of well-being to children, we must worry about the pernicious signals, "don't work, don't marry," that apply especially to low-income individuals who have the potential to move beyond welfare.

This is a structural issue that cannot be avoided. It is not an issue of liberal or conservative leanings. Many lower and moderate income individuals who move beyond welfare find that their family income goes up by $1 due to work, but then they must return 70, 80 cents or more to the government in direct taxes and reduced benefits.

In many cases, especially where account is made for transportation and child care, people who work are actually made poorer as a consequence of working. For almost all welfare situations, marriage causes them to be significantly poorer, and marriage causes their combined income to fall by almost 20 percent or more.

Finally, Mr. Chairman, there are two other issues that I hope this committee will consider in the process of adopting a credit for children. First, adjustments for the presence of children are appropriate at all income levels and need not reduce the progressivity of the income tax. Second, a child credit might be integrated more fully with efforts made at welfare and health reform. I hope that the committee will consider what they do in the welfare and health areas at the same time that they consider many of these adjustments for families and children.

Thank you.

Chairman ARCHER. I should have mentioned earlier that we do appreciate your holding your verbal testimony to 5 minutes, but should you have a longer written statement, without objection, that would be inserted in the record. Further, Dr. Steuerle, I should have told the members of the committee that you are with the Urban Institute where you are a senior fellow and we are particularly delighted to have your institute represented.

Mr. STEUERLE. Thank you, Mr. Chairman.

[The prepared statement and attachments follow:]

TESTIMONY OF C. EUGENE STEUERLE, SENIOR FELLOW
THE URBAN INSTITUTE

Mr. Chairman and Members of the Committee:

Providing a credit for children is at its heart an issue of how the tax system should be adjusted to account for family size, and how to treat individuals who move beyond welfare by working or marrying someone with income. As you may know, my research on the decline in the value of the personal exemption and the taxation of the family was used by President Reagan to support a doubling of the personal exemption in the mid-1980s, by the National Commission on Children to support a child credit in 1991, and by proponents in both the Congress and the Executive Branch to support a child credit today. As a father of some of these bipartisan efforts, therefore, I would like to take the liberty of urging that close attention be paid to the principles that underlie the case for a child credit.

The simple notion of providing tax relief to the middle class, by itself, is not adequate to tell us how to provide this relief. Since most government activity can be seen as payments from the middle class to the middle class, that class can receive more expenditures over time only if it eventually pays for them, and it can reduce its taxes only if it cuts the expenditures it receives. Thus, the case for relief for a family with children is compromised substantially if increased debt burdens are left to those children to pay off in the future. Fortunately, almost everyone is committed to insuring that deficits do not rise.

Given a commitment toward a more fiscally responsible budget, my testimony outlines two primary cases for a credit. First, much of tax policy is concerned with the allocation of the tax burden rather than its total level -- the slicing of the pie, not merely its size. A strong case can be made that the current system adjusts inadequately for the presence of children and that households with children pay substantially higher taxes than other families with equal ability to pay. Even a credit of $1,500 would be insufficient to restore the relative value of the dependent exemption provided in 1948. Second, a credit for children provides one way to attack the extraordinarily perverse incentives of our combined welfare and tax systems. For individuals on welfare, the return to work is often close to zero, while couples typically will find their combined income fall by 20 percent or more simply for taking a marriage vow.

Restoring the Value of the Dependent Exemption

If the dependent exemption in the income tax had been adjusted since 1948 to grow at the same rate as income per person, today it would be about $9,657 rather than $2,500 (Figure 1). The value of a $9,657 dependent exemption -- that is, its value if converted to a credit -- would be worth about $1,642 per child (Figure 2). Far from being radical, therefore, proposals being considered today do not even come close to restoring the types of adjustments that used to be made for the presence of children.

The income tax is meant to adjust for the ability to pay of households. Ability to pay, in turn, is affected by the size of the household. An adjustment for dependents can be made either through credits or, as at present, through exemptions. If this year's dependent exemption of $2,500 were adequate, then in theory it would imply that a couple with two dependents and $50,000 of income ($12,500 per person) has the same ability to pay tax as a family with half as many members -- that is, a couple with no dependents -- and $45,000 of income. After all, the current tax Code charges them the same amount of taxes.

It doesn't take much reflection to realize that most families are required to spend more than $2,500 per year on the food, clothing, housing, education, insurance, and health care of their children. On a per person basis, the current tax Code implies that the family in the example with $22,500 per person is not any better off than the family with $12,500 of income per person.

The argument here is not that the government should cover the normal costs of raising children, only that the tax burden be adjusted to take some of these costs into account. The goal in the income tax is primarily to measure ability to pay tax according to family size and then to tax equally those who have equal ability. All tax systems explicitly or implicitly must decide how

to treat different size families and how to vary that treatment according to the presence of spouses and dependents.

Note, in this regard, that the presentation of distributional tables on tax burdens and tax changes can be very misleading unless adjusted for family size. There is substantial evidence that the failure to make family size adjustments in the design of itemized deduction phase-outs, the earned income tax credit, and other tax items and phase outs are driven in part by distributional tables that do not adjust for family size. A great many decisions made by this Congress will depend significantly upon whether a family of four with $50,000 of income is compared with a household of one with $50,000 of income, with a household with per capita income of $12,500, or something in between.

The relative decline in the value of the dependent exemption over the past few decades led to a significant expansion of the personal income tax base, at least relative to income in the economy. A large expansion in the use of credits, deductions, and exclusions also occurred over the same time, leading to a reduction in the tax base. These historical changes, however, did not apply equally to all types of taxpayers. They increased substantially the share of the tax burden for households with dependents. Meanwhile the share of the tax burden declined for others, in particular, those would could make use of other tax breaks.

A primary reason for providing a child credit or allowance, therefore, is simply that it would be a means of adjusting for ability to pay by family size -- a principle of equity that has been ignored for some time now.

Reducing Welfare's Penalties on Work and Marriage

As long as we live in a society that is going to provide some minimum amount of well-being to children, we must worry about pernicious signals and incentives -- Don't Work! Don't Marry! -- that apply especially to those low-income persons who have the potential to move beyond welfare. This is a structural issue that cannot be avoided; it is *not* an issue of liberal or conservative leanings.

Under current law, many benefits are provided for children through welfare or welfare-like payments. To help pay for these benefits, they are phased out at very high rates of implicit tax on additional income of the family. Many lower- and moderate-income individuals find that if their family income goes up by $1.00 due to work, they must return 70 cents, 80 cents, or more to the government in direct taxes or reduced benefits (Figure 3). In many cases, especially when account is made for costs of transportation or child care, people who work are actually made poorer as a consequence of working.

For almost all welfare recipients, marriage will cause them to be significantly poorer. Marriage will typically cause the combined income of a couple to fall by 20 percent or more (Figure 4). Thus, a couple who marry must simultaneously decide to force their children to live a much poorer life. By the same token, divorce of many middle-income couples would increase their combined income substantially under current law.

A child credit need not increase the payments made to those already on welfare. Nor would it eliminate their participation in the welfare system. The approach mainly provides a mechanism to reduce from confiscatory levels the combined tax rates for low-, moderate-, and middle-income individuals who decide to work or marry.

The perverse nature of incentives in the current system weakens our ability to work together as a society. Many welfare recipients, for instance, work part-time for low amounts in an "informal" sector where wages are not recorded or reported to the government. Many others live in informal relationships and share households in ways that avoid formal marriage

commitments. Still others combine their resources in ways common to any family. In a backhanded way, some of this behavior contains social benefits; at least it involves cooperative, productive, and community-sharing efforts. When it is made to violate the tax and welfare laws, however, it breeds discontent for the law and restricts individuals from engaging in more formal personal relationships where commitment is recognized through marriage and work contracts.

A More Systematic Approach

Here I would like to suggest three further issues for your consideration. First, a credit provides a reasonable way of adjusting lifetime tax burdens according to ability to pay over a lifetime. Second, adjustments for the presence of children are appropriate at all income levels and need not reduce the progressivity of the income tax. Third, the child credit might be integrated more fully with other efforts at welfare and health reform. In that regard, attention needs to be given to those low-income individuals who are not on welfare and would receive neither welfare nor tax benefits for a child. With respect to health reform and reducing the number of those without health insurance, we ought to consider whether child credits and other family-type allowances should be paid to middle- and upper-income families who do not buy health insurance for their families.

Adjusting Taxes for Lifetime Circumstance. In some ways, the goal of a child allowance is merely to adjust taxes and expenditures according to the lifetime circumstances of individuals. The child-rearing years are normally among the poorer years that individuals face over their lives. A child is usually born during the parents' earlier years in the workforce -- before they have acquired seniority and much of the human capital that comes with work experience. For couples, of course, child-rearing either requires significant outlays for child care or a decline in personal income. For single heads-of-household with only one adult to handle both child care and work in the marketplace, the cost of rearing children may be even higher relative to total income in the household. Whatever the reasons, recent statistics demonstrate that children are now the poorest group in the population mainly because of their prevalence in younger households with lower wages. By the time that children are gone from the household, on the other hand, other economic circumstances usually have improved. Wages tend to be higher. In addition, assets are usually greater and debt lower: substantial equity may exist in a house and a car or two.

The provision of a child credit or allowance, therefore, simply attunes the tax system more to the life cycle circumstances of most households. When income is lower and the costs of child care higher, the tax system would provide a modest reduction in tax. In later years, when the household is usually better off, taxes would be higher because of the absence of such an adjustment.

Family-Size Adjustments and Levels of Income. If there is to be a child credit, some argue, it should be phased out as families move into middle- or upper-income status. At fairly high income levels, this philosophy is reflected slightly in current law through a phase-out of the dependent exemption. Family-size adjustments, however, are appropriate at all income levels since children reduce the average income within the household, lessen average consumption levels, and leave less discretionary income out of which taxes can be paid. A closely associated mistake is to believe that child allowances shouldn't go to middle-income or high-income persons because somehow this would reduce progressivity. This is incorrect.

Suppose, for instance, that society believes that two families with $50,000 of income each (or $100,000 in total) should together pay total taxes, after child allowances, of $20,000. Suppose additionally that one family has two children and the other none. A choice still remains: society can decide that taxes, less child allowances, should be $10,000 each or $9,000 for the family without children and $11,000 for the family with children. In either case, child allowances have no effect on the total tax burden paid by those with $50,000 of income. The child allowance simply recognizes that costs of raising children is one source of differentiation in the needs and

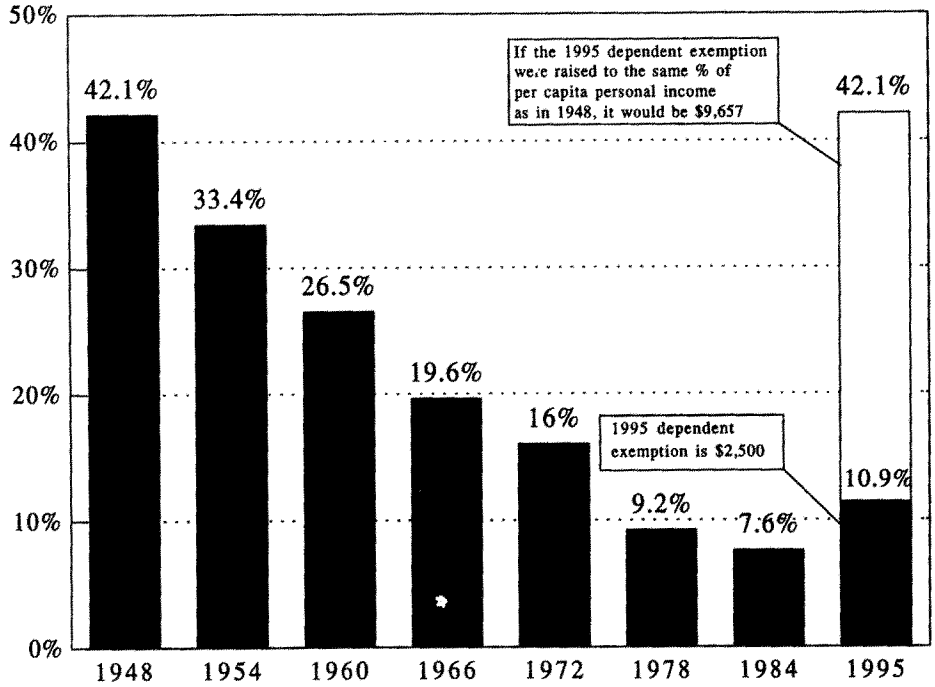
abilities of all households. Indeed, a strong case can be made that treating the two families with $50,000 of income the same is quite inappropriate. It is equivalent to treating children as nonentities or consumption goods of adults rather than living members of the community.

Relationships Among Tax, Welfare, and Health Policy. Finally, over time I hope that this Committee will give some consideration to seeing how child credits integrate with the welfare system and with the health system. Some early attention to these issues could reap some large dividends when these later reforms are considered.

Let me start with the welfare issue. If a non-refundable tax credit is provided through the tax system, and welfare payments are provided through welfare, then one important group is left out of the calculation -- those low-income individuals who neither receive welfare nor pay enough tax to receive the credit. Indirectly the earned income tax credit might be argued to fill this gap somewhat, but there remain some administrative problems with that credit that have not been resolved. An integrated view of welfare, child credits, and earned income tax credits might help us to set up a structure that both reduced some of the perverse incentives of current law and dealt more equitably with this group of low-income individuals not on welfare.

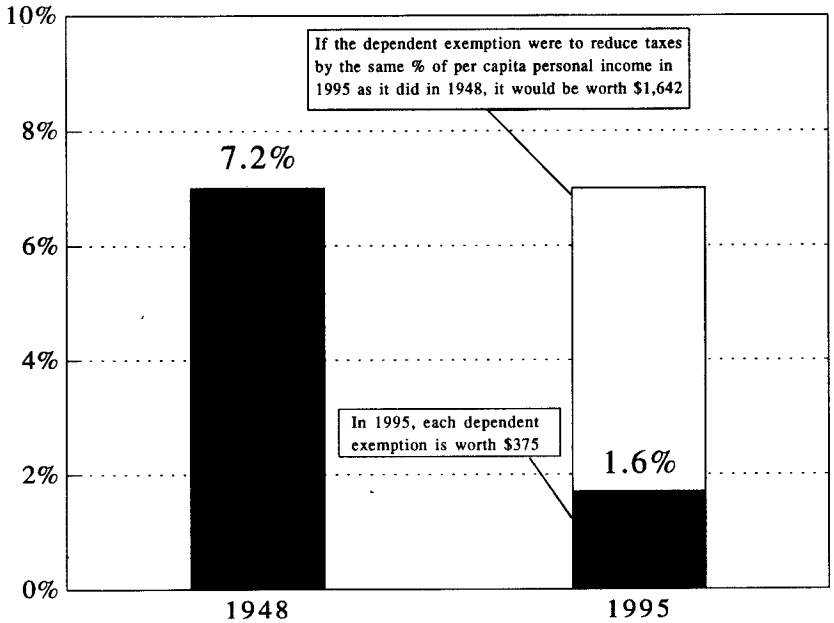
With respect to health reform, last year there was considerable attention given to ways that individuals might be induced to purchase health care -- as opposed to putting mandates on employers. Although a modest step, I suggested that middle- and higher-income households might be denied some tax benefits or made to pay a modest penalty if they did not buy some form of health insurance for their families. In the context of a child credit, some consideration might be made to limiting the availability of the child credit -- or other exemptions -- for middle- and higher-income taxpayers who do not purchase insurance for their children.

Figure 1: Dependent Exemption as a Percent of Per Capita Personal Income, 1948-1995



SOURCE: Eugene Steuerle and Gordon Mermin, The Urban Institute

Figure 2: Amount of Tax Reduction Provided by Each Dependent Exemption, as a Percent of Per Capita Personal Income 1948 & 1995 *

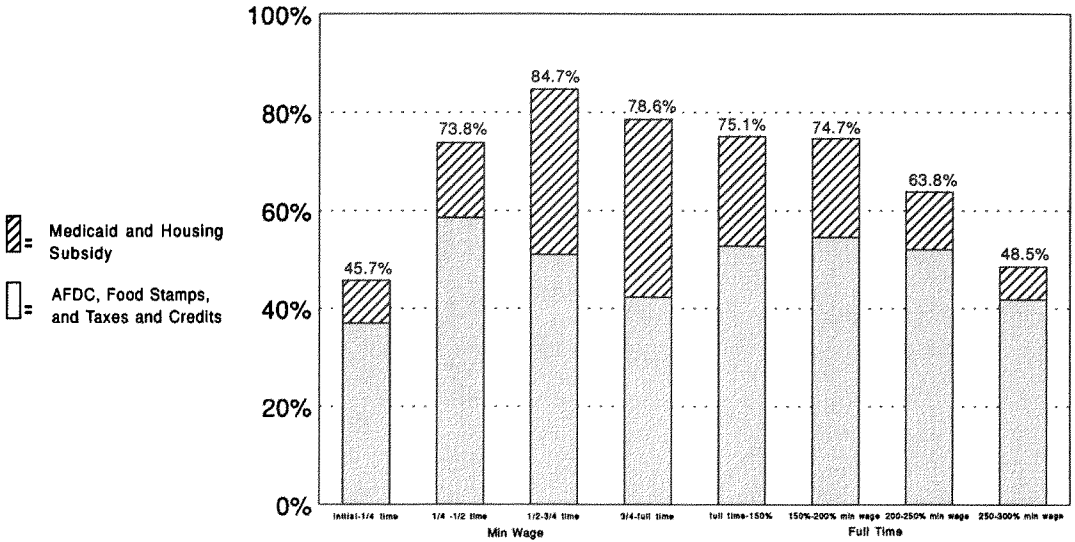


* Minimum amount of tax reduction for those with positive tax liability, i.e., the value of each dependent exemption at the lowest positive tax rate (15% in 1995).

Source: Eugene Steuerle and Gordon Merminn, The Urban Institute

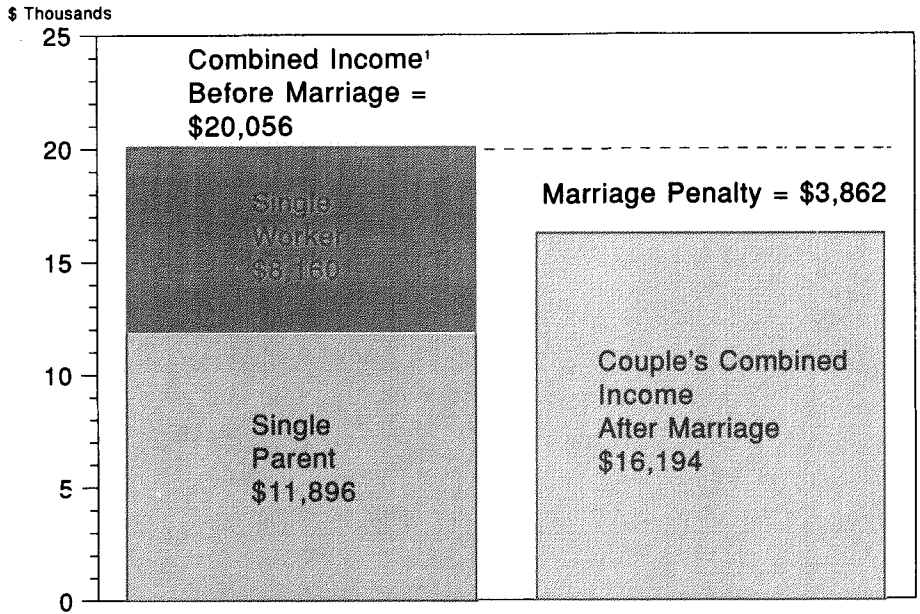
Figure 3: Incremental Tax Rate on Additional Earnings

Sample: All AFDC Households
(Without Work Expenses)



Bars show the proportion of increased earnings that would be lost due to taxes and changes in benefits from the indicated programs over the long-term under 1996 EITC rules. Sample weighted by (household weight) * (change in earnings).
Source: Linda Giannarelli and C. Eugene Steuerle, The Urban Institute.

Figure 4: Marriage Penalty for a Single Parent on Welfare with Two Children Who Marries a Minimum Wage Worker



[1]Income = after tax earnings + welfare benefits.
Source: C. Eugene Steuerle and Gordon Mermin, The Urban Institute

Chairman ARCHER. Our next witness is Professor Zelenak, with the University of North Carolina School of Law. We would be pleased to hear your testimony.

STATEMENT OF LAWRENCE A. ZELENAK, J.D., PROFESSOR, UNIVERSITY OF NORTH CAROLINA SCHOOL OF LAW

Mr. ZELENAK. Thank you, Mr. Chairman, members of the committee. In evaluating the child tax credit proposal in the Contract With America, there are two key questions. First, does the income tax currently make adequate adjustments for differences in family size? Second, if it does not, should an additional adjustment take the form of an increase in the amount of the dependency exemption, or a child tax credit added to the current exemption?

The theory behind the dependency exemption is that ability to pay tax comes only from income above subsistence, sometimes referred to as clear income, and that the cost of subsistence is a function of family size. Thus, the dependency exemption, if it accurately reflects the cost of supporting a child at subsistence, properly adjusts income subject to tax for differences in family size.

If, for example, the subsistence cost of a child is $2,500, then a childless couple with $50,000 income has the same clear income and the same ability to pay tax as a two-child couple with $55,000 income. There is near-universal agreement, however, that the current $2,500 exemption level is unrealistically low, despite the fact that it is based on official poverty level figures. Since their inception in the sixties, the poverty thresholds have been adjusted for inflation, but not for growth in real income or for changes in consumption patterns.

Because of growth in real income, the thresholds have declined from about one-half to about one-third of median income. To the considerable extent that poverty is a relative rather than an absolute concept, people living at the poverty level today are poorer than people living at the poverty level in the sixties.

The thresholds also have not been adjusted for changes in consumption patterns. The sixties study on which the poverty level was based arrived at the total subsistence cost of a child by multiplying the cost of feeding a child by three, because, at that time, food was one-third of the typical family budget. Today the appropriate multiplier would be five, because food is now only one-fifth of a typical family budget, resulting in an exemption of over $4,000.

The ideal solution to the inadequacy of the current exemption would be to increase the exemption to perhaps $4,000 or $5,000. At the same time, the current phaseout of the exemption at high-income levels should be repealed, since family size differences result in differences in ability to pay even among high-income taxpayers.

Standing alone, however, these changes would have a regressive effect, because the tax savings from an increase in the exemption is a function of one's tax bracket. For example, a $2,000 increase in the exemption would save a 36-percent bracket taxpayer $720 per child, but a 15-percent-bracket taxpayer only $300.

This regressivity could be eliminated by combining the increased exemptions with increases in upper income tax rates, so that upper income taxpayers as a group pay the same amount of tax before

and after the legislation, but with less tax from those with larger families and more tax from those with smaller families.

Mr. ZELENAK. With such a rate adjustment, dependency exemptions are not about fairness between different income levels, but about fairness between different size families at the same income level. The problem with this, my preferred solution, is that rate increases are decidedly not on this year's legislative agenda, and without compensating rate increases, I would not support an increased dependency exemption.

The $500 child tax credit added to the existing exemption isn't appropriate under the clear income analysis. Converted to an exemption equivalent, the combined exemption—credit illogically assumes the subsistence cost of a child of a 15-percent-bracket taxpayer is almost $6,000, but the subsistence cost of a child of a 36-percent-bracket taxpayer is less than $4,000. Thus, the credit produces family size differences in incomes subject to tax that are arguably too high at lower incomes and too small at higher incomes.

Despite this objection, I somewhat reluctantly support the proposed credit. I do so because the income tax family size differentiation is currently far too small at all income levels and because the politically realistic alternative to the credit—an increase in the exemption without an increase in rates—is unacceptably regressive.

Thank you.

[The prepared statement follows:]

Statement of

Lawrence A. Zelenak
Reef C. Ivey Research Professor
University of North Carolina School of Law

before the

Committee on Ways and Means
United States House of Representatives

January 17, 1995

Thank you Mr. Chairman and members of the Committee. I am Professor Lawrence Zelenak of the University of North Carolina School of Law. I am testifying today on my own behalf. I have recently completed a comprehensive study of the various ways in which Congress might adjust income tax liabilities on account of taxpayers' family responsibilities, which will be published in a forthcoming issue of the Tax Law Review of the New York University School of Law. My testimony is based on that study.

In evaluating the child tax credit proposal of the Contract with America, there are two key questions. First, does the income tax currently make adequate adjustments for differences in family size? Second, if it does not, should an additional adjustment take the form of an increase in the amount of the dependency exemption, or a child tax credit added to the current exemption?

The theory behind the dependency exemption is that ability to pay tax comes only from income above subsistence--sometimes referred to as "clear income"--and that the cost of subsistence is a function of family size. Thus the dependency exemption--if it accurately reflects the cost of supporting a child at subsistence--properly adjusts tax liability for differences in ability to pay based on family size. If, for example, the subsistence cost of a child is $2,500, then a childless couple with $50,000 income has the same ability to pay (the same clear income) as a two-child couple with $55,000 income, and the current $2,500 exemption (the inflation-adjusted amount for 1995) will result in the two couples paying the same amount of tax.

There is near-universal agreement, however, that the current $2,500 exemption level is unrealistically low, despite the fact that it is based on official poverty level figures. Since their inception in the 1960s, the poverty thresholds have been adjusted for inflation in the Consumer Price Index, but not for growth in real income or for changes in consumption patterns. In her excellent study of the problems in defining and measuring poverty, Patricia Ruggles argues convincingly that simply updating decades-old poverty thresholds for inflation is insufficient.[1]

Because of growth in real income, the thresholds have declined from about one-half to about one-third of median income. To the considerable extent that poverty is a relative rather than an absolute concept, people living at the poverty level today are considerably poorer than people living at the poverty level in the 1960s. The thresholds also have not been adjusted for changes in consumption patterns. The 1960s study on which the official poverty level was based arrived at the total subsistence cost of a child by multiplying the cost of feeding a child by three, because at that time food was one-third of a typical family's budget. Today, the appropriate multiplier would be five (because food is now only one-fifth of the typical budget), resulting in an exemption of over $4,000.

Although I join in the consensus that the $2,500 exemption level is too low, I do not agree with those who argue for a much larger exemption--$8,000 or more--on the grounds that only such a

---

[1] Patricia Ruggles, **Drawing the Line: Alternative Poverty Measures and Their Implications for Public Policy** (Urban Institute Press, 1990).

large exemption would be of equal value to the $600 exemption of 1948. The problem with the 1948-based argument is that it never explains what was so special about the 1948 exemption level. Child tax policy in 1995 should be based on 1995 costs of living (and on 1995 revenue needs), not on blind adherence to the tax law of almost half a century ago.

The ideal solution to the inadequacy of the current exemption would be to increase the exemption substantially, to perhaps $4,000 or $5,000. At the same time, the current phaseout of the exemption at high income levels should be repealed, since family size differences result in differences in ability to pay even among high income taxpayers. Standing alone, however, these changes would have a regressive effect, because the tax savings from an increase in the exemption is a function of one's tax bracket. For example, a $2,000 increase in the exemption would save a 36% bracket taxpayer $720 per child, but would save a 15% bracket taxpayer only $300. This regressivity could be eliminated by combining the increased exemptions with increases in upper income tax rates, so that upper income taxpayers as a group paid the same amount of tax before and after the new legislation--but with less tax from upper income taxpayers with larger families and more tax from those with smaller families. With such a rate adjustment, dependency exemptions are not about vertical equity (fairness between different income levels) but about horizontal equity (fairness between different size families at the same income level).

The problem with this solution, of course, is that rate increases are decidedly not on this year's legislative agenda, and without compensating rate increases I do not support a substantial increase in the dependency exemption, because of its regressive effect.

A $500 child tax credit added to the existing $2,500 exemption is not appropriate under the clear income analysis. Converted to an exemption-equivalent, the combined credit-exemption illogically assumes the subsistence cost of the child of a 15% bracket taxpayer is almost $6,000, but the subsistence cost of the child of a 36% bracket taxpayer is less than $4,000.[2] Thus the credit produces family size differences in income subject to tax (clear income) that are arguably too large at lower incomes and too small at higher incomes.

Despite this objection, I somewhat reluctantly support the proposed credit. I do so because the income tax's family size differentiation is currently far too small at <u>all</u> income levels, and because the politically realistic alternative to the credit--an increase in the exemption without an increase in rates--is unacceptably regressive. I should add that my support is conditioned on the assumption that Congress will find a way to pay for the credit, so that it does not increase the deficit.

Finally, I hope that in the near future Congress will undertake a thorough review of all the other provisions of the income tax relating to dependent children, including head of household status, the child care credit, the exclusion for dependent care assistance programs, and the earned income tax credit. Many aspects of these provisions are difficult to explain or justify. I would especially call your attention to the failure of the child care credit and the earned income tax credit to provide adjustments for family size beyond the second child.

---

[2] A deduction of $3,333 would save a 15% bracket taxpayer $500; thus a $500 credit is the equivalent of a $3,333 exemption to that taxpayer. Adding the $3,333 exemption-equivalent to the $2,500 express exemption produces a total exemption-equivalent of $5,833. A deduction of $1,389 would save a 36% bracket taxpayer $500; thus a $500 credit is the equivalent of a $1,389 exemption to that taxpayer. Adding the $1,389 exemption-equivalent to the $2,500 express exemption produces a total exemption-equivalent of $3,889.

Chairman ARCHER. I assume that J.D. means doctorate, so I will refer to you as Dr. Zelenak. I thank you very much.

Dr. Burtless. Dr. Burtless is with the Brookings Institute. We are pleased to have you and welcome your testimony.

STATEMENT OF GARY BURTLESS, PH.D., SENIOR FELLOW, ECONOMIC STUDIES PROGRAM, BROOKINGS INSTITUTION

Mr. BURTLESS. Thank you and thank all the other members of the committee for the invitation to testify. I am going to confine my remarks to just a couple of the parts of my longer testimony that I submitted for the record, mostly dealing with the child tax credit.

First of all, I see a reasonable case for tilting the income tax in favor of families with children, especially families with limited incomes. Young families headed by adults with little schooling have experienced real erosion in their living standards over the past 20 years. This has occurred in part because of the decline in wages that young men can earn. Adverse wage trends have pushed up poverty rates among children. They have made it harder for young families to buy their first homes. It would be ironical, however, if we provided tax relief to these families mainly by piling extra Federal debt on the shoulders of their youngsters. Tax relief for families with children only makes sense if it does not reduce the total revenue collected by the Treasury.

Second, a generous child tax credit is going to make deficit reduction much harder. The credit will reduce immediate financial pressure on families with children, like my own, but it will worsen the long-term prospects of our kids and grandkids. The reason is very simple. The plan adds to the amount of resources the Federal Government is going to have to borrow to pay its bills. Future taxpayers must pay interest on the additional debt that will be incurred, raising the financial pressure on taxpayers tomorrow.

The credit offers tax relief for parents today, but it represents a tax increase, I think, on future generations. We already have good reason to be concerned about the financial prospects of those future generations. They are going to have to support a huge generation of baby-boom generation retirees. Since wages are climbing slowly or are stagnant, future workers may not have higher incomes with which to support all those extra older people. We are not really sure our children will enjoy higher incomes than we do today.

Many of us are concerned that the future burden of supporting a large population of the elderly, combined with slow wage growth will leave our children with lower aftertax incomes than we receive today. Under these circumstances, it seems to me wrong to lighten current tax burdens only to make the burdens on future taxpayers even heavier. If we describe the tax credit accurately, we would label it as a tax increase on our children and grandchildren.

Third, many of you are going to object that the child tax credit should not be viewed in isolation. The credit is part of a package of proposals that also includes spending reductions and a balanced budget amendment to the Constitution. Now, it is certainly true that if a child tax credit were accompanied by a reduction in overall Federal spending, it would be less objectionable. If revenue losses were matched by spending reductions, the Federal debt we leave our children and grandchildren would be unaffected.

But I see that as a serious problem, not a virtue of the proposed credit. If we care about the well-being of our children and grandchildren, our central goal in fiscal policy should be to reduce the Federal deficit, not to leave it unchanged. Painful spending cuts should yield deficit reduction, not a deficit that remains constant in relation to the size of national income.

The present deficit is too high in view of today's low unemployment rate. In the long run, large deficits represent a threat to the well-being of taxpayers even if deficits spare them from paying taxes today. National saving fell sharply in the eighties. This occurred both because of reduced private saving and because larger Federal deficits absorbed a sharply larger percentage of the savings that we had. The reduction in national saving was reflected in lower spending on private investment. If we want to see private investment return to the levels of the sixties and seventies as a proportion of national income, we should reduce net Federal borrowing.

When you find yourself stuck in a deep hole, it doesn't make much sense to make the hole any deeper. Fiscal policy is in a hole. We should not dig a deeper hole. The first step toward a sustainable fiscal policy is to avoid measures which make the deficit larger. The generous tax credit for families would make our hole that much harder to climb out of. I would like to get out of this hole.

[The prepared statement and attachment follow:]

TAX CREDITS FOR CHILDREN AND TAX REFORM TO REDUCE THE MARRIAGE PENALTY

Testimony for the
Committee on Ways and Means
U.S. House of Representatives

January 17, 1995

by
Gary Burtless[1]

Summary

Tax relief for families with children is a good idea in the abstract, but it will make more difficult the process of reducing the deficit. The immediate effect of the credit is to raise the federal deficit by over $100 billion in the next five years and by nearly a quarter of a trillion dollars within ten years. Tax reductions may be welcome to today's parents, but they leave an unwanted legacy of greater debt to our children and grandchildren. The next few generations of workers already face huge bills connected with the retirement of the Baby Boom generation. It makes no sense to saddle them with even heavier bills for interest on a larger federal debt.

There is a sound case for tilting the personal income tax more in favor with families with children, especially families which have limited incomes. Young families, especially those headed by men with a limited education, have seen some erosion in their living standards over the past 20 years. This trend is partly due to stagnation or actual decline in the hourly wages that young men can earn. Adverse wage trends have pushed up poverty rates among children and made it harder for young families to buy their own homes. It would be ironical, however, if we provided tax relief to these families mainly by piling extra federal debt on their youngsters. Tax relief for families with children only makes sense if it does not reduce overall revenue collected under the personal income tax.

New Tax Credits for Children

The family tax credit proposed in the American Dream Restoration Act offers the wonderful virtue of simplicity. Taxpayers can easily calculate how the proposed credit will affect their own financial circumstances. Families with one child who pay at least $500 in federal income taxes will see their taxes fall by $500 if their annual incomes are below $200,000. Families with two children who pay at least $1,000 in income taxes will see their taxes fall by $1,000. As the number of children in a family rises, the potential credit rises by $500 per child. Families with no children, with no income tax liability, or with incomes over $250,000 a year will obtain no tax relief under the plan.

Making a bad problem worse. Because the child tax credit will make deficit reduction much harder, I oppose the plan. This opposition is not based on financial self-

---

[1] Senior Fellow, the Brookings Institution, Washington, D.C. The views expressed are solely my own and should not be ascribed to the staff or trustees of the Brookings Institution.

interest. (I have children, so would receive a big tax reduction under the proposed credit.) The credit will reduce immediate financial pressure on families like mine, but it will worsen the long-term prospects of our children and grandchildren. The reason is simple: The plan adds to the amount of resources that the federal government must borrow to pay its bills. Future taxpayers must pay interest on the additional debt that will be incurred, raising the financial pressure on those taxpayers. The credit offers tax relief for parents today, but it represents a tax increase on future taxpayers.

We already have good reason to be concerned about the financial prospects of future generations. They will be asked to support a large generation of retirees through payroll taxes needed to finance Social Security and Medicare. They will be asked to pay substantial income taxes to support a large number of aged and disabled who are too poor to pay for their own medical and nursing home bills.

As recently as the 1970s it was easy to be optimistic about the prospects of future generations. Wages and compensation were growing strongly because of steady improvements in worker productivity. Even if future generations of workers were obliged to support larger generations of retired elderly, we were confident that the living standards of future workers would be higher than our own. The rapid growth in wages meant that future workers would be left with more after-tax income to spend on themselves, because their *before*-tax incomes would climb fast enough to support a larger number of retired elderly.

The confidence of most Americans in the future has been shaken. We are less certain that our children and grandchildren will enjoy more comfortable lives than we do today. Many of us are concerned that the future burden of supporting a large cohort of elderly, combined with slow wage growth, will leave our children with lower after-tax incomes than workers receive today. Under these circumstances, it seems wrong to lighten our current tax burdens only to make the burdens on future taxpayers even heavier. If we described the tax credit accurately, we would label it a tax increase on our children and grandchildren.

Budget cuts. Many people who read these comments will point out that the child tax credit cannot be viewed in isolation. The credit is part of a package of proposals that includes spending reductions and a balanced budget amendment to the constitution. The President has proposed a similar though less generous child credit, and he promises to match the tax cut with some spending cuts.

It is certainly true that if the child tax credit were accompanied by a reduction in overall federal spending it would be less objectionable. A $500-per-child credit is expected to cost the Treasury $107 billion in lost revenue over the next five years and $137 billion in lost revenue over the following five years. If the revenue losses were matched by the same amount of spending reductions, the federal debt that we leave our children and grandchildren would be unaffected by the combination of tax and spending cuts. But I see that as a serious problem, not as a virtue of the proposed credit. If we care about the well-being of our children and grandchildren, a central goal of fiscal policy should be to *reduce* the federal deficit, not to leave it unchanged from its current level. Progress toward reducing federal spending should yield deficit reduction, not a deficit that remains constant.

Two Presidents and the last three Congresses have made progress toward reducing the burden of the deficit. After averaging more than 5% of GDP in the mid-1980s, the federal deficit has been brought down to less than 3% of GDP today. But the current deficit is large relative the peace-time average deficit over the post-war period. And it is depressingly high in view of today's low unemployment rate. In the long run, large deficits represent a threat to the well-being of taxpayers, even if deficits spare them from paying some taxes today. National saving -- the share of national income that we collectively set aside for investment and future consumption -- fell sharply in the 1980s. This occurred both because of reduced private saving and because of larger federal deficits, which absorbed a sharply higher percentage of private saving. The reduction in national saving was reflected in lower spending on private investment. Productivity growth during the 1980s and early 1990s was almost certainly affected by this development. Productivity improved more slowly than it would have if the investment share in GDP had been higher. If we want to see private investment return to the levels of the 1960s and 1970s, we should reduce net federal borrowing.

Veterans on this Committee know how painful it has been to reduce the deficit to its current level. No one should be under the illusion that substantial future reductions will occur painlessly. Congress will find it difficult, if not impossible, to achieve the deficit target enshrined in the balanced budget amendment. Giving favored taxpayers an annual tax reduction exceeding $20 billion will only make achievement of a balanced budget that much more difficult. Far-sighted voters and financial markets will question Congress's determination to achieve budget balance if the current Congress adds to the long-term problem by passing a major tax cut this year.

When you find yourself stuck in a deep hole, it doesn't make any sense to make the hole any deeper. Fiscal policy is in a hole; we should not dig a deeper hole. The first step toward a cure is to avoid measures that make the deficit larger. A generous tax credit for families with children makes our hole that much harder to climb out of.

Tilting the tax code toward families with children. Many people believe the world has become a more hostile place for American children. Statistics on child poverty support this view. After declining sharply during the 1950s and 1960s, the official child poverty rate rose modestly in the 1970s and increased about a third after 1978. Adjustments in the poverty count to reflect more accurate measurement of price change and a more inclusive definition of family income would probably show that child poverty fell during the 1970s but rose substantially in the 1980s and 1990s.

Two trends have pushed up child poverty rates -- the increasing percentage of children who live with only one parent and worsening job prospects among young men, especially men who have received no education beyond high school. Families with children depend overwhelmingly on wage earnings to support themselves. When real earnings fall, as they have for many families headed by young men and young women, child poverty rates tend to rise.

Of course, the proposed child tax credit would do nothing for poor families containing children. The Tax Reform Act of 1986 permanently changed the tax code to remove poor families from the tax rolls. Because poor families do not pay income taxes, they will not

enjoy any tax savings from a nonrefundable tax credit. (Poor families with wage incomes received substantial tax benefits as a result of the liberalization of the Earned Income Credit in 1993, however.) Nonetheless, the credit would lift the tax threshold well above the poverty line for families that contain children, helping families whose incomes are somewhat above the poverty line. Table 1 below shows estimated poverty thresholds and tax thresholds for 1996, with and without the $500-per-child tax credit.

TABLE 1. ESTIMATED POVERTY THRESHOLDS AND TAX THRESHOLDS FOR FAMILIES WITH CHILDREN, 1996

HOUSEHOLD TYPE / NO. OF CHILDREN	POVERTY LINE	TAX THRESHOLD UNDER CURRENT LAW	TAX THRESHOLD WITH $500 CREDIT
MARRIED COUPLE / JOINT RETURN			
Number of children			
0	$10,574	$11,935	$11,935
1	12,710	14,535	17,868
2	16,081	17,135	23,802
3	18,844	19,735	29,735
4	21,100	22,335	35,668
SINGLE HEAD OF HOUSEHOLD			
Number of children			
0	$8,215	$8,540	$8,540
1	10,844	11,140	14,473
2	12,723	13,740	20,407
3	16,069	16,340	26,340
4	18,556	18,940	32,273

Source: Author's calculations for households claiming the standard deduction based on assumption of 3% annual inflation.

Under current law, the income level at which families begin to pay positive income taxes is above the poverty threshold. Families containing no children will not be affected by the tax credit, but families with children will see their tax thresholds lifted significantly as a result of the credit. A married couple with three children will see its tax threshold increase from $19,735 to $29,735, for example. Families with incomes in this range will be removed from the tax rolls. Childless couples and single persons will be left on the rolls, however, and they may question the fairness of being denied any tax relief.

On the whole, I favor easing tax burdens on low-income families with children if this could be achieved without reducing revenues from the personal income tax. I question the rationale for offering tax relief to families earning annual incomes of $60,000, $100,000, and even $200,000, however. It would be hard to argue that these families have suffered losses in purchasing power as a result of major tax increases or income reverses over the past 15 years. Census and income tax statistics and Social Security earnings records suggest that these

families have enjoyed at least modest income gains since the early 1980s. Their children have not been harmed by heavier taxation or wage decline. If Congress believes it is desirable to tilt the tax schedule in favor of moderate- and high-income families containing children, it should achieve this goal holding overall personal income tax collections unchanged. Since this involves imposing major tax increases on at least some classes of taxpayers, I do not think voters will find this option very attractive.

Incentive effects. Apart from tax relief, a common motivation for tax reductions is to improve economic incentives. In the case of the child tax credit, only one incentive is clearly changed for a broad cross-section of Americans -- the incentive to have children. In comparison with a childless couple that has the same income, a married couple with one child would pay $500 less in taxes than is the case under current law. The same incentive for additional child bearing is offered to both married couples and single people (see Table 1). If it is thought desirable to encourage Americans to have additional children, a child tax credit offers the advantage of simplicity and clarity. I am not aware, however, that increased childbearing is considered highly desirable either by Congress or the general public.

Tax reductions are sometimes justified because they improve taxpayers' incentives to work and save. The proposed credit can clearly have this kind of effect for taxpayers who are removed from the tax rolls. Because their tax liabilities will fall to zero, the marginal income tax rate imposed on their wage and interest income also drops to zero. Some taxpayers may respond by working longer hours or setting aside more of their current income as saving. But most taxpayers who receive tax relief under the plan will not see their taxes reduced to zero. They will pay lower income taxes, but they will continue to face the same marginal tax rate on income that they face today. They will receive higher after-tax incomes but will face unchanged marginal tax rates. Most studies of work behavior suggest that affected taxpayers will probably work somewhat less than they currently do, although I would be surprised if the effect is particularly large. Economists do not know the likely effects of the reform on personal saving.

One group of affected taxpayers will face *higher* marginal tax rates as a result of the credit. Under both the Republican plan and the alternatives that have been proposed by Democrats, the child credit would be eliminated over some income range. House Republicans propose to eliminate the credit for families receiving between $200,000 and $250,000 per year. Families in this income range will face a higher marginal tax rate than they do under current law. Since their after-tax incomes will be improved by the credit, while their marginal tax rates will be raised, economic theory and empirical evidence suggest that their earned incomes will probably decline, though modestly.

Among the incentive effects mentioned, only one is thought to be desirable by a large majority of Americans. Most of us probably believe it is desirable to encourage moderate-income breadwinners with children to boost their earnings through increased labor supply. Low- and moderate-income breadwinners who are removed from the tax rolls will be offered improved incentives for added work under the credit. The other incentive effects I mentioned are ambiguous in value or are widely believed to be undesirable. It seems safe to say that the child tax credit is being proposed to provide tax relief and to tilt tax burdens away from families with children. It has not been advanced because proponents believe it offers desirable incentive effects.

Reducing the Marriage Penalty

A second plank of the American Dream Restoration Act offers up to $2 billion per year in tax relief to reduce the so-called marriage penalty. Many two-earner married couples perceive the current tax schedule to be unfair. They realize that they pay higher income taxes jointly than they would pay separately as single individuals. Under a progressive income tax system, it is difficult to treat married and single people equitably while still maintaining the principle that tax burdens should rise with ability to pay.

Alicia Munnell, currently in the Department of the Treasury, has shown that is logically impossible to achieve all three of the following equity goals of taxation:[2]

1. *Impose equal tax burdens on couples with equal incomes,* regardless of how income is divided between the spouse with lower earnings and the spouse with higher earnings.

2. *Marriage neutrality,* so that a man and a woman who each earn $25,000 owe the same taxes whether they are single, married, or divorced.

3. *Progressivity,* which implies that a single person earning $50,000 should pay more than the combined tax imposed on two single people who each earn $25,000.

Our present income tax system sacrifices goal #2 in order to achieve goals #1 and #3. In the past, our system has sacrificed goal #1 in order to achieve goals #2 and #3. Some people propose that we eliminate progressivity in the tax system. If this occurs, we can easily achieve goals #1 and #2. However, as long as we seek to achieve all three goals, some compromise between the goals will be necessary.

The marriage penalty in the present system has practical consequences besides the perceived unfairness of the penalty. The spouse with lower earnings often faces a higher marginal tax rate on earnings than he or she would face if unmarried. The penalty may thus discourage employment or reduce work effort below the level it would be under a system that is neutral with respect to marriage. (The penalty may also discourage or delay marriage for some couples.)

A crude but tolerably effective remedy for this problem is to offer a special tax deduction to married couples where both spouses work. In 1981 Congress offered a special deduction equal to 10% of the earnings of the spouse with lower earnings, up to a maximum deduction of $3,000. The deduction was eliminated in the 1986 Tax Reform Act. Congress and the Administration believed the deduction was less needed after marginal rates and the number of tax brackets were reduced. However, the penalty on dual-income married couples remains. If Congress wishes to reduce the penalty, one way to proceed is partially to restore the special tax deduction in effect between 1982 and 1986.

The American Dream Restoration Act proposes to give up only a small amount of revenue to reduce the marriage penalty -- $2 billion a year. The amount is so small that I do not think the revenue loss and resulting deficit increase are particularly significant. However, the small revenue loss ensures that the reform will not make a very big dent in the marriage penalty, either.

---

[2] Alicia H. Munnell, "The Couple versus the Individual under the Federal Personal Income Tax," in Henry Aaron and Michael Boskin, eds., *The Economics of Taxation* (Washington: The Brookings Institution, 1980), p. 247.

Chairman ARCHER. Thank you, Dr. Burtless.

Dr. Steuerle, considering that we perhaps do not have a complete open door to do whatever we want to do, do you think that the $500 per child credit, which goes up to 18 years of age and up to $200,000 of family income, is a reasonable approach? Is that a fair statement that I have drawn from your testimony? If not, would you correct me?

Mr. STEUERLE. I think that is a fair statement, Chairman Archer. There are some other adjustments that I might make. I don't know whether this committee would want to consider them. Again, as I have noted and I believe Professor Zelenak has also noted, I think it actually would be simpler to grant the credit at all income levels and then, if one is worried about the impact on progressivity, trying to make an adjustment elsewhere. I think that would be simpler and it would avoid this problem of these phaseouts, with their additional tax rates, hidden tax rates, and marriage penalties and other things.

If you can't find the adjustments elsewhere, then I understand why they have to phase out. I also suggest in my testimony the consideration of other items, such as how one might integrate with what is going to be done in welfare. Since I don't know what is going to be done in welfare, it is hard for me to get into a great deal of detail.

But I am worried about the gap between the people who are on welfare and getting welfare credits and those who might get tax credits. There is a group in between that is not going to get anything. So I would like to think about if we are going to make payments to States, for instance, some way of making sure this group in between is also accounted for.

I also suggest that in the context of health care reform, I would even consider such adjustments as, at least for middle and upper income taxpayers, requiring that if they get a credit that they buy health insurance for their children. At least those people have income levels where we feel that such a requirement would be reasonable.

All these things add complexity to what you are trying to do. The reason I add them here is because the credit is probably the major item that I see which is going to give something back to taxpayers, as opposed to the expenditure reductions, which are going to take something away from individuals.

So the time, it seems to me, to make these other adjustments—and you may have many of your own, is at the time that we do the giveaway, if we want to call it a giveaway. When we give the money back to the taxpayer, we ought to think about how we balance these things as a whole. If we give the credit now and we decide we need to do some other things later on, we will have a harder time explaining how the balance is achieved.

Chairman ARCHER. Well, the one area that some of us might take a little bit different semantic approach to is we are not really giving anything. We are letting people keep more of their money, and that was adequately articulated by the previous panel. But you think it is not unreasonable to have a phaseout begin at $200,000.

Mr. STEUERLE. As I said, Chairman Archer——

Chairman ARCHER Taken by itself.

Mr. STEUERLE [continuing]. I would have no phaseout at all. The theory of family-size adjustment says that it is not a question of how much people of $200,000 of income pay. It is a question of if we have two families with $200,000 of income, does the one with children have less ability to pay than the one with none, or with a different number of children? One has children, one has no children. Do they have different abilities to pay? Yes, they do and, therefore, it is appropriate to adjust for family size even at that level.

Chairman ARCHER. Thank you very much.

Mr. Crane.

Mr. CRANE. I thank the gentlemen for their testimony. I just want to raise one question that is a concern to me, as Dr. Burtless expressed it, and that is that we not be put in the position of passing the buck, in effect. I reared eight children with my wife and we have four grandchildren so far and a fifth due. The major responsibility that those of us involved in making the laws for this country have is living within our means down here.

There are times in an international crisis when obviously there is an excuse for going into debt. But otherwise, I don't see the basis for having extended that burden and passing it on—especially the magnitude of dollars we are facing today. We are imminently approaching a $5 trillion national debt, and the projections are that it could go to $7 trillion by the end of the century.

On the other hand, it does seem to me one of the concerns addressed by Mr. Kasich is that instead of a projected $3 trillion increase in spending between this year and the year 2002, with the balanced budget amendment, we would only be spending $2 trillion. I think there is a way to provide long overdue relief, especially to families.

My kids grew up in the sixties and seventies. I think there is a way to avoid in effect inflicting real hardship on families with multiple children and simultaneously biting that bullet that does not in turn pass the burden and the hit onto my grandchildren and my great grandchildren when they come along. I would simply be interested in your comments on that.

Mr. BURTLESS. Well, I think that when I heard Senator Grams speak to the question of how he could identify cuts in spending that would match this reduction in taxes, he was very hard pressed to think of where he would go. He has been in the House. He has campaigned, so he has thought long and hard about these issues.

I think it reflects the great difficulty of identifying exactly what you would cut. I heard some people say that they would rather have taxpayers spend money on their own rather than send it down to irresponsible bureaucrats in Washington. I think that is a direct quote. We should remember some of these things people are spending money on through their taxes: Social Security benefits, Medicare, interest on the debt, national defense. That is a lot—that is a lot of the spending and it also represents a lot of the projected increase in spending.

A lot of that additional $3 trillion is going to be for these items. I don't know how you view it, but I don't view sending a Social Security benefit check to someone as a bureaucrat controlling the spending of that money. Social Security permits our elderly people

to live a decent living and partially receive back some of the tax contributions they made earlier on.

Chairman ARCHER. I don't think Social Security belongs in the debate at all. There is a separate tax that goes into the Social Security trust fund, and we have, by incorporating that Social Security trust fund in our total budget, made it look less offensive than it really is.

But beyond that, we could have a big debate here about whole departments of government that I would lop out of existence. I know we could get into keen debate on that issue. But I remember, for example, in 1980, Ronald Reagan campaigned on the pledge that we were going to abolish the Departments of Education and Energy promptly after he took office. These two new departments had just been created by President Carter. We, unfortunately, did not do that. But as I say, it is not just cuts but putting full freezes in place.

I know that Congressman Burton from Indiana a couple of years ago had a proposal just to put a freeze in place. It wasn't a total freeze. It preserved COLAs, and it had a 2-percent-per-department provision for annual increases in spending. That was projected out to produce a surplus shortly after the turn of the century. I think it is more tightening the belt and ideally tightening that belt across the board.

I don't think that necessitates invading what are designated trust funds. In fact, trust funds, I think, have to be preserved as such, and that is a separate issue as to how you finance them.

I thank the gentleman.

Chairman ARCHER. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman. Dr. Steuerle, you mentioned that perhaps if there were to be a $500 tax credit, then there might be some kind of a requirement to purchase health insurance for children. Did I understand that correctly?

Mr. STEUERLE. Mr. Payne, I am jumping into another topic here and obviously it is something that I think the committee staff would have to consider in detail. But during the health reform debate, there was an issue of whether we wanted to have employer mandates and I think as a country we decided that was inappropriate.

But the alternatives were to consider things like individual subsidies and individual mandates; that is, some requirements on individuals that they buy health insurance. One tentative way of approaching that issue is to take middle and upper income taxpayers and to say to them if you are not buying health insurance for your family, or your children, then you are going to be denied certain tax benefits. The reason we do this is because—because by not buying insurance, if you face some catastrophe, you may indeed fall back upon the public sector. You could have bought your insurance. You didn't. Now the public is going to have to pay.

So a tentative way of getting at that is to deny something like a child credit or a dependent exemption or a personal exemption for middle and upper income taxpayers who don't buy health insurance. It doesn't solve the problem for the majority of the people who don't buy health insurance, but it is a way of getting at a small piece of that puzzle.

Mr. PAYNE. So this would then be one element of dealing with a second issue which we will be dealing with this year, which is health reform and how is it that we are able to find a way to make public policy decisions that assist us with health care and particularly the rising cost of health care.

Mr. STEUERLE. That is correct, Mr. Payne.

Mr. PAYNE. I just wanted to understand you because I had not heard of that sort of proposal as we have listened to the elements of the tax credit. Dr. Burtless, you talked about the conflict between reducing the deficit and tax credits. Are you suggesting that there is no kind of tax credit here that makes any sense from a policy point of view?

Mr. BURTLESS. Well, I think there is. I think that I expressed my agreement with the other people who have testified that there is a good case for tilting the income tax schedule more in favor of families who have children.

But I think that because the credit is so clearly directed at children, we should also think about the obligations that we are imposing on those children later on in their lives. We are already expecting a lot of them. We are expecting them to pay for my Social Security benefits and the benefits of people older than myself. If we add to the debt in order to finance this credit for families with children, we are not actually making their circumstances better off over their entire lifetime. The children, I think, end up worse off.

I think that if we finance a more favorable treatment of families with children through a reallocation of the tax burden, that is a very sensible policy. But it doesn't make sense to add to the long-term burden on these kids by adding to the debt.

Mr. PAYNE. Next week we will vote on the balanced budget amendment, an amendment to balance the budget of the United States by the year 2002. We have learned, according to the Congressional Budget Office, $1.2 trillion is the amount of deficit reduction that will have to take place in order to meet that objective. This contract will add some $400 billion, and so it raises from $1.2 to $1.6 trillion the amount that would have to be reduced.

Just quickly, because my time is almost up, do you have any comments generally about the difference between a $1.2 and a $1.6 trillion hurdle as it relates to achieving this goal?

Mr. BURTLESS. Just figure out what the interest payments are that we have to make in perpetuity to finance that $400 billion addition to the debt. Or alternatively, think of all of the additional spending cuts above and beyond $1.2 trillion that you are going to have to find in order to achieve the deficit reduction that is going to be necessary to offset the cost of the credit. It is just a very steep mountain to climb.

Mr. CRANE. The time of the gentleman has expired.

Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman. I would like to just ask this question: Isn't this another form of social programming in a way, that we have been historically, at least the Republican party, has been trying to get away from for a long time?

If in fact we considered that this might be—I will leave it up to you, whether you would determine that to be considered some social programming, what about the flat tax? I would appreciate, if

you would, one by one, just tell me—is the flat tax something that the Federal Government ought to be taking a real good look at?

Mr. BURTLESS. Well, the flat tax largely eliminates I think the problem of the marriage penalty. So it does get you around one problem. But I don't think it spares you the problem of thinking about how you want to make an adjustment to make an equivalent tax assessment on households that have different sizes. You still face that problem.

Even if you want to impose a flat tax, presumably it is a flat tax on income above a certain minimum amount. You have to decide what should that minimum amount of income be that is going to be exempt from taxes? There I think most Americans believe we should make an adjustment that reflects the responsibilities of different kinds of families. So I think you still have the problem of adjusting for family size.

Mr. HANCOCK. In other words, what you are basically saying is that the flat tax is again not a flat tax. Talking about a flat tax, but then adjusting it based on the numbers or members of families which in effect you don't have a flat tax then.

Mr. STEUERLE. That is correct. Most flat taxes either have some sort of personal exemption or some sort of credit per person.

Mr. HANCOCK. A minimum tax, but not necessarily based on the number of people in the household, a minimum amount.

Mr. STEUERLE. Whether you do it based on the number of persons in the house or not, you are correct, it doesn't become flat at the bottom because you are imposing effectively a zero rate on some taxpayers.

Mr. ZELENAK. Every flat tax really has two rates, a zero rate and then one positive rate.

Mr. HANCOCK. Dr. Burtless said that he thought it ought to be looked at. I didn't hear the other two. Do you think we ought to be looking at a flat tax up here in the Congress or do you think we ought to just say that is just some figment of somebody's imagination, it will never work?

Mr. ZELENAK. Oh, I think clearly it can work. It is just the philosophical question of whether—to what extent you believe in progressivity. I happen to favor progressivity. For purposes of this panel, maybe the more important issue is that even under a flat tax, presumably you want family size adjustments—at least I would.

Mr. STEUERLE. First, I think the term flat tax is actually four or five proposals wrapped up in something called flat tax. One is the issue of how much do you want to change the system, vis-a-vis how progressive do you want it.

The second issue is do you want an income tax versus a consumption tax. The third issue, which is important to this committee, is whether you want some of the simplification you get from a flat tax because you can withhold at source. The bank can pay the tax. You don't have to file. That is a simplification. It also tends to often lead to larger government. People don't see what they are paying.

So there are a lot of issues of the flat tax, some of which I think I favor, some of which I am less agreeable toward. But I think it is not just the one issue. In regard to, as this panel has said, things

like child credits or family size credits, flat tax proposals make some adjustment anyway.

Mr. HANCOCK. Thank you.

Mr. CRANE. Mr. Christensen.

Mr. CHRISTENSEN. Dr. Burtless, on page 4 of your written testimony, you—in the second paragraph, reference giving favored taxpayers an annual tax reduction. Who are these favored taxpayers that you are referring to?

Mr. BURTLESS. Well, I just meant that the credit is tax relief that is targeted on a particular kind of family—namely, families that have children and whose incomes are high enough so that they actually owe taxes.

Mr. CHRISTENSEN. You go on in your written testimony to say that people with annual incomes of $60,000, $100,000, and even $200,000 should not be able to receive this kind of tax relief. You question the rationale. I guess I would question your reasoning on the fact that you take two people, as I questioned Senator Grams earlier, a bricklayer making $40,000 a year and a school teacher making $35,000 a year, under your scenario, they are rich.

If you talk to the hard-working people out there that are middle-income earners, they will tell you that they are not rich by any means. How do you define your rich category and how do you define your middle-income category.

Also, I would like to ask you when you are doing your various analyses, do you use a static or a dynamic analysis? Which have you done in the past and which do you favor in the future?

Mr. BURTLESS. Well, first of all, the $60,000, $75,000, $100,000 comment only reflected what I take to be income levels where the financial pressures have been most severe on American households. I do not mean to suggest that people with $100,000 or even $150,000 are not middle-class people. I actually have a very expansive definition of the middle class myself.

It is just that in that income range (above $60,000), American households have not faced particularly higher tax burdens. They have not seen a loss in their income because of adverse economic trends. That is all I am saying.

With regard to dynamic forecasting, it is interesting, when I first came to Washington in the late seventies, that is the very first thing I worked at. I tried to estimate how much reform of the welfare system of the United States would cost, taking into account the fact that if you made benefits more generous or if you reduced the marginal tax rates on low-income taxpayers, they might be expected to respond. As a result, I have tried very hard over my life to figure out what the best estimates are that we can use in order to make reliable predictions of what the cost to the Treasury would be of changing the welfare or tax systems.

Mr. CHRISTENSEN. I have a question related to that. It is concerning GAO estimates, CBO estimates, Joint Tax Committee estimates, and this is a quick question for all three of you.

For example, the GAO has some 4,700 employees, a $400 million budget to produce studies, which outside groups are already doing. Is there a way that you would suggest we go at taking a scalpel to some of these government organizations and could we eliminate

a good majority of them or all of them and instead rely upon private organizations?

Mr. STEUERLE. Mr. Christensen, I happen to be very much a fan of these various agencies. I find that the committees, like Ways and Means, that have the joint tax staffs often end up to be the strongest committees in part because I think of the knowledge base that that type of committee staff gives them, vis-a-vis some of the other committees in Congress that don't have joint staffs or nonpartisan staffs to support them.

Again, I have not looked at the levels. Certainly I understand that there is going to be some attempt to look at GAO, which I think is the only large agency of the ones that you mentioned—to look at their size of staff and see whether all the audits and types of things they do are necessary.

I can say as an outsider many of these studies are very, very helpful at looking at ways of cutting expenditures, looking at issues like a child credit as I said. The nonpartisan staff help empower Congress to do some of the types of changes that it is very much looking forward to doing.

Mr. ZELENAK. I am sure there is room for cutting. I have been generally impressed with the product that has come out of those agencies.

Mr. CHRISTENSEN. Thank you. Thank you, Mr. Chairman.

Mr. CRANE. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman. Let me just ask you, since the present exemption is related to income so that those in the higher income bracket receive a greater benefit than those in the lower, why do you say that the tax credit proposal should go forth without relationship to income level?

Mr. STEUERLE. Mr. Levin, we are dealing with what is perhaps one of the toughest sets of issues of taxation. One issue is how progressive does one want this system to be? A second issue is how much do you want the system to collect? The third issue is, given those, how do you distribute burdens among people at the same income level?

The point I am making is that once we decide the amount we want to collect and we decide the amount we want to collect, say, from wealthy taxpayers, there is still a legitimate issue of how do you distribute the burden among those wealthy taxpayers. So, for instance, we could take two families. Let's say each has $100,000 of income, so they have $200,000 of total income. We could say we are going to charge each of those families $20,000 in tax. Or we can say, in fact, that one family has children, the other doesn't, and there is a difference in their ability to pay tax. So, instead, we will charge one $19,000 and the other $21,000. What you can see I have done is I have collected the same amount of revenue. I have gotten the same amount of progressivity, but I still have adjusted for family size within those families.

So the point, again, that I am making is there is legitimate reason to look at the burden within that income group, just as, for instance, when we provide public education, we may charge wealthy families more than they get back in public education, but there is a legitimate issue of whether we want to provide public education to all families at that level. There is a difference between what we

want to do on net for wealthy families and how we want to distribute the burden among them.

Mr. ZELENAK. Mr. Levin, if I could take a stab at the same question.

Mr. LEVIN. Go ahead.

Mr. ZELENAK. My preference would be to increase the dependency exemption to a level that more realistically reflects the basic cost of supporting children and then retain the current progressivity by increasing tax rates at the upper brackets. So people making $200,000 are paying the total tax they pay now, but more from people without children, less from people with children. Given that is not going to happen this year, the question becomes, is it still appropriate to make some adjustment for family size even at upper income levels? I think it is.

The final question is, will it be paid for? My support for the adjustment is premised on the assumption that it will not increase the deficit, it would be paid for. Ideally, I would like to see it be revenue neutral within the tax system so that the cost that we are relieving from larger families is being paid for by an increase on the tax on smaller families—and perhaps I should add I have no children, so this isn't self-interested.

But given my ideal proposal isn't going to be enacted this year, does it make sense to provide more family size differential even at high-income levels? Yes, it does, especially given the current tax system that provides absolutely no family size differential at high-income levels.

Mr. LEVIN. But your answer indicates that equity among families of the same income brackets is more important than equity between taxpayers of different brackets. I think you need to take another look at that issue. I think what it points to, if there is going to be equity, is to use a different system for dependent allowance. It would make more sense to change it.

What you are doing with mixing an exemption and a credit is, while you are perhaps getting more justice within tax brackets, you are really increasing the differential between them.

I am not sure why you kind of pull your punches on that. That goes for either of you.

Mr. ZELENAK. Well mixing an exemption and a credit is not to my mind the ideal way to do it.

Mr. LEVIN. So why aren't you here testifying as to what makes sound tax policy?

Mr. ZELENAK. I am, but I am also testifying that since what I think makes the soundest tax policy isn't on the table, I think the proposal in the Contract With America is better tax policy than current law.

Mr. CRANE. The time of the gentleman has expired.

Mr. MCDERMOTT. Thank you. Appreciate your coming and testifying. It is nice to have a panel of experts here to sort of throw some stuff to and let you respond to it. I talked to the Joint Tax Committee about this proposal, and it looks like about 10 million families out of the 37 million families in the United States would receive no benefit whatsoever from this proposal.

It is—and they are the people at the bottom. They are the people at $15,000 in income and below. I asked the proponents in the staff

before if they thought that was good policy that those people didn't have a problem. But it seems to me that in a zero sum game that we are talking about here, and you are obviously talking about a zero sum game, we are not going to increase the deficit. So we are going to find someplace to get this money to make this tax credit.

Does it make the most sense to hand back to people who earn above $15,000 the money when most of the people at the bottom don't have health care which produces a cost shift in the health care system? Wouldn't it make more sense to use this money, as at least one of you suggested, requiring people to buy health insurance with the money that they received?

I would like to hear all of you respond to it, because I would like to get your ideas about the social safety net we are talking about here—we are trying to help families.

Mr. ZELENAK. I would like to respond, not so much on the health care issue, but on the question of people making below $15,000 a year who won't get a benefit from a nonrefundable credit. In my written testimony, I make reference to the fact that the earned income tax credit, which does help people making below $15,000 a year, makes no adjustment for family size beyond the second child. I think that is very inappropriate and it is a somewhat separable issue from this.

But I hope, if not in connection with the Contract With America, that Congress very soon will look at that issue. If family size adjustments beyond two children are appropriate for middle-class wage earners, as I think they are, they are also appropriate for beyond the second child for low-income wage earners. I strongly would support a change in the earned income tax credit to that effect.

Mr. MCDERMOTT. Just as an aside, I think those decisions were made because of money. The last time we only could find so much money and that is how much—if we went to three or four, I mean, family size adjustments, it would have cost a whole lot more money and I think that is why it is done.

Mr. ZELENAK. It also may be a quirk of the way the distributional tables work—that they don't properly reflect the differences in family size.

Mr. MCDERMOTT. Somebody suggested that they thought it would—I think it was the first speaker, that it would make sense to require this money to be spent for health care benefits.

Mr. STEUERLE. Again, I realize that this is a difficult area. This area, including the refundability issue, raises a lot of administrative issues that there is just not time to get into detail.

In the health care arena, yes, I think we ought to start thinking about ways to require at least middle and upper income individuals, if they are going to get something like a child credit, to buy health insurance for their families. Again, this doesn't solve the problem at the bottom.

But there is a portion of those without health insurance who have the incomes—they are capable of buying health insurance. Other people at lesser or equal income levels buy it, but then this one group doesn't. So, yes, I would consider some requirement.

With respect to the fundability issue, which is the main issue with the 10 million people you mentioned, in theory I believe the

credit like this ought to be refundable. But having said that, I would want to think about what we do with our welfare system, what we do with the earned income credit, and how all of these integrate together.

I am not sure, for instance, that we can just say we can make it refundable and tell the IRS that they have to send out checks, because I am not sure the IRS is ready to administer that type of system. One thing we might think about, for instance, is how we are going to go toward making block grants to States. One criteria might be to make an adjustment that some amount of credit be available to those families who aren't on welfare and who do not get the tax credit also.

As I said, there is a lot of complexity in trying to integrate this credit with other welfare and health issues. I am sorry if I have done inadequate justice to it in this short time.

Mr. CRANE. The time of the gentleman has expired. Mr. Ensign.

Mr. ENSIGN. Pass, Mr. Chairman.

Mr. CRANE. Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman. Dr. Burtless, your major concern is that we should not increase the deficit and that you have some fears that this tax cut might do that. The majority party has indicated forget about the increase in the deficit, that they are going to provide up front the savings as relates to spending cuts before we even get to the question of deficit.

So for purposes of our discussion, we can assume that they still have that as their goal. The first question, it would seem to me, is before they find out how much money they have to spend, they have to find out how much this tax cut and the other capital gains tax cut will cost.

There is a lot of discussion about static scoring and dynamic scoring. This dynamic scoring by some people is considered cooking the books. I know it is an extreme. But do any of you support what they mean when they say dynamic scoring so that we can first find out how much this thing is going to cost? Do all of you support whatever they are talking about?

Mr. BURTLESS. Well, in my testimony, I tried to indicate what I thought the incentive effects arising out of this would be. I don't have the capacity of the Congressional Budget Office or the Treasury to do any simulations.

Mr. RANGEL. But you talk with your colleagues and this is—what they are doing is speculating on how much revenue is actually going to be raised in the long run as a result of the capital gains tax cut. I mean, I can understand what they are saying because I kind of go along with you, invest in young people in education, in the long run, you are going to raise a lot of revenues. I can't score that way, however. It is a tax hit. It is increasing the deficit if I did it. But I mean, can any of you have enough imagination to say that this concept makes any sense at all, I mean, without defending it?

Mr. ZELENAK. I think it depends somewhat on what kind of tax proposal you are talking about. I don't think even the stronger adherents of dynamic revenue scoring think that there is a great deal of dynamic revenue scoring involved in the child tax proposal, at least not until 20 years when people are making more money now

because more was spent on them when they were children. I would not support a strong dynamic revenue scoring approach to this child tax credit, but I don't think it is being taken as far as I am aware of.

Mr. RANGEL. OK. Now, that is my opinion. Having said that, then we have to go back to the old-fashioned, acceptable scoring method. Now comes a middle-income tax cut. Believe me, I am for earned income tax credit. I am for cuts for the middle class, for the rich. That is not a problem.

The problem that I am going to face is what cuts are going to be necessary under regular, accepted scoring methods in order for the Congress to do what we love to do, and that is reduce constituent taxes? It bothers me that people can talk about the merits of the tax cut and not even suggest that if indeed the cutting in spending are cuts that will cripple the services that are rendered to the poor. They say that Social Security is off the table, and it should be. Military is off the table, and I guess the Republicans know something about a Communist threat, so I assume it should be off the table.

But they say that if you accept all of these things, that you are going to have to cut the remaining programs some 38 to 40 percent across the board. Now, how can we even talk about the merits of a middle-income tax cut without all of you professors and doctors and economists asking what are you going to cut before I can even comment on what is best for the Nation?

Mr. CRANE. The time of the gentleman has expired.

Mr. RANGEL. Can I get one response? Just one response.

Mr. CRANE. Time for one response.

Mr. ZELENAK. As I said before, my preference would be to make the Tax Code more family favorable in a revenue neutral way, and that is not this proposal.

Mr. FORD. I spoke to the Americorp Group over the weekend. It is part of a national service program that was implemented under the Clinton administration. Some of the volunteers who were present that particular night raised some of the questions that have been raised for members today to this panel.

It relates to a tax cut versus programs similar to the national service programs, or things that Mr. Rangel has been talking about. This Contract With America is all about a constitutional amendment to balance the budget by the year 2002. We are talking about families who—naturally those with children would love this type of tax relief. I am included in that group.

But at the same time, are we—are we in a position to really talk about this type of tax relief when we know so many other programs that are reaching out to the human needs of the people of this country and trying to touch the neglected children, the abused children, and those who live way below the poverty thresholds in this country?

Mr. BURTLESS. Well, I think the burden of my testimony is that unless you understand that this tax reduction is going to involve even greater spending reductions than would otherwise be necessary to achieve whatever long-term budget goal you have—and as I understand the goal of many Members, it is a balanced budget—

then you shouldn't proceed with it unless you are really willing to make the spending reductions that are involved.

I agree with you. I don't think that in fact most of the population or most Members of Congress are really willing to make the spending reductions that would already be required, let alone the additional ones needed to offset this credit.

Mr. FORD. If we don't make those cuts, according to your written testimony, you have indicated that we are going to pass that debt problem to our children and grandchildren. It is obviously clear that is what would happen if we passed this tax cut that is before this Congress with the Republicans' Contract With America is that we are going to shift that financial responsibility to the next generation and the generation following.

Mr. STEUERLE. All of us have testified that we would—we believe that a child credit is appropriate. Even Dr. Burtless says, given everything else, he thinks that it would be nicer to make the Tax Code a little more friendly toward households with children if we would do a lot of other things at the same time.

The difficulty here is deciding what is the total size of the pie and how to slice the pie. I happen to think that we can discuss the issue of how to slice the pie at the same time we discuss its total size. For instance, suppose we were looking at the expenditure budget and we discovered that educational expenditures were going predominantly to men and were not going to women. Someone came before the expenditure committee and said, "I think that is an unfair slicing of the pie and that we ought to make sure that a fair proportion of the pie also goes to women." I think most of us would accept that as a reasonable argument to make and would not necessarily say, "Well, we can't do it. We can't create this more equitable system because it is going to cost us too much." I think that has been what the testimony here has enhanced. We believe that the tax system does not make adequate adjustment for households of larger sizes, that have children and have substantial burdens. We ought to reslice the pie. That is an appropriate issue to raise, even while we recognize that the question of whether the deficit is going up is something that cannot be ignored.

Mr. FORD. Right. If I am in that income bracket and I had children, I would get a tax credit. But if the welfare mother has an additional child, the proposal under the Contract With America is talking about capping and cutting the funds off for an additional child. But under this particular proposal, a tax credit is in order if a couple would have a child and work within the work force and earn $50,000 a year, then that person is entitled to an additional tax credit. But if the welfare mother would have another child under the same proposal under this Contract With America, then they would be denied any benefits. I am saying on one hand we are giving a tax cut for the working middle class and for the poor and the downtrodden of this country, we are removing their welfare funds and capping their family size.

Mr. CRANE. The time of the gentleman has expired.

Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman. I think the institutional memory here is really shaky. For 40 years now, the other side of this committee has controlled the tax policy in this Con-

gress, and we have built the deficits on the tax policy that was created by the now minority party, and so we have an institutional memory lapse here in trying to come to grips with who should spend their money.

Remember, as you all know as well as I do, the Federal Government has no money. It only has what it takes from the wonderful people in this country to provide some type of services to those people—namely, the services that they can't provide for themselves. We seem to have a lapse in memory in coming to grips with the decision of the American people last November to balance our Federal budget and set those priorities that are necessary to do that. I don't think you will find that the majority Members now are afraid to face up to the reality of the cuts that are necessary to get to a balanced budget by the year 2002.

Now, you have made many suggestions in your testimony. You didn't think there was enough will to do it or you didn't think there were enough people that realized what it would take to get there. I think you are wrong. I think exactly the opposite has occurred. I think the November 8 elections sent a clear message that what we must do is return more dollars to the people of this country to allow them to spend their own money and have the Federal Government do less. So I think the message we got on November 8 was very clear. Now, if—are you here to dispute that message or am I misunderstanding your testimony?

Mr. BURTLESS. Well, I hope you are right, Representative Bunning. My impression is that in the past, there have been firm promises from the Hill of a balanced budget, including, I can remember, back in the early eighties. Yet it has not occurred. I hope that perhaps I am wrong this time around in my forecast.

I also think that a lot of the spending that looks as though someone in Washington controls the pocketbooks of American citizens in fact has a different reality. The programs are doing very much what American citizens want. They want to receive Social Security benefits, and no bureaucrat tells them how to spend those benefits. They would like to collect Medicare benefits, and no one tells them what doctor to see or what hospital to go to. So I think a lot of the spending does not represent interference of people here in Washington as much as it reflects really what Americans would like to see their money spent upon.

Mr. BUNNING. Then you are disagreeing with the message I got last November 8. You disagree that the fact of the matter is that the new majority of Republicans were sent to Washington to reconsider the amount of taxes we are taking from people and the priority list that we have as far as expenditures?

Mr. BURTLESS. I think that is right. But the question is, is there enough in the Federal budget that we can identify what the public really does want to see reduced that would permit this tax reduction, the child care tax credit, to occur without adding to the debt that we hand down?

Mr. BUNNING. I believe that we have to cut the spending first before we do it, and I think that is the opinion of the majority of the people that sit on this committee. There is no question that we have to cut out the spending to allow the tax reduction to occur. The same goes with all other tax reductions that we are looking at

in the Contract With America. Now, that message came through clear to me. Does anybody else disagree on the panel?

Mr. STEUERLE. No, Mr. Bunning. If I can push aside some veils on the expenditure side, I think the major issue that faces the Congress over the intermediate term is going to be with one of the issues that your subcommittee deals with, which is health care. I have generated some numbers that show if we look at real spending on health and we add together Federal, State, and local expenditures and tax subsidies, we are scheduled to increase something like $150 to 200 billion annually our expenditures on health in just 5–6 years. So we have this enormous built-in growth rate in certain expenditure programs, and as Representative Kasich says, it is getting these types of growth rates under control that is going to allow us the freedom to do other things, such as providing a child credit, which, by the way, is relatively small in size compared to those real health cost increases.

Mr. BUNNING. Thank you, Mr. Chairman.

Mr. CRANE [presiding]. Thank you.

I want to thank the panel for their testimony today.

I would like now to call to the next panel, Anne Alstott, Alan Reynolds, and Marjorie O'Connell, please.

Following our general practice, it is always ladies first, so Ms. Alstott, you may proceed.

STATEMENT OF ANNE L. ALSTOTT, ASSOCIATE PROFESSOR OF LAW, COLUMBIA UNIVERSITY SCHOOL OF LAW

Ms. ALSTOTT. Thank you, Mr. Crane.

Mr. Chairman and members of the committee, my name is Anne Alstott and I am a member of the law faculty at Columbia University. Thank you for the invitation to discuss possible legal rules for alleviating the Federal income tax marriage penalty. I have submitted written testimony for the record and will summarize it very briefly here.

I would like to make four points: First, both the income tax and the earned income tax credit, or EITC, create marriage penalties. In both cases, the marriage penalty is distributionally arbitrary. It imposes a greater tax burden on certain married couples than on unmarried people in similar situations. In addition, empirical evidence suggests that the marginal tax rates applied to married couples by the income tax and by the EITC may create significant work disincentives for married women.

Second, although the marriage penalty is undesirable, it is not easily eradicated. Completely eliminating the marriage penalty, in either the income tax or the EITC, would require significant and costly changes in the Federal income tax system, which could compromise other important policy goals.

For example, in the past, some policymakers and scholars have advocated a system of individual filing, in which each person's tax liability would be determined without regard to marital status. While this kind of tax system would by definition eliminate the marriage penalty, it could undermine the accuracy of the income tax and the EITC and would raise serious administrative issues.

Third, in light of these tradeoffs and the limited revenue available for marriage penalty reform, I believe it is appropriate to ad-

dress the marriage penalty through incremental rather than sweeping change. This is one of the most difficult areas of the Federal income tax to reform.

Theoretical purity is difficult and expensive to achieve and, in my view, is not necessarily desirable. Tax policy toward married couples is inevitably an uneasy compromise, as history demonstrates.

Finally, I recommend that the committee give serious consideration to a tax deduction for two-earner couples similar to the deduction allowed under prior law. Ideally, the deduction should be structured to extend relief to recipients of the EITC as well as to income-tax payers. Extending relief to the EITC population is appropriate because the distributional incentives and concerns that motivate marriage penalty relief apply with equal force to EITC recipients.

My written testimony describes some conceptual and technical issues which arise in coordinating the two-earner deduction with the EITC. Although the two-earner deduction would reduce rather than eliminate the marriage penalty, it is an incremental policy that can be structured to fit within the budget constraints that the committee determines are appropriate.

The principal disadvantage of the two-earner deduction is that it is not precisely targeted. The deduction in its simplest form may offset all the marriage penalty for some couples, a portion of the marriage penalty for others, and even increase the marriage bonus for still others. Truly precise targeting is difficult to achieve without significant administrative cost, however.

In my written testimony, I have described for your consideration an intermediate solution which would help target the deduction to couples facing marriage penalties, with the cost of a slight increase in administrative complexity. My written testimony also describes other alternatives that the committee may wish to consider.

For example, it would be possible to use a tax credit rather than a deduction for two-earner couples. It would also be possible to target the two-earner deduction with a credit to particular income groups, for example, to EITC recipients. Final conclusions must await empirical analysis, but I hope that these suggestions are helpful to you.

Thank you.

[The prepared statement and attachment follow:]

STATEMENT OF ANNE L. ALSTOTT
ASSOCIATE PROFESSOR
COLUMBIA UNIVERSITY SCHOOL OF LAW
BEFORE THE
WAYS AND MEANS COMMITTEE

January 17, 1995

Mr. Chairman and Members of the Committee:

I appreciate the invitation to testify before the Committee today. My testimony will focus on the portion of the Contract with America that promises to bring to the House floor legislation to reform the federal income tax marriage penalty. The views I express today are my own and are not necessarily those of Columbia University.

In the past, the marriage penalty created by the federal income tax has been largest for middle-income and upper-income taxpayers. The federal income tax now incorporates a very large earned income tax credit ("EITC"), which can create marriage penalties that are large both in absolute dollar terms and relative to the incomes of low-income taxpayers. Although the policy issues created by the marriage penalty in the income tax are familiar, the marriage penalty created by the EITC is less well understood. In fact, the traditional distributional and incentive concerns that give rise to criticism of the marriage penalty in the income tax apply with equal force to the EITC. The policy analysis accompanying the Contract with America acknowledges that the marriage penalties created by both the income tax and the EITC are subjects of concern.

My testimony makes four main points:

o The marriage penalty created by both the income tax and the EITC is distributionally arbitrary, imposing a greater tax burden on certain married couples than on similarly-situated unmarried people. Empirical evidence suggests that the marginal tax rates applied to married couples by the income tax and the EITC also may create significant work disincentives for married women. The marriage penalty clearly creates a financial disincentive for marriage, but it is not clear whether that disincentive significantly changes people's decisions to marry.

o Although the marriage penalty is undesirable, it is not easily eradicated. Completely eliminating the marriage penalty in either the income tax or the EITC would require significant and costly changes in the federal income tax system, which could compromise other important policy goals. For example, a system of individual filing, which would determine each person's tax liability without regard to marital status, could undermine the accuracy of the income tax and the EITC and would raise significant administrative issues.

o In light of these tradeoffs and the limited revenue available for marriage penalty reform, it is appropriate to address the marriage penalty through incremental rather than sweeping change. I recommend that the Committee give serious consideration to a tax deduction for two-earner couples, similar to the deduction allowed under prior law. Ideally, the deduction should be structured to extend relief to recipients of the EITC, because the concerns that motivate marriage penalty relief apply with equal force to EITC recipients.

o Although the two-earner deduction would reduce, rather than eliminate, the marriage penalty, it is an incremental policy that can be structured to fit within the budget constraints that the Committee determines are appropriate. The two-earner deduction is not precisely targeted; it may offset all the marriage penalty for some couples, a portion of the marriage penalty for others, and even increase the "marriage bonus" for others. Truly precise targeting is difficult to achieve without significant administrative cost, although intermediate solutions, which enhance precision with some increases in administrative complexity, are possible. The Committee may also wish to consider a tax credit for two-earner couples or a two-earner deduction that

is more narrowly targeted to particular income groups.

Final conclusions and comparisons of these alternative policies require empirical analysis of concrete proposals. This analysis is beyond the scope of my testimony but can be performed by your staff. My goal is to outline the advantages and disadvantages of the most promising legal options and the empirical questions that should be addressed in choosing among these options.

Distributional and Incentive Effects of the Marriage Penalty

Two individuals face a "marriage penalty" when their federal income tax liability is greater (or their refund attributable to the EITC is smaller) if they marry than if they remain single. A "marriage bonus" occurs when two individuals pay a smaller federal income tax if they marry than if they remain single. The current federal income tax imposes a marriage penalty on some couples (typically when the two individuals have similar incomes) but awards a marriage bonus in others (typically when the two individuals have disparate incomes). Under current federal income tax law, two-earner couples are more likely to suffer marriage penalties, while single-earner couples are more likely to receive a marriage bonus. Recent research by Harvey Rosen and Daniel Feenberg suggests that in 1994 52% of married couples faced a marriage penalty, while 38% received a marriage bonus.[1]

Policy makers and scholars have long criticized the current federal income tax treatment of married couples for reasons relating both to distribution and to incentives. Critics of the marriage penalty argue that marital status should be irrelevant to determinations of the income tax. They view any distinctions based on marital status as arbitrary and thus would ideally eliminate any marriage penalty or marriage bonus. Further, analysts note, the marriage penalty tends to be largest for two-earner couples with relatively equal earnings. In contrast, many single-earner couples receive a marriage bonus. Thus, the tax law seems to reinforce traditional gender roles within the family.

Critics of the marriage penalty also criticize two potential behavioral effects. One claim is that the marriage penalty discourages marriage. This argument, although intuitively appealing, typically is made without empirical support. Like any economic incentive, a marriage penalty's actual effects on behavior are unknowable in the absence of empirical evidence. People make decisions about whether to marry or not based on a number of social and emotional factors, and it is impossible to predict, without empirical evidence, how a monetary penalty in the form of a higher tax bill may change those decisions.[2]

A second incentive claim is that the marginal tax rate structure facing married couples may also discourage work by second earners, typically married women. The problem arises from the system of joint filing. When a married woman with an employed husband enters the workforce, her very first dollar of earnings is taxed at the marginal tax rate applicable to the couple based on her husband's earnings. In contrast, an unmarried person entering the work force faces a marginal tax rate determined by her own earnings alone. Thus, a married woman may face a higher marginal tax rate on earnings than a single woman, and the higher rate may discourage work. Once again, however, the actual effects of the incentive on behavior require empirical evidence. Available studies suggest, however, that this work disincentive may have a relatively large effect on married women's labor supply. Critics argue that this aspect of the taxation of married couples also tends to reinforce traditional gender roles by encouraging married women not to work at all or to work fewer hours.

---

[1] Daniel R. Feenberg and Harvey S. Rosen, *Recent Developments in the Marriage Tax*, NBER Working Paper No. 4705 (April 1994).

[2] Harvey Rosen and Daniel Feenberg point out that the marriage penalty may also encourage married couples to misreport their status as single. Rosen and Feenberg, *supra* note 1.

Extending the Critique of the Marriage Penalty to the EITC

Historically, the federal income tax marriage penalty has been relatively small for low-income families, because the federal income tax exempts those with very low incomes. In 1995, for example, the federal income tax threshold for a married couple with two children is $16,550. The EITC, however, can create a large marriage penalty for some low-income workers. For example, consider two individuals, each with two children and earnings of $10,000. In 1996, each individual would be entitled to the maximum EITC of $3,560, for a combined EITC of $7,120. If these individuals marry, however, they would be entitled to a joint EITC of only $1795, which represents a marriage penalty of $5,325, or 27% of income. This example is probably somewhat extreme, but it illustrates the potentially large marriage penalties the EITC creates.

The EITC, like the income tax, may also award a marriage bonus in some circumstances. *See* Example 1 in the Appendix to this testimony. Actual marriage penalties and bonuses for EITC recipients depend on the pattern of earnings and number of children of EITC recipients.

The EITC's marriage penalty and marginal tax rate structure are open to the same criticisms levelled at the income tax. The EITC, like the income tax, arbitrarily penalizes marriage, which is particularly incongruous when other public policies, including welfare policy, increasingly seek to encourage marriage. While the EITC's marriage penalty is distributionally arbitrary, once again it is not known whether the penalty actually affects low-income workers' decisions about marriage. I know of no empirical evidence on the effects of the EITC marriage penalty, but evidence from the welfare context suggests that even seemingly large financial incentives do not automatically translate into behavior.

The EITC may also impose relatively high marginal tax rates on secondary workers. For example, in 1996, a single mother with two children who is considering going to work actually faces a negative 40% marginal tax rate (or earnings subsidy) on wages up to $11,620 thanks to the EITC (and ignoring any phaseout of welfare benefits to which she may be entitled). If that woman marries, however, her husband's earnings may push the couple into the EITC phaseout range (or may be high enough to preclude EITC eligibility altogether), thus reducing the net gain from her work.[3]

Policy Tradeoffs that Constrain Reform in the Income Tax and the EITC

Given these problems, why do we tolerate the marriage penalty? Virtually no one is affirmatively in favor of the marriage penalty, and yet it has been a consistent feature of the federal income tax since 1969. The well-known answer is that the marriage penalty is an unavoidable product of other policy choices incorporated in our federal income tax system. As Boris Bittker has elegantly demonstrated, an income tax system cannot simultaneously have progressive marginal tax rates, equal taxation of married couples with equal incomes, and marriage neutrality. In opting for the first two, we have chosen to sacrifice the third. *See* Example 2 in the Appendix. The corollary is that marriage neutrality is difficult to achieve. Complete marriage neutrality would require either flat marginal tax rates or a system of income taxation in which each individual pays taxes on his or her income alone, without regard to marital status.

Both of these changes would require drastic alterations in the federal income tax. Adoption of flat marginal tax rates clearly could have significant distributional and efficiency implications and is presumably beyond the scope of the Committee's immediate agenda. A system of individual filing may appear to be an easier change, but it is objectionable on grounds of both equity and administration. Such a system would impose the same tax on

---

[3] *See* Stacy Dickert, Scott Houser, and John Karl Scholz, *The Earned Income Tax Credit and Transfer Programs: A Study of Labor Market and Program Participation*, paper prepared for the November 1994 NBER conference on Tax Policy and the Economy (November 10, 1994) (predicting that the EITC may lead secondary workers to reduce hours of work).

(or award the same EITC benefit to) an individual earning $15,000 per year, whether that individual is the sole source of support for a large family or is married to someone who earns $100,000 per year. It would also assess a higher tax on a family in which two workers earn $10,000 and $40,000, respectively, than on a family in which two workers each earn $25,000. The basic point is that the adoption of individual filing would change the distribution of tax liabilities, perhaps significantly, in ways that are arbitrary, because they are based on a faulty measurement of income. The current income tax, of course, does not measure income perfectly; for example, it does not require aggregation of income of unmarried persons who pool their income. Individual filing would, however, further decrease the accuracy of the income measure. Individual filing also raises serious administrative issues, principally questions of allocating joint deductions and unearned income between spouses.

The EITC marriage penalty also is difficult to eliminate. The EITC marriage penalty arises in part because the EITC provides the same dollar benefits to a single individual as to a married couple with the same earnings, adjusted gross income, and number of children. The result is that marriage can reduce or eliminate the EITC, if the couple's combined income is in or above the EITC phaseout range. This marriage penalty could be reduced by restructuring the credit to provide lower benefits to single individuals than to married couples. Such a revision would, however, conflict with other policies that the EITC serves by reducing the potential work incentive and income support benefit of the EITC for single workers. The 1993 increase in the EITC, which received strong bipartisan support, was intended to "make work pay". Cutting EITC benefits for single workers, and particularly single parents, a group which is disproportionately poor, would reduce their well-being, both in absolute terms and relative to married-couple families. Reducing EITC benefits for single parents could also undermine the EITC's work incentives; a recent study indicates that the EITC's greatest success in increasing labor force participation is for single parents.[4]

Further, even amending the EITC to provide benefits to married couples that are twice as large as those awarded to single parents would not eliminate the EITC marriage penalty completely. This remaining marriage penalty is inherent in the EITC and in many other income-tested transfer programs because of the structure of the marginal tax rates that arise from the phaseout of the credit. *See* Example 3 in the Appendix. As I have noted elsewhere, the EITC faces a fundamental tradeoff that is entirely parallel to the tradeoff Bittker demonstrated for the income tax: it cannot simultaneously have high phaseout rates, equal benefits for families with equal incomes, and marriage neutrality.[5] Eliminating the EITC marriage penalty entirely would require adopting either flat marginal tax rates or a system of individual rather than joint filing, which have the disadvantages noted above.

Thus, the marriage penalties created by the income tax and by the EITC both reflect difficult tradeoffs among competing policy goals. Purity is extremely difficult to achieve and is not necessarily desirable. Tax policy toward married couples is inevitably an uneasy compromise, as history demonstrates, and policy makers may reach different conclusions after weighing the competing advantages and disadvantages of alternative policies. My own judgment is that it is reasonable to take incremental measures to reduce the distributional arbitrariness and work disincentives of the marriage penalty, but that these distributional and incentive problems do not warrant drastic or costly actions, such as adoption of individual filing or reductions in EITC benefits for single parents.

Further, the draft legislation accompanying the Contract with America contemplates marriage penalty relief that does not cost more than $2 billion per year. Given this revenue constraint, any relief must by definition be incremental. In contrast, the repeal of the two-earner deduction in 1986 was estimated to raise about $6 billion per year. The comparison is a rough one, but it does suggest that the Contract contemplates modest rather than

---

[4] Dickert, Houser, and Scholz, *supra* note 3.

[5] *See* Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533, 559-64 (1995).

sweeping changes.

Accordingly, I recommend that the Committee give serious consideration to implementing the relevant provision of the Contract with America through a tax deduction or credit for two-earner couples, as described in the next section.

Alleviating the Marriage Penalty Through a Two-Earner Deduction or Credit

Between 1981 and 1986, the federal income tax permitted married couples filing jointly to deduct 10% of the earnings of the lower-earning spouse up to $30,000 per year, for a maximum deduction of $3,000. The Tax Reform Act of 1986 repealed the two-earner deduction.

The EITC is now substantially larger than it was in the early 1980s. It would be appropriate to modify the two-earner deduction so that it provides relief not only for the income tax marriage penalty but also for the EITC marriage penalty. As the preceding section notes, the distributional and incentive effects that fuel concern about marriage penalties in the income tax also apply to the EITC. Ideally, then, any solution will provide relief from marriage penalties in both the income tax and the EITC. The practical importance of extending relief to the EITC population may, however, depend on data which I do not have, in particular the prevalence and magnitude of actual marriage penalties among EITC taxpayers and how effective the two-earner deduction would be in alleviating the penalty. These are empirical questions and depend on the patterns of earnings of EITC recipients.

Technically, the two-earner deduction could be made available to EITC recipients by making the two-earner deduction an "above the line" deduction, as under prior law. An above the line deduction is taken into account in determining AGI, which governs phaseout of the EITC (unless "earned income" is greater). Whether the deduction should be taken into account in determining earned income is a more difficult issue. EITC recipients in the EITC phaseout range would benefit from a deduction that reduces earned income; indeed, many of them might not benefit from the reduction in AGI unless earned income were also reduced (because phaseout would be based on the higher earned income). However, reducing earned income would actually leave EITC recipients in the phase*in* range worse off by reducing the EITC. The matter could be left to the election of the taxpayer, but any election potentially increases complexity. In resolving this issue, it would be helpful to know how many two-earner married couples are in the EITC phasein range.

The two-earner deduction thus represents an incremental change that would reduce rather than eliminate the marriage penalty and would reduce work disincentives for secondary workers. It can be structured so that its revenue cost is modest. The percentage of the second earner's earnings that should be deductible, and the cap on eligible earnings, if any, should largely be structured to meet revenue constraints. A larger percentage exclusion, with a smaller earnings cap, would tend to benefit lower-income families. My testimony does not address how much revenue ought to be devoted to marriage penalty relief or how that revenue ought to be made up elsewhere in the budget.

The principal disadvantage of the two-earner deduction is that it is not precisely targeted. All two-earner couples are eligible for the deduction, but not all such couples face a marriage penalty; some face a marriage bonus. The size of the marriage penalty depends on the individuals' relative earnings and their tax bracket (and, for EITC recipients, the range of the EITC in which their earnings fall). Thus, while the two-earner deduction reduces marriage penalties for some two-earner couples, it may create or increase a marriage bonus for others. The degree of mistargeting is another empirical question: the Committee's staff may be able to provide further information on the degree of mistargeting under alternative versions of the two-earner deduction. It may be that particular combinations of percentage exclusions and earnings caps are better targeted than others, given the distribution of earnings among the population.

Some mistargeting of benefits occurred under prior law and is inevitable with any deduction that applies to all two-earner couples. The only way to target the deduction with complete precision would be to require couples to calculate their marriage penalty and then provide a deduction tailored to that penalty (*e.g.*, some percentage of the penalty). This sort of rule would create considerable administrative complexity, however. It would require taxpayers (and the IRS) to make three *pro forma* calculations (of the couple's tentative joint tax liability and each individual's separate tax liability) before calculating the marriage-penalty deduction and then calculating final tax liability. Further, the *pro forma* calculation of individual tax liabilities raises the administrative issues relating to the allocation of joint income and deductions that would arise in a system of separate filing.

An alternative that may be worth exploring is to target marriage-penalty relief to two-earner couples who are likely to face the largest marriage penalties (*e.g.*, to couples in which the two workers have relatively equal earnings). One solution that was discussed in 1980 but not incorporated into prior law was to create tables that would indicate the allowable deduction based on the relative earnings of the husband and wife. Such tables might be more precise than a simple two-earner deduction but less precise than individual calculations of actual marriage penalties. These tables would, however, avoid the need for numerous *pro forma* calculations by each couple. In general, it should be relatively easy to determine the separate earnings of two-earner married couples. Tables based solely on earnings would simply omit unearned income from the marriage-penalty computation, avoiding the worst administrative problems of separate filing.

Another possible disadvantage of the two-earner deduction is that it increases the complexity of the Code by creating another specialized deduction. This concern may be somewhat greater for the EITC, because of the modification of the "earned income" definition described above. For both the regular income tax and the EITC, however, the additional complexity appears modest, although the Internal Revenue Service could provide more information on exactly how the additional deduction would be reflected on the tax return and Schedule EIC. Concern about complexity would be greater if tables, like those described in the preceding paragraph, are used to improve targeting.

The prior-law two-earner deduction was sometimes justified on the ground that it helped redress the tax code's failure to allow a full deduction for the costs of working -- a failure that hurts two-earner couples more than single-earner couples. While the marriage penalty is conceptually distinct from the treatment of costs of working, the two-earner deduction in effect links the two problems by limiting marriage penalty relief to those couples who also face inadequate relief for costs of working. The two-earner deduction clearly is not a comprehensive solution to this problem, which affects every worker, regardless of marital status. Nevertheless, the disadvantage suffered by two-earner couples relative to one-earner couples does provide some justification for targeting marriage penalty relief to the former group (and for providing no relief for marriage penalties suffered by single-earner families due to unearned income). In addition, if secondary workers incur particularly large costs of working or are particularly sensitive to the potential work disincentives created by the lack of deductions for costs of working, targeting relief in this way may be sensible.[6]

Given the limited revenue available for marriage penalty relief, additional targeting of relief to certain groups of taxpayers may be appropriate. It would be possible, for example, to allow the two-earner deduction only for purposes of calculating the EITC, and not for regular income tax purposes (or to allow a larger deduction for EITC purposes). Targeting relief to EITC recipients is intuitively appealing, because this group faces such potentially large marriage penalties relative to their low incomes and is the object of other social policies designed to encourage marriage. However, any final judgment on whether such targeting is appropriate turns, once again, on how prevalent marriage penalties are among EITC recipients, and how effective the proposed deduction would be in alleviating

---

[6] *See* Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 U.C.L.A. L. REV. 983, 1009 (1993).

these marriage penalties.

An alternative would be to award a tax credit, rather than a deduction, to two-earner couples. The value of a two-earner deduction increases with the marginal tax rate. In contrast, a refundable tax credit would provide the same tax benefit to all eligible couples. A *nonrefundable* credit would provide the same tax benefit to all eligible couples, except those with insufficient tax liability to offset the credit. While a tax credit is often preferable to a deduction for precisely this reason, in this context a deduction may be the better choice, because marriage penalties tend to rise with marginal tax rates (which are highest for some EITC recipients and high-income couples). On the other hand, the marriage bonuses awarded to some two-earner couples also rise with marginal tax rates, and so a two-earner deduction tends to increase those bonuses. Thus, the question of targeting is, once again, an empirical one. While my intuition is that a deduction is probably a better-tailored remedy, any firm conclusion should be based on empirical simulations of the two alternatives, taking into account the distribution of incomes and marriage penalties and bonuses.

If a credit is the preferred solution, further thought should be given to coordinating it with the EITC. A refundable credit would provide relief to EITC recipients who face a marriage penalty but do not have any income tax liability. Consideration should be given to integrating the new credit as simply as possible with the EITC application procedure. A nonrefundable credit would provide less relief to the EITC population and, at a minimum, should be drafted so that income tax liability first offsets the new, nonrefundable credit before being offset by the EITC.

I hope my testimony is helpful to the Committee in its deliberations. I would, of course, be happy to continue to work with your staff on any legal issues that arise as they examine these or other options.

Appendix to Statement of Anne L. Alstott, January 17, 1995

All examples assume that earnings are the only source of income, that all children are "qualifying children" under the EITC and dependents under the income tax, and that taxpayers take the standard deduction. EITC parameters are for 1996, as estimated by the Ways and Means Committee's 1994 Green Book. Income tax parameters, including rates, standard deductions, and personal exemptions, are for 1995.

Example 1. EITC Marriage Bonuses. If a childless worker earning $10,000 per year marries a non-worker with two children, the couple's total EITC, net of federal income tax, actually rises from $0 to $3560. If two workers, each with one child and earning $5,000 per year marry, their total EITC rises from $3,400 to $3,560.

Example 2. The Impossibility of Simultaneously Having Progressive Marginal Tax Rates, Equal Taxation of Married Couples, and Marriage Neutrality. Consider a simple income tax that imposes tax at a rate of 10% on income less than or equal to $10,000 and at a rate of 25% on income above $10,000. Consider four single individuals:

Name	Income	Tax (single)
A	$10,000	$1,000
B	$10,000	$1,000
C	$ 4,000	$ 400
D	$16,000	$2,500

If A and B marry and C and D marry, an income tax that preserves marriage neutrality would leave unchanged the aggregate taxes (positive or negative) paid by each couple. That system, however, would treat the two equal-income couples very differently. The A/B couple would pay tax of $2,000, while the C/D couple would pay tax of $2,900. Adjusting the rate schedule so that both couples pay the same tax would necessarily impose a marriage bonus or penalty on one or both couples. This example is found in Boris I.

Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1395-96.

Example 3. An EITC Marriage Penalty Remains Even If Benefits for Married Couples are Twice As Large As Those For Single Workers. Suppose, for example, that the EITC benefit for a married couple with two children remains $3,560, but that the benefit for a single parent with two children is half that amount, or $1,780, and that result is achieved by applying the EITC parameters (40% phasein rate, 21.06% phaseout rate) to thresholds that are half those for married couples (phasein ends at $4,450 instead of $8,900; phaseout begins at $5,810 instead of $11,620; phaseout ends at $14,262 instead of $28,524). Consider two single parents, each with two children and earnings of $10,000. If they remain single, each is entitled to an EITC of $898, for a total EITC of $1,796. If they marry, they will be entitled to a total EITC of $1,796. This couple thus faces no EITC marriage penalty. If, however, one of the single parents earns $10,000 and the other earns $20,000, they face an EITC marriage penalty: a total EITC of $898 if single but $0 if married.

Mr. CRANE. Thank you very much, Ms. Alstott.

Let me reassure all of you that your entire written testimony will be put into the record.

Ms. O'Connell.

STATEMENT OF MARJORIE A. O'CONNELL, ATTORNEY, O'CONNELL & ASSOCIATES, WASHINGTON, D.C.

Ms. O'CONNELL. Thank you, Mr. Crane.

Gentlemen of the Ways and Means Committee panel, thank you for the opportunity to talk to you this afternoon about the marriage penalty credit in the American Dream Restoration Act.

I come to you I hope as a little bit of a refreshing exception from all of the economists and Ph.D.s. I am a practitioner. I am a tax attorney who for almost 25 years has specialized in the practical problems faced by families trying to file accurate Federal tax returns.

With respect to the marriage penalty tax and its repeal, something which I also advocate, I understand that this legislation only goes partway, but it is an important partway to begin. I have made some assumptions in my written testimony about how the marriage penalty repeal or alleviation as a credit would operate, and it is the practical aspects of the operation of that credit that I would like to elaborate a bit upon today.

First of all, for the naysayers that tell us it would all be too difficult to figure out, I would have to say baloney. We figure out some terribly difficult things administratively in this tax system. When it comes to this part of the population who typically comes before you without its PAC (Political Action Committee), things get awfully costly and awfully difficult, and sometimes they don't happen. I urge you to ensure that this does happen. It is not too difficult for our Treasury Department to figure out how to allocate among married couples the amount of a flat dollar credit and to announce that credit as they distribute the 1040s during the year.

We always adjust for past years' estimates that deserve some adjustment when they trickle down through the economy. When you use a flat dollar credit, if you stop and think about the arithmetic, you will know that you are more advantaging, as a ratio of taxes paid, lower income families.

To the extent that is the policy you seek to enforce, you should stick with a flat dollar credit. But it would be just as easy for the Treasury Department to figure out that in a world where they know they collected some $10 billion of marriage penalty taxes and they only want to give back $2 billion of those taxes to married people, there should be a credit which is 20 percent of the tax that couples would calculate is their marriage penalty. That is a little easier, it is not a flat dollar amount, and it gets us to the same place. It also spreads the benefit differently among the populice. So I leave to you the policy decision of advantaging more lower income married couples or spreading that benefit.

You have to consider, too, as you think of the other rate changes that you may institute this year as you change phaseouts of other kinds of benefits for deductions, the extent to which you are changing the impact of the marriage penalty in the populice. Your staffs, I am sure, can give you a chart that tells you easily where that is.

Those decisions may help you determine whether you still want to skew a flat dollar penalty to lower income couples or rather spread the percentage penalty credit relief among the populice.

When it comes to calculating the amount of income that individuals will need, which one party or the other has to figure out what they would pay had they not been married, when they calculate their taxes, they are going to have to decide whether to itemize deductions, each of them, or whether to use a standard deduction. They ought each be able to be itemizing. They are going to have to allocate deductions between them. That is not hard stuff. They do that for lots of purposes now.

They ought to be able to freely allocate. They are going to have to deal with phaseouts, should that be their joint return number or an individual number. It should be an individual number. They understand what their individual income is. They figure that out for a lot of State law purposes and other kinds of marital property purposes.

They are going to have to look at their unearned income as well as earned income. Don't be led to believe that when you open the door for unearned income, hundreds of thousands of wealthy taxpayers will march through and skew their family wealth. First, they won't, because it is not enough of an incentive.

Second, if it were a great incentive, the way you have designed the credit, it is going to cut in either with a flat dollar or percentage that is going to keep that abuse from being meaningful.

So I applaud the work that you do for the marriage penalty credit. I urge you as you give people the opportunity to attribute to each their actual earned income, you think about giving them an opportunity each to be personally responsible for their liabilities to the government as opposed to picking up each other's on that joint return.

Thank you.

[The prepared statement follows:]

TESTIMONY
OF
MARJORIE A. O'CONNELL, ESQ.
O'CONNELL & ASSOCIATES, P.C.
Washington, D.C.

Before the
U.S. House of Representatives
Committee on Ways and Means

January 17, 1995

CONTRACT WITH AMERICA

The American Dream Restoration Act

"Credit to Reduce the Marriage Penalty"

The amount of additional tax which a husband and wife each having income pay on such income because of marital status, the so-called "marriage penalty", depends upon the amount of the aggregate income of the husband and wife and the ratio of their incomes, one to the other. The marriage penalty is caused by the relationship between the rate schedules for married individuals filing jointly or separately and the rate schedule for an unmarried individual. This relationship, established by the Tax Reform Act of 1969, was specifically designed to alleviate the disparity between taxes paid on equal income by married individuals and an unmarried individual. The relationship assures that an unmarried individual does not pay a tax more than 20 percent greater than the tax paid by married individuals with taxable income equal to the unmarried individual's taxable income.

Congress realized that, in alleviating the disparity between tax rates for married individuals and an unmarried individual, it would cause married individuals each of whom had income to pay more tax on their aggregate income than they would on their separate incomes if they were not married. However, Congress justified this result on the grounds that married individuals expenses were likely to be less than two unmarried individuals expenses. Congress concluded that since married individuals had a greater ability to pay taxes than unmarried individuals, it would impose higher tax rates on the income of married individuals than on the income of an unmarried individual.

Family demographics changed radically in the years following the institution of the marriage penalty tax. In the intervening generation the old laments about "traditional family" were turned on their heads. Those creaking with paranoia about tax evasion's arrival with marriage penalty relief found no political refuge in the 1993 election year mandate. The Contract with America repudiates penalizing the "two career family" and calls for broad relief from the marriage penalty tax.

Section 3 of "The American Dream Restoration Act" provides for a credit to reduce the marriage penalty tax. Specifically, in the case of a "qualified married couple", there would be allowed as a credit against the tax imposed on income for the taxable year an amount equal to an "applicable dollar amount". The term "qualified married couple" means a husband and wife who file a joint return for the taxable year and who but for this credit would be required to pay more in income taxes because of the fact they were legally married during such taxable year than they would be required pay if they had not been legally married. The term "applicable dollar amount" means an amount which the Secretary estimates will result in a $2 billion reduction of revenues for the taxable year in which such credits would be taken. In no event may the amount of the credit to reduce the marriage penalty for which a taxpayer may qualify exceed the marriage penalty which that taxpayer actually suffers in any taxable year.

In examining this provision it is helpful to assume how the credit would operate and then examine based on that assumption issues raised by the credit's operation.

We assume marriage penalty tax relief would operate as follows. Each married couple filing jointly would determine whether they qualified for the credit by (1) calculating the tax on the joint return (using the married filing jointly rate schedule); (2) calculating the tax each would have paid had he or she not been married, and adding these taxes together; and (3) comparing (1) and (2). If (2) were less than (1), the couple may claim the new credit up to the "applicable dollar amount," but not more than the difference between (2) and (1). The "applicable dollar amount" would be the amount determined to be allowable by the Secretary which would result in an estimated revenue cost of $2 billion for the year in which the credit would be claimed.

First, amount of revenue reduction for a given amount of credit, assuming that the Service will know which taxpayers who file joint returns will be eligible to claim the credit, must be estimated for the same year in which the credit amount based on that revenue reduction must be determined. The technique employed in the legislation would require a determination of the amount of the increase in tax resulting from married couples each having income, and the number of joint returns on which there is (or would be) such an increase. Moreover, the method of tax reduction employed in the statute is a flat credit subject to a limit which will vary from joint return to joint return depending upon the absolute amount of aggregate income shown on the return (the marginal tax bracket) and the relative contributions by each spouse to the total. This will be a difficult number to determine with any precision at any time within the year following the year for which the tax is to be calculated, but it must be estimated by the time the return must be filed.

Second, the benefit of the tax reduction is allocated in a way which favors lower income couples. Recent information is that certain higher income couples contribute a larger amount to the revenue increase resulting from higher income tax liabilities being imposed on married couples with two incomes, yet the credit is allocated as a flat dollar amount. This, of course, is the advantage of a credit in that it may result in a larger benefit relative to the tax liabilities of taxpayers in lower income brackets. Recent data shows that for some lower income taxpayers, the marriage penalty tax can be high relative to income, as much $3,000 in one year (by one calculation, 18% of income), but for higher income taxpayers, the penalty tax can be as high as $10,000. For some in the low to middle income ranges, the flat amount credit would eliminate 100% of the "marriage penalty." For those in higher income brackets, the amount of the penalty climinated by the credit would be relatively smaller. Assume that the applicable dollar amount is $3,000. For a highly taxed, low income couple the credit technique reduces the marriage penalty tax by 100%; for the high income couple the reduction is 30%. This has some advantages, and, we assume, is intended.

Consider an alternative approach as the second point interacts with the first point. If the aggregate amount of the increase in revenue resulting from two married taxpayers, each with income, being compelled to file as married taxpayers can be estimated from past statistics with relatively good accuracy, then the amount of the reduction proposed would be easy to determine as a proportion of each married couple's contribution to the total. So, assume that $10 billion is the revenue increase resulting from being married. The amount of the marriage penalty tax which would be credited on each return may be determined as percentage of the increase. In this example, the credit would be 2/10 or 20% of the marriage penalty tax shown on each affected couple's income tax return. This would be easier to determine, but would not benefit lower income families as much.

Third, the amount of the penalty tax is rate sensitive. This means that changes in marginal rates, which are anticipated as well, will affect both the amount of the marriage tax credit and how it is allocated. The 1993 tax changes, including the increase in rates and variations in the phase-outs to which a taxpayer might be subject, had a major impact on the marriage tax penalty, greatly increasing it in some inappropriate ways. Presumably, the projected tax rate changes could have the reverse impact as marginal rates are reduced. It may also be that rates which apply to unmarried individuals will rise (or, to be more precise, will not be reduced as much as rates on married individuals by bracket shifts). Sophisticated rate schedule design could have the effect of changing the tax distribution by imposing relatively more tax on married couples not eligible for the credit than on those for whom the credit is available.

Fourth, the amount of the marriage penalty tax to which the credit applies is determined by calculating the tax each of the married partners would pay if each had filed separately. For most taxpayers, this will not be as easy as it sounds. There is the question, first, of deductions. If deductions are itemized on a joint return, should the separate tax be calculated using only itemized deductions, or should either spouse be permitted to use the standard allowance if that spouse's itemized deductions are less? This, of course, is precisely what would have happened had they really not been married. If both must itemize (or not, depending on the filing status elected on the joint return), then how should deductions be allocated? We really cannot pretend these taxpayers are unmarried, because they are not and presumably would make economic decisions about the payment of expenses taking into account their married status and potential tax liability.

Present law contains phase-outs of allowable itemized deductions and dependency exemptions based on income. How should these phase-outs be taken into account? Should phase-outs be applied to each taxpayer as if he or she were unmarried, or should the actual amount of phase-outs as reflected on the joint return be reflected in the calculation of the marriage penalty? Should taxpayers be allowed arbitrarily to allocate dependency exemptions in order to obtain the largest marriage penalty tax credit, or should dependency exemptions (and the new Family Tax Credit) simply be ignored in making the calculations?

We assume that for community property purposes, the parties will be treated as unmarried in calculating their marriage penalty tax. Thus, the earned income of each spouse will be treated as earned by the earner, and will not be treated as community income. This result overrules Poe v. Seaborn, 282 U.S. 101, 51 S.Ct. 58 (1930) to the extent of the benefit of the credit. It opens an attractive door to "go all the way" and eliminate joint and several liability of taxpayers who file joint returns for tax on income attributable to their spouses.

The proposal applies to all kinds of income. Investment income might then be advantageously allocated between the spouses, shades of Helvering v. Horst, 311 U.S. 112, 61 S.Ct. 144 (1940) and other hoary assignment of income precedents from the time before income splitting. We assume inclusion of unearned income is thoughtfully intended, and the credit mechanism discussed above designed to offset high income benefits which would otherwise result. Potentially, however, it will be a source of difficulty, depending on the amount of rate relief which can be achieved by income-splitting devices.

We applaud the effort to reduce the marriage penalty and urge the Committee to report out favorably Section 3 of the American Dream Restoration Act.

We would like to thank Professor Thomas R. White, 3RD, of the University of Virginia, for his assistance in preparing this testimony.

Mr. CRANE. Thank you for your testimony.

Now Mr. Reynolds.

STATEMENT OF ALAN REYNOLDS, DIRECTOR OF ECONOMIC RESEARCH, HUDSON INSTITUTE

Mr. REYNOLDS. The marriage penalty is one of many work penalties in the Tax Code and also in the transfer payment system that arise from high marginal tax rates. That includes the earned income tax credit, where marginal tax rates for about two-thirds of the people can reach 49 percent, or if they stand to lose food stamps, they can reach 75 percent. That includes the AFDC–UP program, which limits work hours to 100 hours a month. It includes the earnings test on Social Security.

We have a lot of work penalties built into our tax and transfer system. These have been greatly complicated, particularly the marriage penalty, by the increased marginal tax rates enacted, to some extent, in 1990, but mostly in 1993.

For example, if one earner earns $150,000 taxable income, that means $10,000 of that person's income is taxed at the 36-percent rate. If that person's spouse goes to work and makes, say, $30,000, all of his or her income, the second earner's income, will be taxed at the 36-percent rate. Then you throw in State income tax, Social Security tax, the phasing out of deductions and exemptions, and that person can easily face a marginal tax rate of 50 percent or more on a rather modest income which is a pretty punitive penalty indeed.

I do believe that the proposed tax credit for two earners would help a bit, but it is a much more roundabout and complicated method than simply getting to the root of the problem and cutting the marginal tax rates—in the Income Tax Code, but in the welfare system, as well, through appropriate welfare reform.

It matters from an economic point of view—and I am not going to discuss fairness much, I never did that well in philosophy in school—but from an economic point of view, we are running short of labor. That is pretty clearly tied to some of these labor incentives. We need to encourage older people, wives and everybody else, to get back to work.

From 1981 to 1989, the labor force grew by almost 1.7 percent a year. The past 5 years, that has been cut in half.

Why does that matter? Well, if the labor force had grown only by 0.5 percent faster, which would still be lower than the eighties, just half a percentage point faster for 5 years, the labor force would be 2.5 percent larger; the unemployment rate would be 8 percent. Would anybody think we are running out of room to grow with an 8-percent unemployment? Would the Federal Reserve worry that economic growth would be straining our resources? Probably not.

In fact, we are running close to capacity in labor markets and elsewhere, and need to encourage working and saving to remedy that problem. It is impossible for the economy to keep adding 2 or 3 million workers a year if only 1 million of them are showing up, which has been the trend the last couple years, despite rapid increases in immigration, which is quite amazing.

I present in my paper, in my written testimony, quite a few recent academic studies that suggest that labor force response to

marginal tax rates is quite high, particularly among secondary earners. That means that the static revenue estimates do mislead in this case. They do not, as Mr. Rangel suggested, in the case of the child credit; it has no marginal effect. But in the case of marginal tax rates, they have enormous effect.

So if someone is to propose something that will in fact reduce the marriage penalty and encourage women to work, then we are going to have a larger labor force, less constraint in that regard, and the government will in fact receive quite a bit more revenue. You collect more revenue when you are collecting 28 percent of the income of someone that is working, than when you are collecting 40 percent of the income of someone who is not working. Because 40 percent of nothing is nothing.

Many of the current proposals approach average tax rates without affecting the marginal tax rate. That, I think, is a mistake. It fails to get at the nature of the problem.

Many of the past and current proposals have income caps. Income caps, as Gene Steuerle and Gary Burtless argued in their testimony, in fact, raise marginal tax rates. If you put a cap on the child credit, as you are approaching that cap you lose the credit if your income rises. All of these marginal effects have to be taken into consideration more than they have been, in my judgment.

When you are considering the effect of any tax change, ask what the effect will be on incentives to work and incentives to save. If, in fact, they are favorable, it is not going to cost you a lot of money, and a lot of the budgetary problems you are worried about will vanish.

I get the impression that many of the proposals that are being proposed are taking for granted that the high tax rates must stay where they are, and we will then try to fix that problem with deductions and credits and exemptions. This is a reversal of the message of 1986, which is that we should approach that problem directly by reducing the tax rates in a frontal way. It would be more efficient and more effective.

[The prepared statement and attachment follow:]

TESTIMONY OF ALAN REYNOLDS
SENIOR FELLOW AND DIRECTOR OF RESEARCH, HUDSON INSTITUTE

Work Penalties

The "marriage penalty" is part of a much larger problem of *work penalties*. There are many elements of the tax code and transfer payment system that penalize added work effort and savings by imposing high marginal tax rates on any effort or investment that results in higher income. The tax code does not exactly penalize marriage, *per se*, but instead penalizes *added work* by tens of millions of so-called "secondary workers" (mainly wives).

The biggest "marriage penalty" by far is high marginal tax rates themselves. If a small portion of one spouse's income falls into one of the higher tax brackets, then *all* of the second earner's salary is taxed at that rate, regardless how modest the second income may be. If the first earner's taxable income is $150,000, for example, then $10,000 of that would be subject to a 36% federal tax. If that person's spouse then earns an additional $30,000, all of that salary is taxed at 36%, plus state income taxes, Social Security taxes, and the increased loss of deductions and exemptions as income rises above $108,000. Filing separately cannot solve this problem, because in that case all income above $70,000 is taxed at 36% -- in marked contrast with single people, who do not face such a punitive tax until taxable income rises above $115,000.

A single man and woman with a taxable income of $125,000 apiece will each face a 31% federal tax on anything they do to increase income, such as work harder or save. If they married, however, they would be in the highest tax bracket of 39.6%, or 42.5% with the Medicaid tax included. The newlyweds would also find that many more deductions and exemptions would be phased-out by combining their incomes, thus facing an even higher marginal rate.

The number of married couples with two or more earners per family rose by 3.25 million from 1980 to 1990 (from about 19 million to more than 22 million) as marginal tax rates on such families declined. The number of two-earner families suddenly stopped growing between 1990 and 1993, despite the economic recovery since then.[1] The higher marginal tax rates legislated in 1993, and to a lesser extent in 1990 (mainly by shrinking deductions and exemptions as income rises), were most punitive toward working women, particularly middle-aged, college educated women who happen to be married to someone with a relatively high income. While primary workers pay the steep marginal tax rates on only a small fraction of their salaries, their *spouses pay the highest tax rates on their entire incomes.* Static revenue estimates assume that such "secondary workers" will continue working -- an assumption that is already proving false, even for primary workers. Instead of collecting 28% of the additional income produced by millions of new secondary workers, as in the late eighties, the federal government is now collecting 36-40% of zero -- the income that would have been earned had tax rates not discouraged labor force participation.

The simplest and most effective solution to such problems as the marriage penalty is to flatten the schedule of steeply rising marginal tax rates, as was done to a limited degree from 1987 to 1989.

If the high 1993 tax rates are kept in place, a second-best solution to the marriage penalty might be to eliminate the categories of "married filing separately" and "married filing jointly" and simply allow married individuals to file under the same tax schedule as single people. Yet the fact that tax rates are steeply graduated makes this simple solution much more complicated. Even if the low-income member of a high-income family was allowed to file at a tax rate suitable to his or her lower salary, the couple would then lose the benefits of a joint return. The income thresholds at which each increase in tax rates begins to apply are higher for joint returns because the old adage that "two can live as cheaply as one" is not true. A single person with an income of, say, $100,000 is more affluent than a married couple living on the same income, so the schedule for joint returns attempts to take this into account. Even a much larger personal exemption would not solve this problem, because it would still leave most of the affected couples in high *marginal* tax brackets.

The American Dream Restoration Act offers a partial solution, though not an ideal one. Beginning in 1996, it would allow an extra tax credit for two-earner couples who file a joint return. Although a tax credit for a second earner would reduce the *average* tax burden for two-earner families, the impact on marginal rates would be relatively small and rather arbitrary. Secondary earners with relatively low incomes in high-bracket families would still face higher *marginal* tax rates than single people with similar incomes. Since such families can easily get by on one income, the impact of high marginal taxes on the second income would continue to deprive the economy of the labor

services of a sizable group of potential workers who are likely to have invested considerable time and money in acquiring education and job skills.

The best solution would be to roll-back the highest marginal tax rates to no more than 28-30% (or preferably even lower, with a flat tax). The second-best solution would be to double the income thresholds at which the highest tax rates of 36% or more apply, and also offer a tax credit for second earners. The two-earner credit by itself would be a significant improvement over the current situation, but no truly effective solution is possible with tax rates as steeply graduated as they have been since 1993.

A starting date of 1996 is not advisable for the two-earner credit or any other tax relief. Just as high-income individuals and small businesses accelerated income into December of 1992 to avoid the higher tax rates of 1993, they would surely *delay* receiving 1995 income until 1996 to take advantage of any tax relief expected in that year. This could weaken the economy in 1995, or at least create that impression in the national income statistics. *The incentive to postpone income until 1996 would certainly worsen tax receipts in calendar 1995*, possibly jeopardizing tax relief. Any reduction in tax rates, or increase in deductions and credits, should be made retroactive to January 1995.

Static Revenue Estimates Are Wrong

The static revenue estimate of the revenue lost from the proposed tax credit for two-earner families amounts to $2 billion per year for the first five years. It is a mistake to measure the economic impact of tax relief by the amount of revenue lost, because programs that are effective in encouraging added work and/or saving must raise potential GDP and thus result in little or no revenue loss over time. Not all tax cuts have such beneficial effects, of course, but reduced taxation of secondary earners will undoubtedly increase labor force participation.

In economics, as opposed to accounting, there is no longer any serious doubt that decisions among secondary workers about whether to work or not, and whether to work part-time or full-time, are quite sensitive to marginal tax rates.[2] Attempting to impose high marginal tax rates on spouses with not-so-high incomes will, in fact, discourage many wives and some husbands from working. It is doing just that right now. A lower *marginal* rate on two-earner households would unquestionably increase the supply of labor, particularly among those now facing tax brackets of 36% or more. People who work are far more likely to pay a wide variety of taxes than those who do not work. Since the economy is currently operating at a very low unemployment rate, an increase in the labor supply would also alleviate that constraint, raising potential overall economic growth and therefore tax receipts from many sources, including the corporate income tax. Whether or not one believes that such "dynamic" revenue gains would exceed the static losses, it makes no sense to argue that obvious and well-known behavioral responses should be totally ignored, as they usually are today.

The main reason labor force growth in the eighties exceeded demographic projections is that "most of the increase in women's labor supply [participation rates] took place among the wives of husbands with high earnings."[3] This is precisely what a huge body of theory and evidence would lead us to expect at a time when the highest marginal tax rates on secondary earners was reduced from 70% to 28%. Women in higher-income households are often college-educated, so the fact that they were induced to rejoin the labor force from 1982 until 1990 provided the economy with a sizable new source of valuable skills. Because the labor force grew so rapidly, employment was also able to grow by 2.4% per year for an exceptionally long period -- from 1983 to 1989 -- accounting fro two-thirds of the 3.7% average rate of growth of real GDP during those years.

The Looming Labor Shortage

In the immediate future, and for at least the coming decade, the U S. faces a serious shortage of willing workers, not a shortage of jobs. In the absence of policies to restore and improve work incentives, potential economic growth in the United States is very likely to be constrained by slow growth of the labor force and inadequate incentives for personal investment in human capital.

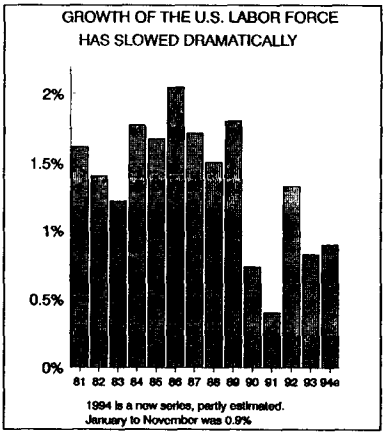
Economic growth can be usefully divided into two components: Growth in the number of workers

plus growth in output per worker, or productivity. There are practical limits to how low unemployment rates can be pushed, due to the inherent frictions of people quitting their jobs, young people seeking first jobs, mature women reentering the labor force, and mobility of workers between cities and industries. Except for periods of war, when unemployment was artificially reduced by removing many young men from the civilian labor force, unemployment in the postwar years has never been sustained much below 5.5% for very long. With the unemployment rate already at 5.4% nationally, and substantially lower in many cities, further growth of employment in the near future will mainly depend on enticing more people into the ranks of job seekers.

The issue was adeptly explained by the Congressional Budget Office, in the January 1994 Economic and Budget Outlook, as follows:

> Growth of the labor force has been unusually slow in the past three years. This slowdown was caused not by a slump in population growth but by a leveling off of the growth in the percentage of the working-age population who desire to work, that is, the participation rate of the labor force.

The number of Americans who were either working or seeking work grew by nearly 1.7% a year from 1981 to 1989, but slowed to about half that pace over the past five years, apparently remaining below 1% even in the mature phase of expansion in 1993-94. This is particularly remarkable considering the fact that annual immigration in recent years has been several hundred thousands higher than in the eighties. Most immigrants are of working age, and tend to have *higher* than average labor force participation rates (particularly those from Mexico).



If employment grows by only 2% a year in the near future (much slower than in the eighties), and the labor force grows by only 1% a year, that means the unemployment rate has to fall by one percentage point every year. When starting with an unemployment rate of 5.4%, this becomes quite impossible very quickly. Nobody seriously believes that unemployment can fall to 4.4% over the next year, and to 3.4% the year after that.

With unemployment already lower than it was during the cyclical peak of 1987-89, employment cannot possibly grow much faster than the labor force -- which means 1% or less with current policies. With such a job slowdown, it would require implausibly large productivity gains to generate economic growth much above 2%. Big productivity gains are particularly unlikely in the next few years, because brutal tax rates on "the rich" have shrunk the personal savings needed to finance additions to the economy's strained capacity. The economy is rapidly approaching binding constraints on *supply* -- the supply of labor and savings. These problems are classic symptoms of excessive marginal tax rates.

It is not simply that we cannot add more jobs without inflation. We cannot add more jobs than there are workers with or without inflation. Inflation provides no solution to this dilemma. Inflation has never improved economic growth. When faced with scarcity of labor and savings, "stimulating demand" cannot do anything but raise imports, sink the dollar and inflate prices.

Why are so few people looking for jobs at a time when unemployment is near a record low? As the CBO observed, there has been a levelling-off or decline of previously rising "participation rates" (the

percentage of those over age 16 who are either working or looking for work), particularly among women and young people. The problem of growing work disincentives affects both the high and low ends of the income distribution. Those with above-average incomes face new tax brackets if they do anything extra to raise family income, while those with low incomes face the equivalent of marginal tax rates of 50-100% because adding to earned income results in losing welfare or the earned income tax credit, and also food stamps and Medicaid.

Dropping out of the labor force has not been confined to married women. The participation rate among single women rose from 64.4% in 1980 to 68% in 1989, but then fell to 66.4% in 1992-93. The participation rate among married men older than 35 actually increased a bit from 1985 to 1989, in contrast to previous trends, but has declined in all age groups since then.

For all the attention being paid to the "middle class," that is the only income group that has *not* suffered an increase in *marginal* tax rates in recent years, aside from the increase in Social Security tax rates and (more importantly, at the margin) the amount of income affected by those rates. Those earning less than about $100,000 (before deductions) are still in a 28% bracket, and do not have their deductions and exemptions whittled-down if they add to their incomes through work or saving.

In 1994, the problem of slow labor force growth persisted. A new and more-inclusive measure of the labor force was adopted, which cannot be properly compared with the different figures for 1993. In the first eleven months of 1994, however, labor force growth was below 1% -- extremely low, considering the fact that labor markets are tight. The argument that people have dropped out of the labor force because they are "discouraged with their job prospects," rather than discouraged by taxes, is difficult to reconcile with the fact that the slowdown has gotten worse as unemployment fell -- in marked contrast with the rapid increase in participation rates in the eighties, when unemployment was often much higher.[4]

Estimates of potential economic growth -- how fast the economy can grow after reaching full employment -- typically treat labor force growth as "given" by demographics, and productivity as given by past trends. This is a convenient but misleading simplification, because both labor force and productivity can be affected by economic policies.

Income and payroll tax rates affect the percentage of the working-age population that is willing to work ("labor force participation rates"). Labor force participation is also affected by "entitlement" policies that offer cash and non-cash benefits on the condition that recipients either do not work (unemployment benefits, and the work test on Social Security retirement), work only limited hours per month (the AFDC-UP program), or keep earned income below certain limits (the Earned Income Tax Credit, food stamps, Medicaid, housing allowances, and AFDC).[5]

The labor force consists of the number of people who are either working or seeking work. It is a measure of labor supply, not demand. Public policy cannot do anything about demographics -- the number of births 18-20 years ago -- but that is only one source of added labor. Many adults not currently looking for work are nonetheless capable of working, if the after-tax rewards looked more appealing than alternatives (such as relying on a spouse's income, pensions or transfer payments).

Because of rising participation rates until 1989, demographers *under*estimated actual labor force growth in the eighties (it was expected to be no more than 1.5%, but turned out close to 1.7%). Demographers have *over*estimated labor force growth since 1989, because participation rates have responded to different tax incentives. For demographic reasons alone, the labor force "should" be growing by at least 1.3% a year. But the actual increase in 1993 and 1994 was only about 0.9%. If continued, that means the economy's potential future economic growth will be nearly a half percentage point below what demographic projections have led many to expect, and even further below the experience of the eighties (when labor force growth was above the demographic trend).

Tax policy can do something about weak labor force participation. This just requires lower *marginal* tax rates -- particularly on secondary workers and prospective retirees, but preferably on affluent primary workers (who can easily afford to work less, or retire) and welfare recipients as well.

A Brief Survey of Some Evidence on Work Incentives

In the past, it was common for economists to be skeptical about the impact of high marginal tax rates on work effort. Early studies were rather crude, sometimes just surveys. Even the more serious studies usually focused on people with low or moderate incomes, rather than those in the highest tax brackets, and studied only the effects of tax rates on hours worked among those who did work, rather than on the decisions about whether to work at all (participation rates), where recent studies find a strong response among women.

What follows is a brief sample of recent research on the labor supply response to marginal tax rates:

- Robert Triest finds "the participation decision is more sensitive to economic incentives than hours worked." Despite problems with existing studies that tend to underestimate the response, Triest nonetheless finds the evidence clear that "increasing the higher tax rates results in sharply higher efficiency cost, and raises less revenue."[6]

- An econometric study by the research staff of the International Monetary Fund nonetheless estimated that work hours too would be greatly affected: "An increase of 1 percentage point in either consumption or labor income taxes may induce a reduction in the hours of work between 1/2 and 1 1/2 percentage points."[7]

- James Ziliak of the University of Oregon estimated that a 30% increase in marginal tax rates on the top 1% of U.S. taxpayers [smaller than the actual 52% increase -- from 28% to 42.5%] would eventually reduce hours worked by as much as 11% and reduce revenues by a comparable amount.[8] People with very high incomes have a great deal of discretion over how much they work and invest, in what forms they are compensated, and so on.

- Martin Feldstein, President of the National Bureau of Economic Research, notes that increases in marginal tax rates induce people "to alter their taxable income in a wide variety of ways including changes in labor supply, changes in the form in which employee compensation is taken, changes in portfolio investments, changes in itemized deductions and in other expenditures that reduce taxable incomes, and changes in taxpayers compliance."[9] Feldstein uses data from the 1986 Tax Reform to estimate that the 1993 increases in the higher marginal tax rates are quite unlikely to increase revenue in the longer run, as Ziliak and Triest also found, but due here to greater tax avoidance as well as reduced work effort.

- Alan Auerbach argues that Feldstein's research on the surprisingly favorable effect on tax revenues from reducing the highest tax rates in 1986 is likely to *understate* the revenue losses from the 1993 increases in tax rates. "Because the 1993 Act is very progressive," Auerbach wrote, "its income effects on labor supply and saving . . . would lead to a greater behavioral response . . . than occurred after the 1986 Act."[10] The CBO has observed that the tax schedule is now as steeply graduated as it was back in 1977 (tax rates *appear* lower today partly because we forget how many "loopholes" there were back then).

With so many of these distinguished economists predicting that the 1993 increases in marginal tax rates would lead to reduced revenues, an obvious question is why has this not yet been apparent? First of all, there was a huge surge in reported income, and tax receipts, in December of 1992 [fiscal 1993]. That was because many clever people arranged to receive bonuses, investment income and accounts receivable paid into the 1992 calendar year in order to avoid the expected 1993 tax hike. That is, the revenue surge in fiscal 1993 was paid at the *lower* tax rates of calendar 1992. There was a second surge in tax receipts in April of 1994, when payment became due on taxes retroactively imposed on 1993 income. Aside from the few who chose to take three years to pay the surprise additions to their 1993 tax bill, this was a one-time revenue windfall that will not be repeated.

Finally, it should be pointed out that not all responses to higher tax rates are immediate. Decisions to retire early, for example, will be affected for many years by the tax rates enacted in 1993.

Philip Trostel of the University of North Carolina finds that decisions to go to college or graduate school are also *extremely* sensitive to expected future tax rates on income later in life -- particularly

graduated tax rates that fall most heavily on the rewards to education at the peak earning years (middle age).[11] Each 1% increase in tax rates leaves the economy with nearly a 1% smaller stock of human capital, Trostel estimates. Punitive tax rates on "the rich" (that is, on mature two-earner families with college degrees) gradually leave the economy with fewer rich people to tax. But that also means fewer educated people left in the work force, and a less productive and prosperous economy.

What we can already observe is that the labor force is not growing nearly as fast as it used to, and the slowdown is too large and sudden to explain by demographic trends. The inclination to drop out of the labor force (or at least not drop in) appears concentrated where work penalties have most clearly increased since 1990 -- among married women in families where the husband earns more than about $100,000, and also among single women with children who are caught in a "poverty trap" -- risking the loss of many benefits if they work.[12] The combined system of tax rates and transfer payments thus imposes huge *work penalties* on women, married or not. Steep marginal tax rates are unduly harsh on men too, which helps explain why the *male* participation rate has begun falling again, from 78.5% in 1989 to 77.3% in 1993. Labor force participation also dropped in Canada after they imposed higher marginal tax rates on upper-income families in 1990, and tax revenues then *fell* for four years despite the addition of a national sales tax.

Child Tax Credits With An Income Ceiling Would Raise Marginal Tax Rates

Proposed tax credits per child -- even if they were extended to college-age dependents -- would reduce *average* taxes without lowering the *marginal* rate.[13] If someone is in a high tax bracket before calculating such a tax credit, she is still in a high tax bracket *after* the credit. With no added incentive to increase labor effort or savings, tax credits can promise no dynamic feedback effect on revenues.

Ceilings on the income at which tax credits for children would be available would, in fact, *increase* marginal tax rates for those whose income approached the ceiling. Any efforts to raise income would be punished by losing the credit. The lower the income ceiling, the more families would be affected by this disincentive. The more children such families had, the higher the effective marginal tax resulting from phasing-out the tax credit. If a tax credit or enlarged deduction for children is adopted, as a matter of social rather than economic policy, there should be no ceiling on the income of taxpayers eligible for the ceiling.

Taxing Social Security Benefits Is Not Exactly The Problem

If people work beyond age 65, and earn more than a trivial sum, they lose half their Social Security benefits. In a society with an aging and slow-growing population, a more perverse penalty on working can scarcely be imagined. Proposals to double the amount of income that older people are "allowed" to earn are far too modest. There should be no earnings test at all. Once again, static estimates of what this would supposedly cost, in terms of increased Social Security outlays, are worse than useless. Clearly, many older people would keep working if there was no earnings test -- often earning very high incomes and paying high income, payroll and sales taxes as a result.

In 1993, retired couples with incomes above $44,000 (or singles with incomes above $34,000) were subjected to income taxes on 85% of their Social Security benefits. This further penalizes work among older people, since earned income could easily push income above these very modest thresholds.

The income thresholds at which benefits become 85% taxable *penalize prudence* as well. Putting "too much" savings away for old age, or contributing "too much" to defined contribution pension plans, will push income up to the point where Social Security benefits become heavily taxed. The message to those not yet retired is this: Do not save too much for retirement, or the government will tax-away most of the Social Security benefits you have been promised. In a society that is aging fast, this policy is a dangerous encouragement to irresponsibility and dependence, even aside from the effects of weak savings on capital formation.

The Senior Citizens Equity Act would gradually roll back the tax to 50% of benefits within five

years, rather than 85%. The long phase-in period makes the change appear more vulnerable to political reversal during that time, which means it is apt to have a less beneficial effect on retirement planning than outright repeal.

The most serious problem, however, is not the taxation of benefits *per se*, since those benefits certainly are income. The perverse incentives arise from the much higher taxation of benefits for those who have foolishly saved for retirement, or who continue to work. If all Social Security retirement benefits were taxed at the same rate regardless of income, then older people with low incomes would still pay taxes at a zero or 15% rate on their total incomes, including whatever proportion of benefits is counted as income, while those with higher total incomes would (under the current rate schedule) pay a higher percentage of their incomes in taxes. As with the income ceilings on deductions and exemptions, and the proposed income ceilings on child tax credits, the income ceilings on what proportion of Social Security benefits is taxed constitutes a very steep marginal tax on activities that would add to income.

Incentives Matter

The economy cannot keep adding several million jobs a year, as we became accustomed to in the eighties, if the labor force continues to grow by only about one million a year, as has been true in the recent past. Labor is rapidly becoming quite scarce, and skilled labor even more so. The economy cannot afford tax and transfer policies that virtually force two earner families to become one-earner families, bribe one-earner families to go on welfare, or slash and tax the Social Security benefits of older people if they dare to keep working. The economy needs better incentives to both work *and* save, which are two activities that normally depend on each other. If many people stop trying to earn a salary, they can't very well save..

There are two basic alternative strategies for repairing the tax code. One technique is to leave high marginal tax rates in place and attempt to repair the resulting inequities and inefficiencies by extending tax deductions and credits. While such a piecemeal approach is often better than doing nothing, it is almost always less efficient than the second strategy -- rolling-back the highest, most distortive marginal rates to the pre-1993 level.

In the debates over tax legislation of 1986, 1990 and 1993, economic efficiency and incentives often took a back seat in recent years to competing definitions of tax "fairness." Yet the foundations of economic progress -- labor and savings -- have been rapidly eroding since 1992, and a solution cannot prudently be delayed much longer. Labor force growth is very slow, savings have fallen, and U.S. investment opportunities are not attracting sufficient foreign capital to finance needed investments or the current account deficit. Without prompt improvement in labor and savings incentives, the U.S. economy is likely to run out of room to grow before 1996, when many of the proposed tax changes begin to take effect.

Marginal tax rates are simply too high, particularly on the poor, the semi-rich and their spouses, and the aged. Tinkering around the edges of the tax code may help, but not much.

1. *Statistical Abstract of the United States*, 1994, Table 666, p. 430.

2. Jerry A. Hausman & James Poterba, "Household Behavior and the Tax Reform Act of 1986," *Journal of Economic Perspectives*, Winter 1987.

3. Frank Levy, "Comments and Discussion" *Brookings Papers on Economic Activity*, 2:1993, p. 329.

4. This argument is cited in Steven Pearlstein, "What's the Speed Limit on Economic Growth?," *The Washington Post*, January 15, 1994.

5. This is documented in Alan Reynolds, "The Incredible Shrinking Labor Force," *Hudson Briefing Paper* No. 168, September 1994.

6. Robert K. Triest, "The Efficiency Cost of Increased Progressivity," National Bureau of Economic Research [NBER} Working Paper No. 4535, November 1993.

7. E. Mendoza, A. Razin & L. Tesar, "An International Comparison of Tax Systems in Industrial Countries," *Staff Studies for the World Economic Outlook*, IMF, December 1993, p. 101.

8. James P. Ziliak, "three Essays on The Effect of Taxes and Tax Reform on Life-Cycle Labor Supply," *Proceedings of the Eighty-Sixth Annual Convention of the National Tax Association*, St. Paul, 1994, p. 126.

9. Martin Feldstein, "The Effect of Marginal Tax Rates on Taxable Income: A Panel Study of the 1986 Tax Reform Act," NBER *Working Paper* No. 4496, October 1993, p.3.

10. Alan Auerbach, "The U.S. Fiscal Problem," NBER Working Paper No. 4700, April 1994.

11. Philip A. Trostel, "The Effect of Taxation on Human Capital," *Journal of Political Economy*, April 1993.

12. Social Security taxes are a particularly strong work disincentive for "women whose earnings are so low that they would receive more as their husband's dependent than they would based on their own earnings." Martin Feldstein & Andrew Samwick, "Social Security Rules and Marginal Tax Rates," NBER *Working Paper* No. 3962, 1992.

13. Several recent proposals, such as the idea of increasing the exemption from estate taxes while leaving the *marginal* rate at 35-55%, suggest widespread misunderstanding of how taxes affect behavior. See Alan Reynolds, "Marginal Tax Rates" in David R. Henderson, ed., *The Fortune Encyclopedia of Economics*, Time Warner, 1993.

Mr. CRANE. Thank you very much for your testimony.

The first to inquire is Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman.

Prior to the 1986 Tax Reform Act, working couples could claim a deduction of up to $3,000. Ms. O'Connell, you said that we could do something like that or something else.

I wanted to understand exactly what you were proposing. You propose that we may bring that back or do you think it is a good idea to bring that back or to do some kind of percentage, like you were talking about?

Ms. O'CONNELL. Mr. Bunning, the credit operates most simply in the minds of taxpayers, in my opinion, and it gets at the problem most readily. The deduction at the lower levels is simply less relief for the penalty.

The ratio that I discussed is a little bit different notion from making the credit a flat dollar amount. I made some assumptions about how that, which I have read in the Contract With America, and in the statute, the American Dream Restoration Act, would have to work for taxpayers to be able to figure out what their marriage penalty was and then figure out a credit.

They are going to have to calculate income as if each had that income individually, then figure a tax as if each were unmarried individuals, then calculate their joint return tax and subtract the lower unmarried individual sum from the higher joint return tax to get a marriage penalty.

When they come up with that number, there are a few things that they could do. One is know that under some other formula they can take up to whatever the government says, whether it be $3,000 or $2,500, depending upon where the revenue limit cuts in.

But another thing the government could do is estimate what that total marriage penalty was for that year and then know that the cost that will be relieved in this year is, for example, $2 billion, as is currently proposed for 1996. So if the Treasury Department made an estimate, as we have heard alluded to, that the total marriage penalty were a $100 billion, and then we knew we were going to relieve $2 billion of it, when people calculated their marriage penalty, they would reduce that amount by 2 percent and that would be their credit. So there is an opportunity, once people walk through what they are going to have to walk through to calculate their penalty, we can't avoid that, they could be given some 2 percent number in that example for them, instead of just a flat dollar amount.

Mr. BUNNING. Currently, the marriage tax penalty falls particularly hard on low-income workers since marriage means the loss of earned income tax credit and means-tested benefits. In essence, doesn't our current income tax system tell these groups not to work or to marry?

Anyone.

Ms. O'CONNELL. Well, if I may continue——

Mr. REYNOLDS. Yes.

Ms. O'CONNELL. It certainly may——

Mr. BUNNING. The answer to the question is yes?

Mr. REYNOLDS. Yes, the tax and the transfer payment system do that, including the EITC.

Mr. BUNNING. If Congress passes new work requirements in the context of welfare reform, doesn't marriage penalty relief come as a priority?

Ms. ALSTOTT. As I have said in my testimony, I think that if we are going to have marriage penalty relief, it is appropriate to direct it to EITC recipients.

Mr. REYNOLDS. I agree.

Ms. O'CONNELL. I agree, too, up and down the board.

Mr. BUNNING. OK. We don't do the whole thing, and we can't because of the cost, obviously. But the thrust and the direction we are trying to take in the Contract is $10 billion over the next 5 years. Is that too little, too small, or too large, or is there a happy medium that we could find? Obviously, to make a bigger impact on it, the number ought to be larger. But in reality, the cost gets into what is the ability of what we can do and what we can't do.

Mr. REYNOLDS. If it works, it shouldn't cost anything.

Aren't we trying to encourage people to work?

Mr. BUNNING. Absolutely.

Mr. REYNOLDS. Don't they pay Social Security tax, income tax, sales tax?

Mr. BUNNING. We are trying to do that on many sides of this whole thing here.

Mr. REYNOLDS. You have got to encourage work. It certainly won't cost much.

Ms. ALSTOTT. I suppose that gets us squarely back into the issue of dynamic scoring.

Mr. REYNOLDS. I was doing some dynamic scoring.

Ms. O'CONNELL. How broad the analysis is going to be. To confine yourself solely to the marriage penalty, I would say the relief ought to be more. It is probably a 2-percent drop in the budget.

Ms. ALSTOTT. On the other hand, as the previous panel pointed out, the committee is considering these proposals in the area of deficit reduction. So in my judgment, incremental relief is appropriate.

Mr. BUNNING. OK.

Thank you, thank you panel.

Mr. CRANE. Mr. Hancock.

Mr. HANCOCK. Just a real brief comment.

Ms. O'Connell, when you first started your statement, you said that you had been working for several years helping people accurately fill out their income tax return.

Ms. O'CONNELL. Yes, sir.

Mr. HANCOCK. You stressed the word "accurately" it seemed like. Is this—a part of what we are doing here, even though I am very much in favor of doing something about the penalties, is there anything we can do to simplify the tax return? I mean, the compliance cost is just getting absolutely ridiculous. You may make a good living doing it, filling out returns, but the average Ph.D. ought to be able to fill out his own income tax return.

Ms. O'CONNELL. I think some of the best minds the Treasury Department can bring to bear works on making that simple as possible. It is an extraordinarily difficult system about which it asks people to report.

Unfortunately, there is a lot of data on that return for which most of the people you are hoping to help with marriage penalty

tax relief have no interest. We have tried to pull most of that more complicated data out on to schedules and have EZ returns and such, so that most of the people all of the time never see the full-blown complexity of the 1040. We should always continue to be achieving that goal.

I want to underscore that this calculation that you ask people to make, it is my experience from practice, will not be one that they will find either too time consuming or too complicated because they think they are going to get money back. That always causes an enthusiasm for recordkeeping from the outset.

Americans forget to find a lot of records, but everybody I know this month is looking for that statement from their bank about how much mortgage interest they paid. So we know that if we design a relief provision that facilitates the family's economic situation, however those very brilliant people in the Treasury Department stress it on one more form, it will be something that people will look for, that they will carefully report about, and that they will be able to do.

I urge on you that some of these allocations, for most of the families all of the time, are things they simply know. They know the interest on Mary's account is Mary's, and the interest on John and Mary's joint account is theirs, 50/50. This is not end-of-the-world complexity for them.

Mr. REYNOLDS. I would like to comment.

I think most of the people on the previous panel as well as this one have made the point that high marginal tax rates complicate your chores. We get a bigger marriage penalty, this includes marginal tax rates in the welfare system. The marriage penalty becomes a problem because you have got high marginal tax rates.

From 1982 to 1986, we alleviated that by giving a credit of 10 percent of the second-earner salary up to a lid of $3,000, which effectively meant up to a lid on income of $30,000. That sounds a little low to me right now.

Second, it was certainly simple and clean and a lot easier to figure out than this proposal, which I still can't figure out. Reviving the pre-1987 two-carrier credit is one way out.

Ms. O'CONNELL. I will help you.

Mr. REYNOLDS. But in 1986, when the rates came down to 28, or 33, or 31 percent, I have a feeling not many people cared any more. We certainly had a tremendous increase in work effort, and particularly among wives of high-bracket taxpayers. We had a tremendous increase in the formation of two-earner families. I think that the obvious solution is we made a mistake in 1993, and I think that the recent election had something to say about that question, too.

Mr. HANCOCK. I just came back this last weekend and they informed me of what went on, not only with 1993 and what it has done to subchapter S companies, but also I happen to be from the State of Missouri, and I am convinced that Governor Mel Carnahan and Bill Clinton must have belonged to the same fraternity or something, because he did it in the State of Missouri, and it is a 50-percent increase in the amount of Missouri income tax, all corporations, a substantial increase.

In fact, you can no longer take the deductibility of the Federal tax from your Missouri tax, which is a double whammy. They were both passed, in fact, at the same time, in May 1993, by the Missouri State Legislature and the U.S. Congress. I don't know what is going to happen, but there is going to have to be something done about it. The Chairman is not there so I can go ahead and use the time.

Mr. BUNNING. The Chairman is here.

Mr. HANCOCK. Oh, you are still here.

OK, I didn't see him there in the middle.

I am sorry, Mr. Bunning.

Mr. BUNNING. That is all right.

Mr. HANCOCK. May I ask one final question?

Mr. BUNNING. Go right ahead.

Mr. HANCOCK. Just real quickly; should we consider the flat tax? I mean, should we get into it with both feet and look at what is going on there, or should we just say, well, it sounds good?

Ms. ALSTOTT. I would like to really concur with the answer you got last time from Dr. Steuerle. Flat tax means some different things to so many people, income versus consumption and so on. I think there are some intriguing proposals out there that would combine a flat rate of tax for a lot of people, which does help with administrative simplification, with a fair amount of progressivity by increasing personal exemptions and so on.

Mr. REYNOLDS. The best should not become the enemy of the good, and you are not going to be passing a flat tax any time soon. We've got problems ahead right now: a $50 billion annual shortage in personal savings compared to 1992, a big drop in labor force participation, a slowdown in labor force growth.

You are not going to make it to 1996, when most of these proposals kick in. The economy is going to run up against a wall. A flatter tax is in order right now.

We had one prior to 1989. It was working pretty well. It was muffed in 1990 and 1993, in my judgment. Go back and take a look. Not all the changes that were made were bad, but the ones that had the effect of discouraging additional work and savings were bad, and have been ineffective and will prove to be revenue ineffective as well.

Ms. O'CONNELL. I think there are enough of us to consider more than one thing at a time. I wouldn't let us be distracted by the flat tax.

I urge you to do these kinds of things that the public expects and understands. They heard about this, they are looking for this.

A flat tax becomes interesting to them, I think, as they hear about it in the press, but let's not get off on a sidetrack where we could park our engines for years. I think we ought to go forward down the main track.

Mr. BUNNING [presiding]. The time for the gentleman has expired.

Mr. McDermott will inquire.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

I always listen to these and read these proposals that are put forward by the Republicans. They don't believe in social engineering. So I try to figure out what is behind what they are doing.

It sounds to me from listening to you, like the purpose of this is to get women into the work force, to make women go to work so that we will have enough employees or something. I can't understand what this is directed at.

Is this directed at people at the bottom who are on welfare, to get them into the work force? Or is it dealing with two attorneys who are married, each making $100,000 apiece, are they the ones this is directed at, so we will keep that woman at work at a $100,000 apiece, or what is it you are—what do you think the principle is that drives this proposal? Because as the gentleman says, it is not fairness we are worried about here, so it is something else. What is it?

Mr. REYNOLDS. Is the question addressed to me?

Mr. MCDERMOTT. Well, to any of you.

Mr. REYNOLDS. The two groups you mentioned, low income and high income, are the people that face the highest marginal tax rates. That is to say, if they do anything to add to their income, save, work longer hours, second person goes to work, they are very, very heavily punished for their efforts.

One could make a fairness case that this is not very nice, that to tax the $30,000 income of a wife whose husband makes $150,000 at a 36-percent rate isn't very nice. But I don't particularly care about the fairness issue.

What I care about is that we have effectively discouraged a lot of people—encouraged them to drop out or discouraged them from dropping into the labor force. That is actually an economic problem. That is a constraint on economic growth.

We are at 5.4 percent unemployment. The previous cyclical peak, 1987 to 1989, and it is also the peacetime peak, is about 5.5 percent. You can't knock it down very far from there.

So now, from now on, any growth of the economy has got to come from productivity growth or more workers. We don't have more workers, we are running short. You have got a problem. If you add 1 percent labor force growth to even an optimistic 1.5 percent productivity growth, the best you can hope for is 2.5 percent GDP growth.

Mr. MCDERMOTT. So the real purpose is to drive women into the work force, is that what you are talking about?

Mr. REYNOLDS. Not to artificially discourage them from working in the same way that we do not artificially discourage other people, like men.

Ms. ALSTOTT. I would also say that I am concerned about both distribution and incentives. Distributionally, it is simply arbitrary to impose a marriage penalty on people.

Mr. MCDERMOTT. I agree with that. I mean, it is arbitrary. We have arbitrary stuff all through the code, we have the notch that we deal with with senior citizens. Maybe we should pay for this by taking away the marriage bonus from the other people and pay for the people who are getting the penalty.

Ms. ALSTOTT. If that were administratively feasible, I think it might not be a bad idea. A marriage bonus is at least as arbitrary as a marriage penalty.

Mr. McDERMOTT. So you don't have any real problem with that. It is simply that it is arbitrary and you would like to get rid of the arbitrariness by giving everybody a bonus for getting married?

Ms. ALSTOTT. I would like to at least reduce the arbitrariness. Eliminating would cost a lot more money.

Mr. McDERMOTT. You all raise this. I mean, everybody should understand that the Treasury says this thing would cost $72 billion to do properly over the next 5 years. That is about $14 billion a year. We are putting in $2 billion, and it is very nonspecific.

Do you trust the Treasury to design the kind of thing? I mean, they are unwilling to put forward any language about how it should be done. Do you trust the Treasury to do something better than what is already there?

Ms. ALSTOTT. I actually don't support the proposal as written in the act now. I understood the committee would be considering that proposal and others.

My own testimony goes into a number of variants on the two-earner deduction and the two-earner credit, and one thing the committee might want to consider is targeting it, based on empirical information from your staff, to different income groups and/or in other ways, in other words, to get the most money you can out of the $2 billion a year that is allotted.

Mr. McDERMOTT. So if you use the $2 billion entirely for the people who are in the lower end of the economy, that would make more sense to you?

Ms. ALSTOTT. I would want to see numbers. It gets a little bit complicated because, as you know, marriage penalties and marriage bonuses depend on the distribution of income within the couples, and I think your staff might be able to give you some better information. But sort of subject to that kind of information, and seeing how well targeted the two-earner deduction or credit would be, it might make some sense to target it to the low end of the population.

Ms. O'CONNELL. It is my opinion that women haven't stayed out of the labor force just because of the marriage penalty. In 4 years, you ought to across the board try to eliminate this problem. The credit is not too complicated a way to do that. People will understand it. Treasury can show them how to do it on a form. It is just not that hard to do.

Mr. McDERMOTT. Would you think, though, it would be better to have this very targeted at those people at the bottom, those people making $15,000, $20,000? If a man making $15,000 and a woman making $15,000 marry, they are going to get in this penalty situation. So would it be better—wouldn't it be better, in my opinion, at least, to target it at that couple than the one making $100,000 and $100,000?

Ms. O'CONNELL. Well, it certainly sounds appealing. It is a policy question about progressivity. When I last looked at the public data about this, it turned out that for the couples who were paying the marriage penalty tax, something like 90 percent of the people who were paying it were paying it in respect of earned income alone. So if you take out people who have investment income, which you think of as the higher end of the economy usually, you are helping

most of the people all the time. So I think you could spread the marriage penalty pretty broadly, give significant help——

Mr. McDERMOTT. As long as it was only on earned income.

Ms. O'CONNELL. That is right, give significant help to the lower ends of the marketplace about which you are concerned, and yet give a lot of help to some other families I have heard described here who are starting out with two—whether they be professional or professional Bachelor of Arts degrees, who are getting their first job. They are closer relatively in income and that penalty hurts them the most. As they walk through our system now with its higher rates and its phaseout of other benefits, it keeps hitting them harder and harder and harder.

So you have to pick a policy place from where to stop it, and you maybe have to pick a practical place for what it costs to stop it there. But you can go a long way down the road doing a lot of good, even at the numbers you are talking about now.

Mr. BUNNING. The gentleman's time has expired.

Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

Mr. Reynolds, you mentioned during your oral testimony that we should attack the Tax Code in a more frontal way, rather than deductions, credits, exemptions and so on. I would like to know your best-case scenario for a frontal attack and does that include all the alternatives on tax provisions we have heard for the upcoming year that we are going to be looking at?

Mr. REYNOLDS. Well, the best-case scenario would be something like Representative Armey's plan. But I just made the point that I don't think the best should become the enemy of the good. If, for example, we were to restore a credit similar to the one we had for two earners up until 1986, considering the high marginal tax rates we have in place today, that, of course, would be folded out later if we went to a flat tax.

Mr. CHRISTENSEN. Well, I know the——

Mr. REYNOLDS. The best I think I would expect to accomplish in this session of Congress is to repeal the 36-percent tax bracket. I would also like to see repealed the "temporary" 1990 provision that was made permanent in 1993, that folds out deductions and exemptions as your income exceeds $108,000. That, too, is an increase in marginal rates, a very sneaky one, and part of the marriage penalty, as was just pointed out.

As your income rises, whether it is from one earner or two, you begin to take a step from the 28- to the 31- to the 36-percent bracket, and you are losing your deductions and exemptions. Pretty soon the message is very clear: let's play more golf, one of us should stay home. The economy is deprived of the services of some very highly educated, competent professional people who would, were they not being so heavily punished, go to work.

Although I said I wouldn't dabble in fairness, I don't think it is particularly fair that just because one spouse happens to make over $140,000 of taxable income that the other one, regardless of his or her income, is taxed at that same rate. I don't see that as fair. That is not two people making the same income. Very often the second person is making only $20,000 or $30,000, yet they are in the highest tax brackets.

Mr. CHRISTENSEN. You mentioned Dick Armey's flat tax. Some day I hope we will be able to sit down on April 14, the night before our taxes are due, and on a 4 by 6 card or a 3 by 5 card be able to put down earned income or unearned income and go ahead and put down the 17-percent tax, fill out this little card and have it all done with.

My question to Ms. O'Connell would be, on that idea, there are probably 70,000, 80,000-plus accountants in your profession that belong to the AICPA and other organizations. As a tax attorney, what kind of ramifications do you see for your own profession?

Ms. O'CONNELL. We would love it, and there is plenty to do. You know, the gentleman has left the dais who asked me questions about helping people prepare returns accurately. Tax attorneys rarely prepare returns. We tend more to follow the elephants, I am afraid, after the returns have been filed.

But in thinking about how to make it easier for a nation to understand what is on the returns, and thinking about how to advise my clients how to keep those receipts in the first place, what to look for, how to conduct themselves in the most advantageous way when they don't have sophisticated financial situations, something like the marriage penalty tax is doable.

What do we think about a simpler tax system with simpler returns? There is a wonderful thing to be accomplished there, for individuals in particular. The business return, whether it be a subchapter S or a small C corporation and major corporations' returns will give this profession enough to do as long as any of us in this room would be doing it, I think.

Mr. CHRISTENSEN. I thank you.

Ms. Alstott, what kind of law do you teach and what did you do prior to your tenure at Columbia?

Ms. ALSTOTT. I teach tax law and tax policy and social welfare policy. Before I became a law professor at Columbia, I was in the Office of Tax Policy of the Treasury Department as an attorney advisor.

Mr. CHRISTENSEN. I really enjoyed your remarks.

Thank you, Mr. Chairman.

Mr. BUNNING. Mr. Ramstad will inquire.

Excuse me, Mr. Rangel.

You are next, Charlie.

Mr. RAMSTAD. That is right, Charlie. They get us confused more than once.

Mr. BUNNING. Mr. Ramstad.

Mr. RAMSTAD. I will be glad to yield.

Mr. BUNNING. Go ahead.

Mr. RAMSTAD. Thank you, Mr. Chairman.

First of all, I want to commend this panel for its pragmatism and wisdom as well. It is refreshing to hear the input of the type we have just heard. Let me ask one question.

In view of what I think is a consensus of the panel and most experts that phaseouts or targeting of tax benefits aggravate marriage tax penalties and produce work disincentives, I would ask the panel, how would you evaluate the administration's proposal to limit child tax credits to families with incomes of less than $60,000?

Ms. ALSTOTT. I think when we are talking about phaseouts, I mean, revenue is always important and I am sure that the administration's proposal was driven by that. Clearly, whenever you have a phaseout, whether it is in the tax system or the welfare system, you do get work disincentives.

On the other hand, it is important to distinguish between disincentives, which are financial penalties on actual earnings, and the actual effects of those disincentives, which is a much more complicated question. The task of the committee is a very difficult and complex one, which is to weigh the additional revenue cost of giving some relief to people over $60,000 or $65,000, against the marginal disincentives. So my point is just that I think it is a little harder question than Mr. Reynolds does.

Mr. RAMSTAD. What you are saying really, it is difficult to generalize as to the effect of the disincentives? Conceding the disincentive aspect, it is difficult to generalize behavior there from?

Ms. ALSTOTT. I think that is right. Although I am not an economist, it depends on which kind of group and at which income level the disincentives are falling on. Married women at all income levels are relatively sensitive to work disincentives, married men I believe are less sensitive to them.

Mr. RAMSTAD. Would the other two witnesses care to comment?

Mr. REYNOLDS. Yes, I would.

I have quite a few studies that you can go and check yourself that show the incentive effects are quite strong. I believe they are also stronger on primary earners than people think, primarily through the process of early retirement. But we will leave that aside.

The lower the threshold at which you cut off this benefit, any benefit, or the lower the threshold at which you begin to tax Social Security, for that matter, the more people are affected, obviously. So your $200,000 cap, although I object to it in principle, isn't going to affect very many people, because most people who earn over $200,000 don't have young children anymore. They have old children, who by the way, are more expensive. But as you approach—let's say you phase it out between $60,000 and $75,000, which is what I think the President's proposal is. To be losing a $500 credit that quickly, that is a very sharp marginal rate. The more children you have, the sharper it is.

With four children, that is $2,000 of tax breaks lost by raising your income $15,000. You would think twice about increasing your income. It encourages you to do almost anything but do that. To the extent you can, you will fudge your tax return. But when that is not possible, one person is not going to work, or you are going to work a little less, or you are going to not bother to save, or something—something bad happens.

Ms. O'CONNELL. I think the phase-out limit is strictly driven by budget considerations. It doesn't make a lot of sense to me that that, per se, affects people's conduct. My practical experience is they found out that it happened after it happened to them, when they in the spring of the succeeding year file a return about last year's activity. Then they are close to halfway through that year and they have to decide what to do about it, they can't necessarily do something about it immediately. So these ties are very hard to

make. Practically speaking, these kinds of family linked benefits have gone in and out, up and down, cut in and not cut in. I think a lot of people are saying, I am going to live the best life I can and cross my fingers. That is what I think.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Thank you all three of you.

Mr. CRANE [presiding]. Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman.

Professor Alstott, you said that you taught social policy as well as taxation. As a matter of social policy, does it make any sense for us to consider the tax cuts that are presently in the Contract With America, if the cost in terms of revenue of the tax cut is to be made up by cutting spending in order to reach a balanced budget? If you assume that Social Security is not going to be cut and neither the military, and if you assume further that at least 50 percent of the rest of the spending—since we can't cut interest on the debt that has to be paid, is it good social policy to cut into those existing programs, many of which are called entitlements, that provide for the services for the poor?

Ms. ALSTOTT. Let me just say that my written testimony was limited really to the merits of this proposal. I understand that your question goes more broadly. I am not in favor of cutting domestic, certain domestic programs, in particular, welfare programs. I am not in favor of taking welfare programs out of their current entitlement status.

It was my understanding that the committee was not particularly interested in my judgment on that. If that is your question, that is true. Certainly the committee needs to weigh what cuts are going to be made in order to come up with the $2 billion a year for this proposal.

On the other hand, I believe there are other areas in which we might, by changing the tax system or other areas of the budget, make up the revenue. So it is a difficult question.

Mr. RANGEL. Well, you didn't sound like it was difficult. You said that if you have to cut social programs, it doesn't make sense. It would seem to me that others might have said earlier that if it didn't cut the deficit, it doesn't make sense.

I didn't ask you that question, because you were not in that area. So your response—you are saying that you are only responding to this particular tax policy as it affected people married with children. But whether or not it is sound economic policy, based on the hypothetical I gave you, it would not be.

Ms. ALSTOTT. Based on the hypothetical you gave me, if there were an opportunity to make up for the revenue in other areas, for example, by curtailing the home mortgage interest deduction, you would get a different answer. I think that this policy is a good policy in the hypothetical you gave me. I think I gave you my answer.

Mr. RANGEL. All right.

Now, for the others, the Census Bureau and the IRS indicate that there are 14.3 million couples that experience a marriage penalty. This contract is very vague, they just say that $2 billion a year is supposed to be allocated toward relief of this penalty. So division would say that then you get about $140 a couple relief.

Now, if that matter is correct, should we be going through all of this for $140? I mean, is it really worth the administrative costs and the other problems that we would face, or at least IRS claims they would face, in changing the system, if indeed it turns out that they get $140 out of the $2 billion for the families affected?

Ms. O'CONNELL. If I may first, I think it is really worth it, Mr. Rangel. First, I am not sure about how many dollars on any particular couple's return it would mean.

Mr. RANGEL. This is only IRS. They hardly know either, but you know it is hard to know. We are just basing this on the little information that has been given to us by those that support this. They have no bill, so they just say take $2 billion and give relief to the married couple, couples who are penalized. So we said, OK. If that breaks out to $140, you can say, well, it is a start.

Ms. O'CONNELL. Well, Mr. Rangel, what I would urge on you is that at the lower income levels, while it might be $140 on the average for every single couple, if everybody was going to get the same credit, it could be at the lower income levels that you could do the arithmetic in such a way that it would be $500 or $1,000 for a particular couple. That then makes a big difference. So while it is a drop in the bucket on the average, for some couples it is going to be a lot more than that. For some families, it can mean a lot more than that.

Mr. RANGEL. Would you suggest that income cutoff at the high levels, where you don't think the $140 would make that much difference, and apply it to the lower income, make it progressive, so that it really would be something for the low-income people?

Ms. O'CONNELL. I dislike this result so much in the code that I would like to open it up to everybody without limit. But I realize that there is a cost of it somewhere, where that just becomes unreasonable. I would urge you to push it as far as you can to help some, every single couple that is paying a tax, just by virtue of the fact that they chose to be married; that is wrong.

Mr. RANGEL. But you would agree with the professor that if indeed it meant cutting deep into programs that the poor depend on, that we shouldn't even be discussing this at all?

Ms. O'CONNELL. Well, you are going to have to get the $2 billion somewhere. I think it is silly to meet—well, I would not think it would be appropriate to somewhat meet yourself coming and going. If you skew a credit to help lower income people who are seriously disadvantaged by a marriage penalty tax, it doesn't make sense to put it in their left pocket and take it out of their right pocket.

Mr. RANGEL. Makes a lot of sense to me, counselor.

Mr. CRANE. The time of the gentleman has expired.

Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

I think that what we are talking about as far as eliminating the marriage penalty, first of all, we have to look at what as a country we want to say when we are dealing with our Tax Code. Do we want to say that we don't want to encourage people to stay married?

I think that over the course of the history, obviously the family is the foundation of this country and I think a lot of us when we were looking at repealing the tax penalty on marriage, are really

looking at this in more general terms. We want to start reversing some of what the last 30–40 years has done to the family in this country.

We want to say we are looking for policies that will strengthen the family. We don't want to give incentives to break down the family.

Addressing some of the flat tax issues that we have heard brought up today, I want to echo my support for a flat tax. I think that it, first of all, automatically eliminates the marriage penalty. You don't have to do any figuring. If everybody's paying a flat tax, there is no marriage penalty, there is no single penalty, there just are no penalties in that regard. Obviously, it addresses some of what Ms. O'Connell talks about, and that is the simplification.

One item that I would like addressed maybe by you, Mr. Reynolds, is the GAO was in my office this morning briefing me on some tax policies and they talked about the earned income tax credit, that they are going to have a study coming out next week that will show approximately $1–$5 billion in fraud. When we are talking about some of these tax credits, could you address, the problems of fraud? Once again—versus the flat tax. When you don't have to worry about the fraud, you have more people coming into the system.

Mr. REYNOLDS. Yes. I am actually somewhat sympathetic about the earned income tax credit. It is, after all, kind of a negative income tax, an old Milton Friedman idea.

I was with George McGovern recently, he was pumping the old "Democrat" idea he proposed in 1972. I said, "We enacted that, you know, and it was greatly increased in 1993." There are a lot of problems with it. One of them is fraud. Another one is that it imposes high marginal tax rates. The more generous we get with it, the higher the tax penalties on work become. Why? Because you have to peel it away as income rises.

There is really no alternative to that. Unless you are going to be giving the EITC to people who make $60,000 a year, you have to peel it off fairly quickly. If you then combine it with some other program such as food stamps, extra work can face a 75-percent marginal tax rate. The EITC family is probably not poor enough to qualify for Medicaid, but if they were, it is all over: They just can't increase family income by extra work.

I can't over emphasize the importance of thinking at the margin. The Republicans are talking about increasing the amount of money exempt from inheritance tax. But once you reach that limit, the marginal tax rate is 35 to 55 percent, like it always was. So you have a very strong incentive to limit the amount of savings to avoid ending up with a big estate, and to do a lot of estate planning that probably ends up losing the government a lot of money. This failure to keep marginal tax rates reasonable permeates all of these issues.

We are starting to use the Tax Code to try to redistribute income. There is no evidence in any country, at any time, that this has ever worked. The only thing redistributive tax policy has ever done is put a lid on prosperity. It can do that, it can keep people from getting up there. It doesn't help poor people to know that rich people are being punished for being rich. Basically, the whole no-

tion is goofy. It leads to all sorts of other problems, including the EITC, which also has high marginal tax rates.

Mr. ENSIGN. Thank you, Mr. Chairman.

Mr. CRANE. Mr. Ford.

Mr. FORD. Thank you, Mr. Chairman.

Mr. Chairman, I have got one question for professor, is that Alstott?

Ms. ALSTOTT. Yes.

Mr. FORD. Yes, you concluded your testimony in saying: "If a credit is the preferred solution, further thought should be given to coordinating it with the earned income tax credits. A refundable credit would provide relief for earned income tax credit recipients who face a marriage penalty but do not have the necessary income." There has been a lot of talk on the welfare reform package in reference, joined with, I guess, out-of-wedlock births by a number of members on this committee and others throughout this country. We are talking about low-income people having family breakup and family values, talked a lot about over this last campaign.

Should we target this marriage penalty credit directly to low-income families, this marriage penalty? Should it be applied only to low-income families as we take a look at the teenage pregnancy problem in the welfare package, or will we see family breakup among low-income families in this country?

Ms. ALSTOTT. Two points, I guess. First of all, again, drawing this, I recognize, academic distinction, but I think an important one between incentives and behavior, it is not all that clear to me to what extent out-of-wedlock births really are encouraged by financial penalties in the welfare system or the tax system. But that being said, clearly it is inconsistent for us, on the one hand, to tell low-income people through our welfare policy that they ought to be getting married, and then, on the other hand, through our welfare and tax policies take money away from them if they do. As to the question whether we should——

Mr. FORD. But the refundable credit would be a credit directly, even if they did not have the income. They would be receiving a credit, a refundable credit, I guess, in terms, would mean that they would receive the amount of money from the Federal Government.

Ms. ALSTOTT. A transfer payment, just like the EITC.

Mr. FORD. Which would, in essence, reduce the welfare payments on families; is that correct?

Ms. ALSTOTT. It would depend on the language you enacted, basically. The EITC, for example, does not directly reduce welfare payments, at least in the first months after it is received. It depends on how quickly it is spent.

You could adopt that or you could coordinate it differently with welfare. But it would be possible to give welfare families some credit, at least if they were two-earner couples. That is an empirical question, how many of them are two-earner couples.

Mr. FORD. But we don't know all of the reasons why paternity is not established at or before birth. We really don't know whether the marriage penalty, applying only to that population that would qualify for the earned income tax credits, whether or not it would reduce the payments or reduce the out-of-wedlock births. I mean, we are faced with the problem in this country and when we talk

about those out-of-wedlock births, we know that there is not only a problem at the upper income or middle-income people in America, but the lower income people who are getting all of the blame for the teenage pregnancy problems, as well as the out-of-wedlock births.

Ms. ALSTOTT. Right. I think you are right, that we simply don't know. I think of the best social science evidence that we have suggests if there is, if any, a very weak relationship between marriage penalty and welfare programs, there is clearly a lot of factors that go into the decision to have a child out of wedlock. Whether tax and welfare policies contribute in a big way, it is not at all clear.

Mr. FORD. When you talk about the refundable credit, what do you really mean?

Ms. ALSTOTT. By a refundable credit, I simply mean, if we are going to do this through a tax credit, that we ought to ensure that at least some of the relief is available to people who get the EITC or who are otherwise so poor that they do not owe income tax.

Mr. FORD. What if they do not owe income tax, would any of that apply for a direct——

Ms. ALSTOTT. Yes, a refundable credit would mean if they are too poor to owe income tax, whatever extra credit they have would simply be a cash refund to them from the IRS, they would get a check.

Mr. FORD. Most AFDC or public assistance programs are means-tested programs, which would reduce any other Federal payment going to them through food stamps or through AFDC.

Ms. ALSTOTT. It wouldn't necessarily do that. You could write into the legislation language that we now have the current EITC which limits the extent to which the refund is treated as an asset or a resource for the transfer payments.

Mr. FORD. It would not have impact overall?

Ms. ALSTOTT. Exactly, if that is what you want.

Mr. FORD. Thank you, Mr. Chairman.

Mr. CRANE. I want to thank the panel for their testimony. We appreciate your appearing here today.

Now I adjourn this panel and convene panel No. 4, Thomas Bloch, Phyllis Schlafly, Gary Bauer, Beverly LaHaye, and Robert Shapiro.

If you folks will come up here, please.

Mr. CRANE. Proper etiquette dictates that ladies shall go first. I want to welcome this panel, but especially I want to welcome a very dear and longtime friend, a fellow Illinoisan, Phyllis Schlafly.

Phyllis, if you would be so kind to kick it off, we will work down the line with the fellows.

STATEMENT OF PHYLLIS SCHLAFLY, PRESIDENT, EAGLE FORUM

Ms. SCHLAFLY. Thank you very much, Mr. Chairman—and I am very happy to see you there as chairman—and members of the committee.

Among the many dramatic changes that have taken place in America over the last 40 years, the changes in taxes are one of the most important. It is difficult to avoid the conclusion that the Federal Tax Code has been waging a silent war on traditional families,

the kind of families that stay together, work hard, raise their children, and pay their taxes.

When I was having my children, the typical couple with two children paid 2 percent of its annual income in Federal taxes. Today, the same type of family pays almost 25 percent of its annual income in Federal taxes. That means one-fourth of everything they earn goes right off the top to the government here in Washington.

When we hear wives and mothers assert that today's economy requires two incomes, that they have to take a paid job in order to maintain a reasonable standard of living, and that they therefore need subsidized day care, let's be blunt about what this means. Mothers don't have to work in order to support their families. They have to work in order to pay their taxes and support the Federal bureaucracy.

Of course, we all know that everybody's taxes have gone up. But the tax burden on traditional families has risen out of all proportion to taxes on other segments of our society. The skewing of the Federal income tax came about because of the change in the way that children are valued and treated.

When I was having my children in the fifties, each child enjoyed a $600 income tax exemption, which then amounted to 17 percent of the median family income. A family consisting of a father, a mother, and two children thus had exemptions of $2,400, or 72 percent of the then median family income.

When my grandchildren were born in the eighties, a child had an income tax exemption of $1,000 but factoring in the changes in the median income, the value of money and the tax rates, the $1,000 child exemption was then only 4 percent of the median family income. The per-child exemption had been devalued by three-fourths.

Since Eagle Forum started exposing this discrimination in November 1982, the per-child exemption has been slowly raised to its present level of $2,450. But if a child were to have the same worth in today's income Tax Code as it did 40 years ago, the child's exemption would have to be at least $7,500. However, the per-child exemption starts to be phased out at the $83,850 level.

Meanwhile, the Federal Tax Code has been powerfully skewed to favor single-parent families. The head-of-household tax status provides single mothers virtually the same benefits as the joint return. The huge expansion of the refundable earned income credit has tended to make a wage-earning father irrelevant. The Democrats have falsely called the earned income credit a tax reduction, but it is actually just more welfare to single mothers because it is a cash payment scaled up to $2,528.

Also, families that use hired day care for their children instead of in-home mother care are favored with the dependent tax credit of up to $960. This is available to parents without any income cap for wealthy parents. Incidentally, it is the only tax benefit that is not capped. This means that the higher income two-earner couples get a credit for higher child care but in-home mothers are even deprived of the ordinary child exemption.

These factors have resulted in the situation that traditional families, the ones who are keeping their families together and raising their children, have borne an enormous and discriminatory share

of the great expansion of government spending over the last 40 years. This result is not only unjust and unfair, it is counterproductive for society because all social data confirm that children from traditional families cost the taxpayers much less in remedial social problems than children from broken families.

The devaluation of the child in traditional families in the Federal income Tax Code was done really without any public debate or discussion whatsoever. I, therefore, thank this Ways and Means Committee for holding this hearing to flesh out this issue for public discussion. I hope you will consider this $500 tax credit for children just one step on the way to a large tax reduction and tax relief for all Americans.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT TO THE U.S. HOUSE WAYS AND MEANS COMMITTEE

by PHYLLIS SCHLAFLY, President, Eagle Forum

January 17, 1995

Among the many dramatic changes that have taken in America over the past 40 years, the change in taxes is one of the most important. Taxes are not merely a means of raising revenue for the government; taxes provide incentives and disincentives that induce or inhibit human behavior in a powerful way. It is difficult to avoid the conclusion that the federal tax code has been waging a silent war on traditional families, the kind of families that stay together, work hard, raise their children, and pay their taxes.

When I was having my children, the typical couple with two children paid 2 percent of its annual income in federal taxes. Today, the same type of family pays almost 25 percent of its annual income in federal taxes. That means one-fourth of everything they earn goes, right off the top, to the government here in Washington.

When we hear wives and mothers assert that today's economy "requires two incomes," that they "have to take a paid job" in order to maintain a reasonable standard of living, and that they therefore "need subsidized daycare," let's be blunt about what this means. Mothers don't "have to work" in order to support their families; they "have to work" in order to pay their taxes and support the federal bureaucracy.

Of course, we all know that everybody's taxes have gone up. But the tax burden on traditional families has risen out of all proportion to taxes on all other segments of society. This skewing of the federal income tax came about because of the change in the way that children are valued and treated.

When I was having my children in the 1950s, each child enjoyed a $600 income tax exemption, which then amounted to 17 percent of the median family income. A family consisting of a father, a mother and two children thus had exemptions of $2,400, or 72 percent of the then median family income.

When my grandchildren were born in the 1980s, a child had an income tax exemption of $1,000. Factoring in the changes in the median income, the value of money and tax rates, the $1,000 child's exemption was then only 4 percent of the median family income. The per-child exemption had been devalued by three-fourths.

Since Eagle Forum started exposing this discrimination in November 1982, the per-child exemption has been slowly raised to its present level of $2,450, but if a child were to have the same worth in today's income tax code as it did 40 years ago, the child's exemption would have to be at least $7,500. However, the per-child exemption starts to be phased out at the $83,850 income level.

Meanwhile, the federal tax code has been powerfully skewed to favor single-parent families. The "head-of-household" tax status provides single mothers virtually the same benefits as the joint return. The huge expansion of the refundable earned income credit has tended to make a wage-earning father irrelevant. The Democrats have falsely called the earned income credit a "tax reduction," but it is actually a cash payment scaled up to $2,528, i.e., more welfare to single mothers.

Also, families that use hired daycare for their children instead of in-home mother care are favored with the dependent-care tax credit of up to $960. This is available to parents without any income cap for wealthy parents (incidentally, the only tax benefit that is not capped). This means that higher-income couples get a credit for hired child care, but in-home mothers are even deprived of the ordinary child exemption.

These factors have resulted in the situation that traditional families, the ones who are keeping their families together and raising their children, have borne an enormous and discriminatory share of the great expansion of government spending over the last 40 years. This result is not only unjust and unfair, it is counterproductive for society because all social data confirm that children from traditional families cost the taxpayers less in remedial social programs than children from broken families.

The devaluation of the child in traditional families in the federal income tax code was done without any public debate or discussion whatsoever. Politics has been my lifetime hobby, but I never heard a single Congressman or commentator discuss this massive change in the income tax code during the years when the U.S. tax burden was shifted onto the backs of traditional families with children. It was done covertly, behind closed doors, by the Congressional committees that wrote the fine print of the income tax law.

I thank the House Ways and Means Committee for holding this hearing to flesh out this issue for public discussion. We support the $500 per-child tax credit as a first step toward fairness for families. It should be just as available to upper-income families as the dependent care tax credit.

The Congressional election last November contains many lessons, but one of them surely is a loud cry for tax reduction — for everyone. I urge the Committee to look upon the $500 per-child tax credit as just one step along the way to tax relief for all Americans.

Mr. CRANE. Thank you for your testimony.
Ms. LaHaye.

STATEMENT OF BEVERLY LAHAYE, PRESIDENT AND FOUNDER, CONCERNED WOMEN FOR AMERICA

Ms. LAHAYE. Mr. Chairman, members of the committee, as president of the Nation's largest profamily women's organization, I represent the over 600,000 members of Concerned Women for America, or CWA. CWA is a grassroots organization with local and State chapters across the United States and our commitment is to the preservation of the American family. I am here today to testify in favor of the American Dream Restoration Act because for too long, government has placed an undue tax burden upon the shoulders of families.

CWA is primarily a woman's organization, and as president, I travel frequently across the United States meeting and speaking to many different women from all backgrounds and interests. But I am consistently overwhelmed and saddened by the untold numbers of women who tell me they wish they could stay at home to raise their children, but for economic reasons they must work. When you look at the figures, it is clear why so many of these women must remain in the work force.

In 1948, only 3 percent of a family of four's median income went to the Federal Government in taxes. But by 1992, that family was paying almost 24.5 percent of its income to the Federal Government. Add to that figure the amounts paid for State, local, and indirect Federal taxes and that same family of four paid 37.6 percent of its income in taxes. While an unmarried, median-income American's Federal taxes have risen 31 percent since 1948, a median-income family of four's taxes have increased 2,500 percent in the same time. Furthermore, the current Tax Code discriminates against those mothers who choose to remain at home instead of pursue a career. Two-income households are given the DCTC, dependent care tax credit, of $480–$720 per child for up to two children. But this credit is not available to those families where one parent remains at home. What kind of message does this send to American families?

Families are the cornerstone of this Nation. In recent years we have all heard a great deal about family values and the importance of strengthening families. Americans are waking up to the fact that without families, we will fall as a nation.

I was particularly heartened by this Congress' actions to create a family friendly environment. I think that is just one example of a growing realization in America that not only are families vital, but government cannot provide an adequate substitute for the family. Families instill values, tradition, discipline, and serve as the best agency for health, education, and welfare. So when American families cannot prosper, neither can the future of America.

Currently, in a two-parent, two-income household, two-thirds of the average working mother's salary goes toward increased taxes. That means the additional income she brings in does not go toward paying for a house mortgage, braces for the children, or groceries. This may be one very good reason that so many voters opted for a change in Congress last November.

It is not difficult to understand why so many parents who must work are frustrated when you consider that they watch their money being consumed by a government that spends six times the amount each year of what it did in 1948.

I believe the American Dream Restoration Act would begin to rectify the unfair tax burden on the family and would instead empower them. Thirty-five million American families would be eligible for this 500-dollar-per-child tax credit. For a family of four earning $40,000 a year, that would mean their tax bill is reduced by 10.4 percent. But all American families should be able to receive this tax credit, regardless of their level of income. By means-testing this credit now, the door stands wide open for the level to be decreased in future years. Furthermore, I think it is helpful to remember that this money belongs to the men and women who earn it, not to the government. This tax credit is not entitlement money; if anything, it serves as a handcuff to keep the government from reaching deeper into the pockets of American families.

It has been reported that some Members of Congress are questioning whether or not this tax credit is a good idea. Some have estimated it would cost the Treasury $110 billion over 5 years. There are, without doubt, many difficult decisions that will have to be made in order to bring the deficit down and put our country's finances back in order. But families cannot continue to shoulder the responsibility of paying for government's insatiable appetite. Spending cuts must be made and Concerned Women for America will support you in that process.

Mr. Chairman, members of the committee, thank you for allowing me to—the opportunity to present our views on this important issue. Tax relief for American families is critical and its time is certainly overdue. Concerned Women for America supports the American Dream Restoration Act fully and hopes that this committee and Congress will pass it quickly. Thank you.

[The prepared statement follows:]

Testimony of Dr. Beverly LaHaye
President of Concerned Women for America
to The Committee on Ways and Means
United States House of Representatives
January 17, 1995

Mr. Chairman, Members of the Committee, as President of the nation's largest pro-family women's organization, I represent the over-600,000 members of Concerned Women for America (CWA). CWA is a grassroots organization with local and state chapters across the United States, and our commitment is to the preservation of the American family. I am here today to testify in favor of "The American Dream Restoration Act" because for too long government has placed an undue tax burden upon the shoulders of families.

CWA is primarily a woman's organization, and as President, I travel frequently across the United States meeting and speaking to many different women from all backgrounds and interests. But I am consistently overwhelmed and saddened by the untold numbers of women who tell me they wish they could stay at home to raise their children, but for economic reasons, they must work. When you look at the figures it is clear why so many of these women must remain in the work force.

In 1948 only three percent of a family of four's median income went to the federal government in taxes. But by 1992, that family was paying almost 24.5 percent of its income to the federal government. Add to that figure the amounts paid for state, local and indirect federal taxes, and that same family of four paid 37.6 percent of its income in taxes. And while an unmarried, median-income American's federal taxes have risen 31 percent since 1948, a median-income family of four's taxes have increased 2,500 percent in the same time. Furthermore, the current tax code discriminates against those mothers who choose to remain at home instead of pursue a career. Two-income households are given the Dependent Care Tax Credit (DCTC) of $480 to $720 per child for up to two children. But this credit is not available to those families where one parent remains at home. What kind of message does this send to American families?

Families are the cornerstone of this nation. In recent years we have all heard a great deal about "family values" and the importance of strengthening families. Americans are waking up to the fact that without families, we will fall as a nation. I was particularly heartened by this Congress' actions to create a "family friendly" environment. I think that is just one example of a growing realization in America that not only are families vital, but government cannot provide an adequate substitute for the family. Families instill values, tradition, discipline, and serve as the best agency for health, education and welfare. So when American families cannot prosper, neither can the future of America.

Currently, in a two-parent, two-income household, two-thirds of the average working mother's salary goes toward increased taxes. That means the additional income she brings in does not go towards paying for a house mortgage, braces for the children, or groceries. This may be one very good reason that so many voters opted for a change in Congress last November. It is not difficult to understand why so many parents who must work are frustrated when you consider that they watch their money being consumed by a government that spends six times the amount each year of what it did in 1948.

I believe that "The American Dream Restoration Act" would begin to rectify the unfair tax burden on the family and would instead empower them. Thirty-five million American families would be eligible for this $500-per-child tax credit. For a family of four earning $40,000 a year, that would mean their tax bill is reduced by 10.4 percent. But all American families should be able to receive this tax credit, regardless of their level of income. By means-testing this credit now, the door stands wide open for the level to be decreased in future years. Furthermore, I think it is helpful to remember that this money belongs to the men and women who earn it, not to the government. This tax credit is not entitlement money; if anything, it serves as a handcuff to keep the government from reaching deeper into the pockets of American families.

It has been reported that some Members of Congress are questioning whether or not this tax credit is a good idea. Some have estimated that it will cost the Treasury $110 billion over five years. There are without doubt, many difficult decisions that will have to be made in order to bring the deficit down and put our country's finances back in order. But families cannot continue to shoulder the responsibility of paying for government's insatiable appetite. Spending cuts must be made and Concerned Women for America will support you in that process.

Mr. Chairman, Members of the Committee, thank you for allowing me the opportunity to present our views on this important issue. Tax relief for American families is critical and its time is certainly long overdue. Concerned Women for America supports "The American Dream Restoration Act" fully and hopes that this Committee and Congress will pass it quickly.

Mr. CRANE. Thank you for your testimony. Let me reassure all of the witnesses that if you have any remarks that go beyond presentation time, all of your remarks will be included in the record.

Mr. Shapiro.

STATEMENT OF ROBERT J. SHAPIRO, VICE PRESIDENT, PROGRESSIVE POLICY INSTITUTE

Mr. SHAPIRO. Thank you, Mr. Chairman. I want to thank the members of the Ways and Means Committee for the opportunity to appear here today and offer the views and analysis of the Progressive Policy Institute and the Democratic Leadership Council regarding tax relief for American families with children.

We believe, first, the Tax Code should be reformed to exempt from Federal income tax the private resources which a moderate-income or middle-income family needs to raise its children. This can be achieved by replacing the current $2,400 dependent exemption with a $720 per-child tax credit for families in the 15-percent income tax bracket, covering all families with incomes of roughly $45,000 a year or less. For these families, this credit would be equivalent to doubling the current children's exemption, excluding from income tax $4,800, or roughly the amount an average-income family spends each year raising a child. This reform would reduce Federal revenues by roughly $55 billion over 5 years.

This relief is especially pressing given the gradual and steady deterioration over the last 20 years in our economy's underlying growth rates for net investment, productivity, and overall output which has reduced opportunities for upper mobility by most American families.

Consider the following data. The average person entering the work force at age 20 or age 30 in 1950 doubled his or her income over the next 20 years, even after adjusting for both inflation and the cost of raising a child. Unhappily, these opportunities for mass upper mobility ended in the seventies. An average American entering the work force at age 20 or age 30 in 1970 found that after 20 years of hard work in 1990, his or her family income had grown by barely 10 percent after adjusting for inflation and the cost of raising a child. As a result, for some time, the vast majority of two-parent families have required two working parents just to maintain their incomes and a large share of single parents are forced to hold two jobs.

The first responsibility of the Congress and the President should be to restore the economic conditions for mass upward mobility by reducing the deficit, actively promoting personal savings, and expanding vital public investment in education and training, the economic infrastructure, and basic research. Until these reforms are achieved, the Federal Government at the least should not burden the child-rearing efforts of average-income families by taxing the resources they need to raise their children.

Second, we believe that at this time tax relief should be focused on families in the 15-percent tax bracket. To begin, the economic case for tax relief for higher income people is less pressing. The data showed that through the seventies, eighties, and into the nineties, while most working families have been struggling with protracted stagnation in their standard of living, highly educated

and highly skilled people have been able to maintain the rates of economic progress open to everyone in the fifties and sixties. Roughly the top 20 percent of the work force, principally professionals and managers, have continued to enjoy annual income gains averaging 4 to 6 percent a year over the last 20 years, sufficient on average to double their incomes, after accounting for inflation and the cost of raising a child. Moreover—and I would like to emphasize this—the current tax system already provides nearly comparable support to higher income families. For families in the 28-percent tax bracket, the present $2,400 per-child deduction is already equivalent to a $672 per-child tax credit.

Every dollar of tax relief approved this year will reduce the pool of private capital available for business investment in the plant, equipment, training, and technological advance necessary to restore mass upward mobility. Providing additional tax relief to these higher income families as well would reduce potential private investment by $10 to $12 billion a year, more than 10 percent of the average annual net business investment over the last 5 years. At this time, it would be a serious error in economic and social policy to reduce potential private investment in order to increase the post tax incomes of families whose incomes have been rising substantially and steadily, who already earn the resources necessary to provide their children significant advantages, and who already enjoy a tax exclusion for children nearly comparable to the reform we propose for those with lower incomes.

Finally, Congress must provide a permanent stream of resources to finance any tax relief for moderate- and average-income families with children. The only way to ensure that family tax relief does not expand deficit borrowing and thus reduce the long-term economic prospects of these same children is through permanent revenue or entitlement changes. Reductions in discretionary spending cannot provide this assurance since at any time Congress could increase the same appropriated accounts.

In order to promote the economic prospects of America's children in both the near term and the long term, Congress should provide family tax relief as part of a much larger package of spending and tax changes which reduce the deficit by at least $2 for every $1 of tax reduction. These resources should come first from current spending and tax programs which actively undermine the economy's basic efficiency and productivity, principally spending and tax subsidy programs for particular industries which in the past have been able to exercise inordinate influence over the budget and tax-writing process.

One year ago, the Progressive Policy Institute published a report, "Cut and Invest To Compete and Win: A Budget Strategy for American Growth," identifying 68 instances of spending and tax subsidy programs serving no overriding social or economic purpose and which, if eliminated, would yield $225 billion over 5 years. I would note this program was endorsed this morning in the lead editorial of the New York Times. Previously, it was endorsed by the Wall Street Journal. Next month, we will publish a second edition of this report cataloging additional unproductive subsidies which, if reformed, could provide the resources for deficit reduction and public investment as well as family tax relief.

We at the Progressive Policy Institute are gratified that the President and both parties in Congress now endorse tax relief for financially strapped American families. We urge you to enact this reform on a sound and proper basis. Until the deficit is eliminated, tax relief should be provided to those families which most need it. It should be financed on a permanent basis and it should be part of a larger effort to reduce the deficit, focused on subsidies and other ineffective Federal activities that undermine American growth and the long-term prospects of all American children.

Thank you.

[The prepared statement follows:]

Statement of Robert J. Shapiro
Vice President, Progressive Policy Institute

before
The Committee on Ways and Means
United States House of Representatives

Washington, D.C.
January 17, 1995

I want to thank the members of the Ways and Means Committee for the opportunity to appear here today and offer the views and analysis of the Progressive Policy Institute and the Democratic Leadership Council regrading tax relief for American families with children. It is a matter of genuine social and economic significance.

I will first state our conclusions and then offer our underlying analysis and evidence.

First, the federal tax code should be reformed to exempt from federal income tax the private resources which a moderate-income or middle-income family needs to raise its children. This can be achieved by replacing the current $2,400 dependent exemption with a $720 per-child tax credit for families in the 15 percent income-tax bracket, covering all families with incomes of roughly $45,000 a year or less. For these families, this reform would be equivalent to doubling the current children's exemption, and so excluding from federal income tax $4,800 or roughly the amount an average-income family spends each year raising a child. This tax credit, like the current dependent's exemption, should be indexed for inflation. This reform would reduce federal revenues by roughly $55 billion over five years.

Second, at this time this tax relief should be focused on families in the 15 percent tax bracket. The current tax system *already* provides nearly comparable support to higher-income families: For families in the 28 percent tax bracket, the current $2,400 per-child deduction is equivalent to a $672-per child tax credit. Moreover, in the current budget environment in which any tax reduction, by itself, would reduce the store of investment capital needed by American business to generate jobs and increase their productivity and output, family tax relief should be focused on those families whose limited incomes constrain their ability to raise their children.

Third, family tax relief should be financed by other revenue reforms which raise equivalent resources, in order to preserve the existing federal revenue base and ensure that this reform does not inadvertently undermine the economic prospects of the children we wish to help, by expanding the federal deficit in later years.

If and when Congress and the President eliminate the federal deficit or otherwise substantially increase the national savings rate, we would urge the Congress to expand the extent and coverage of tax relief for all families with children.

Since its founding, the Progressive Policy Institute has advocated federal reforms to relieve the economic stresses facing moderate-income and middle-income families raising children. In this effort, we urge the Committee to recognize certain economic developments of recent decades which threaten the prospects of most American children. First, a gradual and steady deterioration over the last 20 years in

the U.S. economy's underlying growth rates for net investment, productivity, and overall output has reduced the opportunities for upward mobility by most American families. Consider the following data. The average person entering the work force at age 20 or age 30 in 1950 doubled his or her income over the next 20 years, even after adjusting for both inflation *and* the costs of raising a child. These broad opportunities for mass upward mobility, however, ended in the 1970s. An average American entering the work force at age 20 or age 30 in 1970 found that, after 20 years of hard work, his or her family income had grown by barely 10 percent, after adjusting for inflation and the cost of raising a child.

This radical deterioration in the long-term income gains of American parents has significantly reduced the time and care many parents can provide their children. For some time, the vast majority of two parent-families have required two working parents just to maintain their incomes, and a large share of single parents are forced to hold two jobs. The first responsibility of the Congress and the President should be to restore the economic conditions for mass upward mobility, through broad economic reforms that can elevate the economy's underlying growth rates of investment, productivity and output: Reduce the deficit; actively promote personal savings; and expand vital public investment in education and training, the economic infrastructure, and basic research. Until these basic economic reforms are achieved, the federal government, at the least, should not burden the child-rearing efforts of average-income families by taxing the resources they need to raise their children.

The economic basis for family tax relief provides guidance for its coverage as well as its extent. Through the 1970s, 1980s and into the 1990s, while most working Americans have been struggling with a protracted stagnation in their standards of living, highly-educated and highly-skilled people have been able to maintain the rates of economic progress open to everyone in the 1950s and 1960s. Roughly the top 20 percent of the work force, principally professionals and managers, have continued to enjoy annual incomes gains averaging four-to-six percent a year over the last 20 years; sufficient on average to double their incomes, after accounting for inflation and the costs of raising a child. In any event, as noted earlier, for these families, in the 28 percent tax bracket, the current $2,400 per-child exemption is already nearly equivalent to the $720 per-child tax credit we propose to eliminate tax liability on the income a moderate- and middle-income family needs to raise a child.

Every dollar of tax relief approved this year will reduce the pool of private capital available for business investment in the plant, equipment, training, and technological advance necessary to restore mass upward mobility. At this time, it would be a serious error in economic and social policy to reduce potential private investment in order to increase the post-tax incomes of families whose incomes have been rising substantially and steadily, and who already earn the resources necessary to provide their children significant advantages. Providing comparable additional tax relief to these higher-income families as well would reduce potential private investment by $10 to $12 billion a year, or more than 10 percent of average annual net business investment over the last five years.

Finally, Congress must provide a *permanent* stream of resources to finance any tax relief for moderate- and average-income families with children. The *only* way to ensure that family tax relief does *not* expand deficit borrowing, and thus reduce the long-term economic prospects of these same children, is through permanent revenue or entitlement changes. Reductions in discretionary spending cannot provide this assurance since at any time Congress could increase the same appropriated accounts. Financing family tax relief through a legislative cap on discretionary spending also will not protect the economy and our children from the deficit implications of tax relief, because a cap represents only a promise to find the necessary resources in the future.

In order to promote the economic prospects of America's children in both the

near-term and the long-run, Congress should provide family tax relief as part of a much larger package of spending and tax changes which reduce the deficit by at least $2 for every $1 of tax reduction. These resources should come, first, from current spending and tax programs which actively undermine the economy's basic efficiency and productivity—principally spending and tax subsidy programs for particular industries which in the past have been able to exercise inordinate influence over the budget and tax-writing processes.

These subsidies—from public payments to profitable agribusinesses and below-market-priced power from federal hydroelectric facilities, to federal payments to Amtrak and special tax breaks for oil and gas firms, business entertainment, and large credit unions—weaken our national economic base in two principal ways. First, industries receiving these taxpayer-financed favors gain an artificial edge in the economy, leaving other sectors and companies at a competitive disadvantage and preventing labor and capital from slowing to their most efficient uses. And second, like a narcotic, these subsidies ultimately weaken the firms and industries that come to depend on them, by artificially underwriting their rates of return and so insulating the, from competitive pressures to figure out how to be more efficient, productive and innovative.

A year ago, the Progressive Policy Institute published a report, *Cut and Invest To Compete and Win: A Budget Strategy for American Growth*, identifying 68 instances of spending and tax subsidy programs serving no overriding social or economic purpose and which, if eliminated, would yield $225 billion over five years. Next month, we will publish a second edition of this report cataloguing additional unproductive subsidies which, if reformed, could provide the resources for deficit reduction and public investment as well as family tax relief.

Reforming industry subsidies will not be easy. As former budget director David Stockman learned in 1981—and President Clinton learned again in 1993—Congress almost never withdraws special treatment for special interests on a one-by-one basis. Therefore, we urge the Congress and the President to tackle this problem by using the all-or-nothing model of the Military Base Closing Commission. A Commission on Industry Subsidies and National Competitiveness should be created to evaluate all industry-specific programs in the budget and the tax code, recommend their reform or repeal if they serve no overriding social or economic purpose, and present the entire package of changes to Congress. As with base closings, Congress would have to vote these recommendations up or down *without amendment.*

We at the Progressive Policy Institute are gratified that the President and both parties in Congress now endorse tax relief for financially-strapped American families. We urge you to enact this reform on a sound and proper basis. Until the deficit is eliminated, tax relief should be provided to those families which most need it; it should be financed on a permanent basis; and it should be part of a larger effort to reduce the deficit focused on subsidies and other ineffective federal activities that undermine economic growth and the long-term prospects of all working Americans.

Mr. CRANE. Thank you.
Mr. Bauer.

STATEMENT OF GARY L. BAUER, PRESIDENT, FAMILY RESEARCH COUNCIL

Mr. BAUER. Yes, sir. Mr. Chairman, it is a real pleasure to be here this morning. I suspect by now that you probably have all heard all the figures that could possibly be put in this debate, so with your permission, I would like to submit my statement and use my time to just make a couple of points about the overall debate.

Mr. Chairman, the last couple years, there has been a lot written about cynicism in America and why Americans are so cynical. I don't think you have to look much further than the debate over profamily tax relief than to find a reason for that cynicism.

Back in 1986, Ronald Reagan asked me to head up a working group on the family and to come up with some recommendations to help the family. We spent months looking at all the issues and a major—one of our major recommendations was exactly this kind of family tax relief.

The public responded very positively, but within a couple of weeks, it was absolutely obvious that there was no political consensus in the Congress for helping families. Rather, there was more interest in protecting the Washington bureaucracy than there was in allowing families to keep more of their own money.

A few years later, in 1991, Senator Rockefeller headed a bipartisan commission on children. Bill Clinton served on that commission. They spent over 1 year looking at the problem. Lo and behold, they came up with the same solution: Major tax credits and increases in the exemptions.

The public loved it. Within a few weeks, the issue died down again because there was no political will to deal with it.

I have been traveling around the country the last couple of months trying to tell folks that this time it will be different, that, in fact, this Congress really is serious about doing something to help American families keep more of their own hard-earned money. I would hope that as this debate gets more heated, which inevitably it will, that you all will not back down on that goal.

The second point I would like to make is about how Washington almost always has it exactly backward. In the last 10 years, there have been a number of tax increases that have hit the American family. Every time those taxes have been increased, the Washington establishment has praised the politicians who voted the increases. In fact, you even got more praise if you ran on a platform of lowering taxes and then came to Washington and raised them, because then the Washington establishment inevitably said that you had grown in office by reversing your position.

Compare that rhetoric to the rhetoric of the last 2 months on this issue. The entire Washington establishment and even some Members of the House have accused you of pandering to the American people because you want to allow them to keep some of their own money. Now that is extraordinary. Take money away from the American family and you have grown. Let the American people keep their hard-earned money and you are pandering to them. So

again, I would urge you just keep in mind that whatever this city is saying is probably a good signal to do the exact opposite.

My final point I would like to address to those on Wall Street, because there is some skepticism on Wall Street about this kind of tax break. Many on Wall Street would like to see only a decrease in the capital gains tax, which I also support, and some economists and some business magazines have said that profamily tax relief isn't good because it really won't do much to generate economic growth. I think we need to remind Wall Street that the wealth of a nation is not measured only by what the close was in the Dow Jones average. The wealth of a nation is not measured only in the last incremental dollar in the gross national product. That the wealth of a nation is measured by the health of its families. That, in fact, today in America, the most important decisions will not be made in committees like this but they will be made around the dinner table.

Too many American families making those decisions are finding themselves hemmed in by big government and high taxes, and I can't think of anything that would be better for you to do for those families than to reverse that burden.

Thank you very much.

[The prepared statement follows:]

Testimony of Gary L. Bauer
President, Family Research Council

before the
United States House Committee on Ways and Means

January 17, 1995

Mr. CHAIRMAN, thank you for the opportunity to address your committee today. I appreciate your willingness to consider my input.

Mr. CHAIRMAN, nine years ago, President Reagan asked me to chair a White House Working Group on the Family to explore ways that federal policymakers could help strengthen America's families. That task force issued a report in 1986 entitled, The Family: Preserving America's Future, which had as its central recommendation a dramatic expansion in per-child tax benefits. Five years later, after much talk but no action on this issue, the bi-partisan National Commission on Children (on which then-Governor Bill Clinton served) issued a 1991 report which also had as its central recommendation a dramatic increase in per-child tax benefits.

Given that leading officials from both parties have been talking about pro-family tax relief for nearly a decade, the debate we now should be engaged in is one of whether the House GOP's proposed $500 children's tax credit offers adequate relief to America's families or whether instead Congress should move in the direction of the National Commission on Children's call for a $1,000 per-child tax credit.

Sadly, that is not the debate taking place in Washington today. During the last two months, a noisy chorus of critics and naysayers have been raising all sorts of objections to pro-family tax relief. Their criticisms -- which are sometimes contradictory -- advance six myths. Let's examine them one at a time.

Myth #1. Pro-Family Tax Relief Is An Extravagant Political Giveaway At Odds With The Larger Public Interest.

This idea is advanced frequently by members of the media, who realize just how popular pro-family tax relief is. Rather than thoughtfully considering the merits of various tax-cutting proposals, these reporters and pundits smugly sneer at public officials, accusing them of "pandering" to middle Americans.

Mr. CHAIRMAN, I do not often find myself in the position of defending politicians, but this sort of activity must be recognized for what it is -- an attempt by members of the liberal media elite to make you feel guilty about doing what the people elected you to do. It is the flipside to the liberal media's reaction to politicians that advance unpopular tax increases, who are routinely hailed as "profiles in courage."

Mr. CHAIRMAN, may I remind the members of your committee that voters see nothing courageous about broken campaign promises. Indeed, few things have contributed to voter cynicism more than President Bush's failure to keep his "no new taxes" pledge and President Clinton's decision to abandon his promised "middle-income tax cut" soon after the 1992 election.

The American people strongly support pro-family tax relief. They want to keep more of the money they earn. They sense that the well-being of their families -- and the well-being of the nation -- would improve if they had greater control over their lives.

On this point, they are right. To acknowledge as much is not pandering.

Myth #2. Pro-Family Tax Relief Will Increase the Deficit and Cause Interest Rates to Rise.

It is quite true that the deficit would rise if a pro-family tax cut were adopted by itself. It is also quite true that an increase in government borrowing would contract the supply of funds available for private lending, thereby putting upward pressure on interest rates.

But it is important to point out that no one is talking about adopting a pro-family tax cut by itself. All of the sponsors of major legislation have pledged to offset pro-family tax cuts with dollar-for-dollar reductions in government spending.

Pro-family tax cuts "paid for" by spending cuts cancel each other out on the balance sheet. They should have no effect on the deficit or on interest rates.

Myth #3. Pro-Family Tax Relief Won't Spur Economic Growth.

This concern comes from many of my conservative friends who believe that tax policy should only serve economic ends, that it should steer clear of social considerations and focus exclusively on promoting economic growth.

There are two problems with this viewpoint. First, much of what is called "economic growth" isn't growth at all. It is a movement of economic activity from the non-market home economy to the quantifiable market economy. For example, when a family that once cared for its own child enrolls the child in a paid day care program, there is no increase in the amount of economic activity. There is simply a shift from the non-market economy to the market economy. Yet this shift is counted as "positive" economic growth even though it often has a "negative" effect on the child's well-being.

True economic growth involves an increase in productivity, not simply in market activity. Until our nation's economic debate is built around this fact, much of what is advanced in the name of "growth" ought not to be adopted.

The second problem with the "pro-family tax cuts don't spur growth" myth is that it pretends that economic policy can be separated from social policy, that the size of a family's tax burden simply affects its economic well-being and decision-making. The truth, of course, is that tax policy not only affects people's economic decision-making (about working, saving, spending, investing, etc.) but also their "non-economic" decision-making (about marrying, childbearing, childrearing, etc.).

While it is true that economic policy should strive to exert as little influence as possible over "non-economic" decisions (so that, for example, people who otherwise would not marry won't get married just for the tax breaks), it is also true that our nation's current economic policy exerts considerable influence over "non-economic" decision-making and that this influence is almost always in an anti-family direction.

For example, Allan Carlson of the Rockford Institute has shown that the Social Security system has a pernicious anti-child bias because it robs parents of the social insurance value of their children, thereby creating a disincentive for young couples to invest in childrearing. Indeed, if Congress were to seek to offset this bias via the tax code (which is the only option given Social Security's sacrosanct status), it would have to raise actual per-child savings to roughly $2,100 per child. When one considers that the net value of the current child tax exemption is less than $400 per child (for the average family) and that the high water mark in the current debate is an additional $500 per-child tax credit, it is easy to see why pro-family conservatives like myself are disappointed that the proposals before you aren't even bolder -- or to use the media's phrase, more courageous.

Of course, the reason some are reluctant to adopt even a $500 credit is because they are intimidated by the economic "cost" in lost revenue to the government. While I understand that anti-family policies that took more than 50 years to develop cannot be wiped out in 50 (or even 100) days, I do want to remind the committee that there is a social "cost" to inaction or compromise. The social "cost" of weak families is measured in things like divorce rates and crime statistics. And lest the "green-eye shade types" forget, these social problems impose enormous economic costs to our society and our government. Indeed, the best way to reduce the demand for government services is to free families to care for themselves. Conversely, the best way to hinder the dismantling of the welfare state is to leave the tax burden on families with children at or near their current levels.

Myth #4. Pro-Family Tax Relief Should Only Go To Middle-Class Taxpayers.

This concern makes the mistake of viewing tax issues through the prism of class rather than through the prism of family. It is true that middle class Americans often get the shaft in current tax policy. For example, when combined employer-employee payroll taxes are added to income taxes, some middle-income couples actually have a higher marginal tax rate than affluent individuals in the 28 percent bracket.

But it is even more true that families with children are shortchanged in current tax policy. For example, during the first four decades after the end of WWII, the income tax burden on singles and childless couples increased only slightly, while it increased more than 200 percent for families with two children. Reagan-era reforms helped to reverse this trend moderately, but the dramatic shift in tax burden from non-parents to parents still dwarfs any shift in tax burden along income lines.

Thus, it is important that policymakers view this as a debate over "pro-family tax cuts," not simply "middle-income tax relief." This is the way my 1986 Working Group viewed the issue and the way then-Governor Bill Clinton's 1991 National Commission on Children saw the issue. Indeed, neither of these reports advocated some type of means-testing on per-child benefits. Both recognized that the principle being advanced was tax relief for families of all incomes to use in raising children, not tax relief to people who happen to fall into an income category that no one considers upper-class (a category that invariably shrinks as public debate progresses).

The fact that tax relief should be first and foremost pro-family does not mean that policymakers should be unconcerned about the distributional impact of these cuts. To its credit, the House GOP plan extends relief in the form of a per-child credit rather than an increased per-child exemption. In actual dollar terms, a credit provides equal relief to all taxpayers; but in percentage-of-tax-burden terms, it offers greater relief to working-class and middle-income taxpayers than to wealthier taxpayers. (Tax exemptions, conversely, skew savings up the income scale offering greater per-child savings to those in higher brackets.)

This is not to say that tax exemptions are always inferior to tax credits (indeed, one of the virtues of the current exemption is that its value rises if tax rates rise, thereby guaranteeing continued horizontal tax equity between parents and non-parents at any income level).

Still, given the tax code's current problems, a non-means-tested tax credit is the best mechanism for helping families with children. Indeed, if Congress wanted to maximize its distributional bang for buck, it might want to consider a non-refundable version of the 1991 National Commission on Children's $1,000 credit (which replaced the existing exemption, thereby offering $600+ in net per-child relief to those in the 15 percent tax bracket, but less than $300 in net per-child tax relief to those in higher tax brackets). Moving in this direction would make it easier for Congress to lift the existing (and newly-proposed) income caps on per-child benefits -- a problem that definitely needs addressing since income caps at any level produce marriage penalties.

Speaking of marriage penalties, the income caps on the Earned Income Tax Credit have created such a serious anti-marriage effect that Congress should use all of the monies set aside in the marriage penalty section of the American Dream Restoration Act to address the marriage bias facing families earning below the median income. The Talent-Faircloth welfare reform initiative from 1994 called for a $1,000 pro-marriage tax credit. This would be a constructive, problem-solving first step. It ought to be adopted.

Myth #5. Pro-Family Tax Relief Should Tie Benefits to Family Expenses (Like Education) That The Government Should Promote.

This concern springs from the notion that the government knows more about what families should spend their money for than parents do.

Not only is this a false premise, but it leads to all sorts of unproductive economic distortions. Indeed, one of the chief reasons college tuition costs have risen at a pace exceeding the general inflation rate for some time is that many students have been given grants and loans that could only be used for educational purposes. Knowing this to be the case, college administrators have raised the cost of higher education beyond what it would be if students' economic resources were completely fungible and available for multiple uses.

While no one wants to discourage bright young people from pursuing a higher education, the sad truth is that tax cuts earmarked for this or any other family expense will have the effect of increasing the cost of that good or service, thereby exacerbating current problems and putting a college education out of the reach of some interested students.

While it would be counter-productive for Congress to provide tax cuts for specific expenses, it would be helpful for Congress to modify existing Individual Retirement Account (IRA) rules to permit taxpayers to enjoy tax-favored savings for a wider variety of purposes (college tuition, first-time home-buying, etc.). In the first case, Congress would be limiting families' economic freedom, in the second, it would be expanding it.

This is not to say, however, that the Super IRA included in the House GOP Contract should be adopted in its current form. The "back-loaded" nature of its design obligates future generations to an economic promise made today. Given the size of the federal debt, and the pernicious anti-family influence of intergenerational entitlement programs, Congress should steer clear of repeating past mistakes. If tax-favored savings are to be expanded, they should be expanded within the context of a "front-loaded" savings mechanism.

Myth #6. Pro-Family Tax Relief Will Solve America's Family Problem.

While it is important for Members of Congress to recognize the virtues of pro-family tax relief, it is also important for you to recognize the limitations of pro-family tax relief.

Pro-family tax relief will not make husbands love their wives or children respect their parents. It will not clear up filthy TV or remove child predators from our streets. In short, pro-family tax relief, by itself, will not magically solve the myriad social problems facing America's families, neighborhoods, and communities.

But pro-family tax relief will make it easier for families to thrive by reducing economic stress. It will make it easier for parents to monitor their children's TV viewing habits or to shield them from other harms by freeing them to spend more of their time with their children and less of their time frantically chasing the almighty, overtaxed dollar.

In short, pro-family tax relief will empower parents to address many family needs that only they can meet.

Mr. CHAIRMAN, America needs parents who want to raise their children well. But we also need policies that empower them to act upon these sentiments. I implore you and the members of your committee to adopt nothing less than $500 in per-child tax relief for all taxpaying families.

Thank you very much.

Mr. CRANE. Thank you, Mr. Bauer.
Mr. Bloch.

STATEMENT OF THOMAS M. BLOCH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, H&R BLOCK, INC.

Mr. BLOCH. Thank you, Mr. Chairman. I appreciate the opportunity to appear before you today to present H&R Block's views on certain tax provisions contained in the Contract With America.

H&R Block is the Nation's largest tax preparation firm. We serve approximately one out of seven U.S. taxpayers. We have over 9,000 offices and employ over 89,000 people during the tax-filing period.

I am here today because the vast majority of our customers are middle and lower income taxpayers. We have more experience working with and listening to middle- and low-income taxpayers than any other firm. We believe that middle-income families are not being treated quite as fairly by the Federal Tax Code as they were in past years. For many of our clients, the Tax Reform Act of 1986 increased their tax burdens. In particular, they saw the elimination of many personal deductions.

H&R Block commissioned its own study, which was released in April 1992, to investigate the shifting tax burden onto middle- and low-income taxpayers. Our findings showed significant increases over the previous decade in the tax burden for middle-class taxpayers. A summary of our study is attached to my testimony.

First, I would like to commend the authors of the Contract With America. A number of its provisions will bring tax relief for middle and lower income families. The American Dream Restoration Act, H.R. 6, would offer families with an income of less than $200,000 a year a $500 refundable tax credit for each child under age 18. Fewer taxpayers would receive benefits from President Clinton's proposal of a $500 tax credit for each child younger than 12 for families earning up to $60,000 a year.

Representative Gephardt's $300–$600 tax credit proposal would apply to the greatest number of our low- and middle-income clients, because it would be available to all taxpayers earning less than $75,000 who do not take the earned income credit. We favor this approach because it does not exclude lower and middle-income taxpayers who do not have dependent children.

In contrast, Senator Gramm's proposal to double the dependent exemption to $5,000 is not one H&R Block would favor in the form proposed. A refundable tax credit would generally benefit lower income taxpayers more than increasing the personal exemption for children. Increasing the personal exemption for children has merit, but it gives the largest dollar benefits to upper income families with children.

Another provision in the American Dream Restoration Act, which assists middle-income families, is the credit to reduce the marriage penalty. This is currently structured as a nonrefundable credit and would help married couples who file joint returns. We would recommend changing it to a refundable tax credit, since as a refundable credit, it would be more beneficial to taxpayers affected by the marriage penalty by increasing the size of their refunds or directly reducing the amount of their tax liability.

The Family Enforcement Act, H.R. 11, provides taxpayers with a maximum $5,000 refundable tax credit for adoption expenses and a tax credit of $500 per parent or grandparent for custodial care. We encourage Congress to enact both of these proposals because of the benefits they would bring to the affected taxpayers.

I would also like to address a tax provision contained in H.R. 9, the Job Creation and Wage Enhancement Act. The expanded home office deduction included in H.R. 9 would allow taxpayers to deduct more costs attributed to maintaining a home office. This would help many taxpayers who incur expenses from conducting businesses in their homes.

I want to mention one additional tax proposal which H&R Block supports. It is the college tuition tax deduction proposed by President Clinton. The deduction would be up to $10,000 per year for families with an income of $120,000 per year or less. The deduction would be used for many forms of education, including college, vocational school, and worker training.

One of the criticisms of this proposal is that as a deduction, it would benefit higher income taxpayers more than the middle class. This criticism could be addressed by converting it to a credit. We encourage you to consider doing so. This proposal, like many of those included in the Contract With America, would help to make many taxpayers optimistic about their economic future.

H&R Block firmly believes that middle and lower income taxpayers deserve a break in the Federal tax system. We have witnessed our customers' concern that their economic future is at risk for them and for their children. Providing tangible tax relief to middle and lower income Americans will go far to restore confidence in their future.

Thank you for allowing me to appear before you today. I would be happy to answer any questions you may have.

[The prepared statement and attachments follow:]

TESTIMONY OF THOMAS M. BLOCH
PRESIDENT AND CHIEF EXECUTIVE OFFICER OF H&R BLOCK, INC.

Mr. Chairman and members of the Committee, my name is Thomas M. Bloch, President and Chief Executive Officer of H&R Block, Inc. I appreciate the opportunity to appear before you today to present H&R Block's views on the provisions of the Contract With America concerning tax credits for families with children, marriage tax penalty relief, refundable tax credits for adoption expenses and refundable tax credits for home care of the elderly.

H&R Block is headquartered in Kansas City, Missouri and is the nation's largest income tax preparation firm. We serve approximately 1 out of 7 U.S. taxpayers. H&R Block has 9,511 company-owned and franchised offices worldwide employing over 89,000 people during tax filing season. Last year, we prepared 12% of all individual U.S. tax returns for a total of over 13 million returns. In addition to our U.S. operation, we have offices in several other countries.

We have been serving America's taxpayers since 1955 when my father, Henry Bloch, and his brother founded the company. I am here today because the vast majority of our customers are middle and lower income taxpayers. We have more experience working with and listening to middle and low income taxpayers than any other firm. As a result, we are in a unique position to learn of the particular problems and concerns faced by America's taxpayers.

We believe that middle-income families are not being treated quite as fairly by the federal tax code as they were in past years. For many of our clients, the Tax Reform Act of 1986 increased their tax burdens. In particular, they saw the elimination of the deductions for personal interest and sales taxes, as well as restraints on deductions for medical, job related, and moving expenses, as contributing to this burden.

We strive to provide more than quality tax preparation services. We are also committed to listening to our customers' concerns and, in turn, using our expertise to help them get a fair shake from the federal tax system.

H & R Block commissioned its own study, which was released in April 1992, to investigate the shifting of the tax burden onto middle and low income taxpayers. Our findings showed significant increases over the previous decade in the tax burden for middle class taxpayers. A summary of our study is attached to my testimony.

THE AMERICAN DREAM RESTORATION ACT, H.R. 6, AND OTHER TAX CUTS

Mr. Chairman, I testified in favor of middle class tax relief before this Committee in February of 1992. At that time, we recommended Congress enact a tax relief proposal to benefit the largest cross-section of low to middle income Americans and to enhance tax equity in the federal tax system. In particular, I noted that, in our experience as America's largest tax preparation service, tax credits that are refundable will benefit the largest number of taxpayers in the most evenhanded way. The advantage of refundable tax credits is that more lower income taxpayers would get some relief, as compared to nonrefundable tax credits which can shut out lower income taxpayers. Ideally, a middle income tax credit should not be limited to families with children, but be available to all lower and middle income workers, regardless of their family size or situation.

My testimony today addresses those tax credits that are part of the "Contract with America," and include comments on tax cut plans offered by others including President Clinton, Minority Leader Richard Gephardt, and Senator Phil Gramm.

First, I would like to commend the authors of the Contract With America. A number of its provisions will bring tax relief for middle and lower income American families. The American Dream Restoration Act, H.R. 6, would offer families with an income of less than $200,000 a year a $500 refundable tax credit for each child under the age of 18. Millions of taxpayers, including many of our clients would be eligible for this credit and consider this a reasonable reduction in their federal taxes. Fewer taxpayers would receive benefits from President Clinton's proposal of a $500 tax credit for each child younger than 12 for families earning up to $60,000 a year. Representative Gephardt's $300 to $600 tax credit proposal would apply to the greatest number of our low and middle income clients because it would be available to all taxpayers (not just those taxpayers with children) earning less than $75,000 who do not take the earned income credit. Again, we favor this approach because it does not exclude lower and middle income taxpayers who do not have dependent children.

In contrast, Senator Phil Gramm's proposal to double the dependent exemption to $5,000, is not one H&R Block would favor in the form proposed. A refundable tax credit would generally benefit lower income taxpayers more than increasing the personal exemption for children. Increasing the personal exemption for children has merit, but it gives the largest dollar benefits to upper income families with children. Adjusting the amount of increase in the personal exemption so it is greater for those in the lower income brackets would help to provide some equity to this type of benefit. However, it still limits the relief for those in the lower and middle income brackets to households with dependent children.

Another provision in the American Dream Restoration Act which assists middle-income families is the credit to reduce the marriage penalty. This is currently structured as a nonrefundable credit and would help married couples who file joint returns. We would recommend changing it to a refundable tax credit, since as a refundable credit, it would be more beneficial to taxpayers effected by the marriage penalty by increasing the size of their refunds or directly reducing the amount of their tax liability.

THE FAMILY REINFORCEMENT ACT, H.R. 11

The Family Reinforcement Act, H.R. 11, provides taxpayers with a maximum $5,000 refundable tax credit for adoption expenses and a tax credit of $500 per parent or grandparent for custodial care. Although the refundable tax credit for adoption would benefit a small portion of H&R Block's clients, we nonetheless encourage Congress to enact this proposal for those taxpayers who incur adoption fees and expenses, court costs, attorney's fees and other related expenses.

The custodial care credit would be available for taxpayers who care for a disabled parent or grandparent and would assist many of our clients. This type of refundable credit would assist those taxpayers caring for elderly parents or grandparents in their homes with the expense involved in providing the necessary care.

THE JOB CREATION AND WAGE ENHANCEMENT ACT, H.R. 9

I would also like to address a tax provision included in H.R. 9, The Job Creation and Wage Enhancement Act. The expanded home office deduction included in H.R. 9, would allow taxpayers to deduct more costs attributed to maintaining a home office. This would help the many taxpayers who incur expenses from conducting businesses in their homes.

TAX RELIEF FOR HIGHER EDUCATION AND TRAINING

I want to mention one additional tax proposal which H&R Block supports. It is the college tuition tax deduction proposed by President Clinton. The deduction would be up to $10,000 per year for families with an income of $120,000 per year or less. The deduction could be used for many forms of education including college, vocational school, and worker training. Many taxpayers would be eligible for this benefit and would greatly appreciate the assistance in educating their children. One of the criticisms of this proposal is that, as a deduction, it would benefit higher income taxpayers more than the middle class. This criticism could be addressed by converting it into a credit. We encourage you to consider doing so. This proposal, like many of those included in the Contract With America, would help to make many taxpayers optimistic about their economic futures.

CONCLUSION

H&R Block firmly believes that middle and lower income taxpayers deserve a break in the federal tax system. Specifically, we recommend tax relief in the form of a refundable tax credit, marriage penalty relief, the custodial dependent care credit, the adoption credit and the expanded home office deduction. We have witnessed our customers' concern that their economic future is at risk for them and for their children. Providing tangible tax relief to middle and lower income Americans will go far to restore confidence in their future.

Mr. Chairman, we would be happy to provide any assistance to you as you consider the tax-related proposals of the "Contract With America." As I stated earlier, we have more experience with American taxpayers than anyone else, except the IRS. Because of this, we have extensive expertise and information we can offer to you and the rest of the Committee about both taxpayer attitudes and the mechanics of specific tax proposals. Thank you for allowing me to appear before you today. I would be happy to answer any questions you may have.

The Shift in Federal Tax Burden onto the Middle Class

Wanda James and Larry R. Garrison
Tax Policy Research Project
Henry W. Bloch School of Business and Public Administration
University of Missouri-Kansas City
Kansas City, Missouri 64110-2499

Executive Summary

American citizens are aware of the on-going debate regarding middle class tax cuts, but are not likely to find the results of econometric studies which focus on methodological nuances relevant to their individual economies. The approach undertaken in this study is centered on describing the tax burden imposed by those tax provisions readily perceived to affect taxpayers directly - i.e., personal federal income tax and employee contributions to social security. Therefore, to investigate the distributional equity of the federal tax burden across various income levels, illustrative cases are utilized to determine the effective tax rates experienced by US taxpayers filing as single, married joint, and head of household.

The ultimate objective of this study is to produce a resource from which taxpayers may judge for themselves (1) the impact of specific tax provisions on the taxes they pay in relation to other taxpayers within their income class (horizontally) and taxpayers across income classes (vertically); and, (2) how their relative positioning has changed over the course of the last fifteen years.

Trends in the effective rate of taxation on American taxpayers were determined through the development and analysis of thirty-two (32) illustrative cases. Four distinct filing statuses were employed in the study and are presented in Table E-1 with the number of dependents assigned to each.

Table E-1. Types of Filing Status and Assumptions Used in Illustrative Cases.

Filing Status	Number of Exemptions
Single Filer	1
Head of Household, 1 Dependent	2
Married Filing Joint, No Dependents	2
Married Filing Joint, 2 Dependents	4

For each type of taxpayer shown in Table E-1, eight income groups were selected to represent the range of income distribution in the United States from the lower end of the middle class to that representing wealthy persons. Table E-2 presents the various income groups for the four tax years of interest to this study; namely, 1977, 1984, 1988, and 1990. The income levels shown represent adjusted gross income.

Table E-2.	Income Groups for Each Tax Year and the Treatment of Deductions.				
Income Group	Type of Deduction	Adjusted Gross Income, Nominal Year $ 1977	1984	1988	1990
I	Standard	$ 7,250	$ 11,920	$ 13,580	$ 15,000
II	Standard	12,090	19,870	22,630	25,000
III	Standard	16,920	27,820	31,680	35,000
IV	Itemized	24,180	39,750	45,260	50,000
V	Itemized	36,270	59,620	67,880	75,000
VI	Itemized	48,360	79,500	90,510	100,000
VII	Itemized	72,530	119,240	135,770	150,000
VIII	Itemized	96,710	158,990	181,030	200,000

The overall shift in federal tax burden may be described by changes in effective federal tax rates on taxpayers within varying income groups. Several trends in effective tax rates are described by the findings of this study:

- The percentage change in the effective income tax rates and effective total (income tax and social security) tax rates showed the taxpayers reporting $100,000 or more had a large percentage decrease in tax rates from 1977 to 1990 while rates for the middle income taxpayers rose (see Figures E-1 and E-2).

  EXAMPLE: Taxpayers earning $50,000 (in 1990 dollars) from 1977 to 1990 showed an average percentage *increase* in total tax rates of over 7 3/4 percent for the four filing statuses. Taxpayers earning $200,000 from 1977 to 1990 showed an average percentage *decrease* in total tax rates of over 27 3/4 percent for the four filing statuses.

- The overall trend in federal income tax has been to flatten its rate structure across income levels. The difference between the effective income tax rate for the wealthiest income group ($200,000 in 1990 dollars) and the median income group ($35,000 in 1990 dollars) in 1990 was half that in 1977.

  EXAMPLE: In 1977, a married taxpayer filing a joint return with two dependents earning $35,000 (in 1990 dollars) had an effective income tax rate of 10.64 percent. A married taxpayer filing a joint return with two dependents earning $200,000 had an effective income tax rate of 29.30 percent, or a difference of 18.66 percent. In 1990, a married taxpayer filing a joint return with two dependents earning $35,000 had an effective income tax rate of 9.16 percent. A married taxpayer filing a joint return with two dependents earning $200,000 had an effective income tax rate of 20.98 percent, or a difference of 11.92 percent.

- In conjunction with the lessening progressivity of the tax rate schedule, the middle income taxpayers suffered effective total tax increases due to the increased FICA effective tax rates from 1977 to 1990 (see Figures E-3 and E-4).

- The percentage changes for married filing joint with no dependents or two dependents showed an increase in effective total tax rates through the middle income groups (see Figure E-2).

  EXAMPLE: A married taxpayer filing a joint return with two dependents earning $50,000 (in 1990 dollars) from 1977 to 1990 had a 5.26 percent *increase* in total taxes. During the same time period, a married taxpayer filing a joint return with two dependents with adjusted gross income of $200,000 had a greater than a 24.29 percent *decrease* in total tax liability.

  EXAMPLE: Using 1990 dollars, a married taxpayer filing a joint return with two dependents earning $50,000 from 1977 to 1990 had an *increase* of $4,649 in total taxes. During the same time period, a married taxpayer filing a joint return with two dependents with adjusted gross income of $200,000 had a *decrease* in total tax liability of $16,583.

- The changes in effective tax rates from 1988 to 1990 reflect the implementation of the general tax increases of the Tax Reform Act of 1986. However, the middle income taxpayers experienced a larger increase in taxes than did the lower or higher income taxpayers.

  EXAMPLE: A married taxpayer filing a joint return with two dependents with earnings of $75,000 (in 1990 dollars) had a percentage increase of 4.18 percent in total tax rates from 1988 to 1990. A married taxpayer filing a joint return with two dependents with earnings of $200,000 had a percentage increase of 2.4 percent from 1988 to 1990.

- Uniform tax rate adjustments have not occurred across all income classes.

  EXAMPLE: In 1990, the difference in effective total tax rates between single taxpayers and married taxpayers filing a joint return with two dependents earning $35,000 (in 1990 dollars) was 7.3 percent. The difference in effective tax rates between single taxpayers and married taxpayers filing a joint return with two dependents earning $200,000 was 1.5 percent. In 1977, these same differences between filing statuses at the same earnings levels were 7.3 percent for $35,000 incomes and 7.0 percent for $200,000 incomes.

- Changes in the standard deduction allowances for head of household filers assisted in reducing their effective federal income and total tax rates between 1977 and 1990.

- A much larger portion of the middle income taxpayers are subjected to the maximum FICA tax rate due to the increase in the FICA earnings cap to 145 percent ($51,300/$35,353) of the median income amount in 1990 as compared to only 103 percent ($16,500/16,009) of the median income amount in 1977 (see Figures E-5 and E-6).

The impact of flattening the federal income tax structure, i.e., the loss of federal revenues, was countermanded by the increased rate of FICA taxation. The result

has been a tax savings for the wealthy while increasing the amount of federal tax paid by middle class taxpayers.

Figure E-1

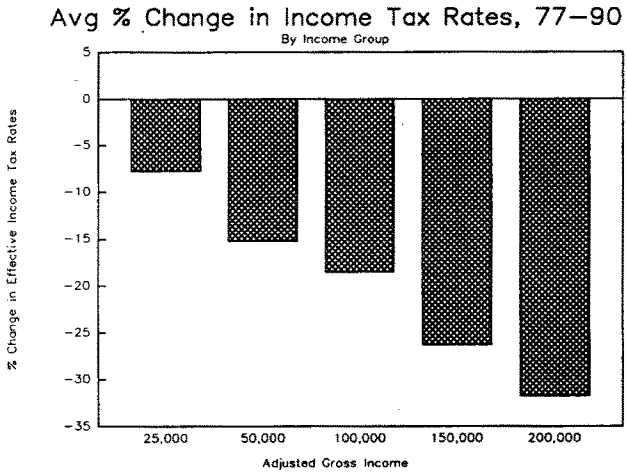


Figure E-2

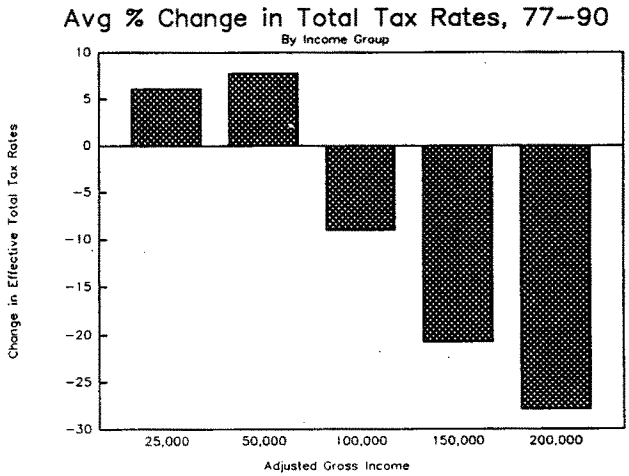


Figure E-3

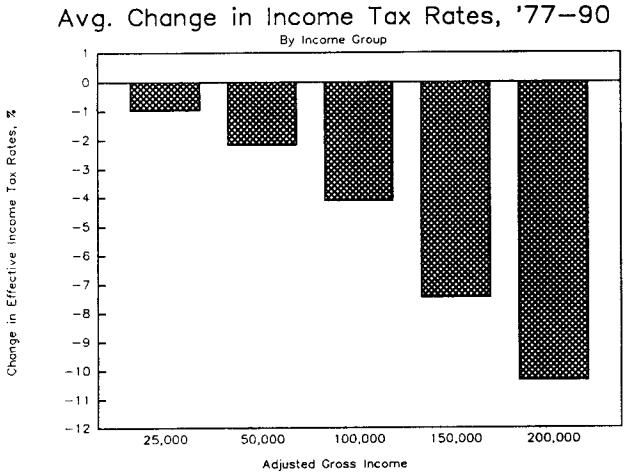


Figure E-4

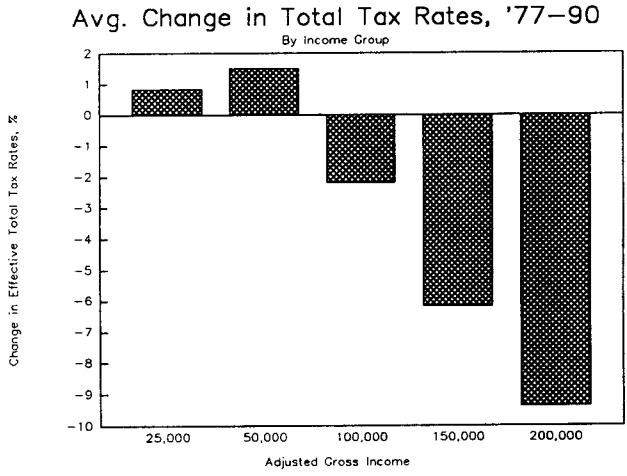


Figure E-5

Difference in FICA Earnings Cap and the Median Income Level by Tax Year

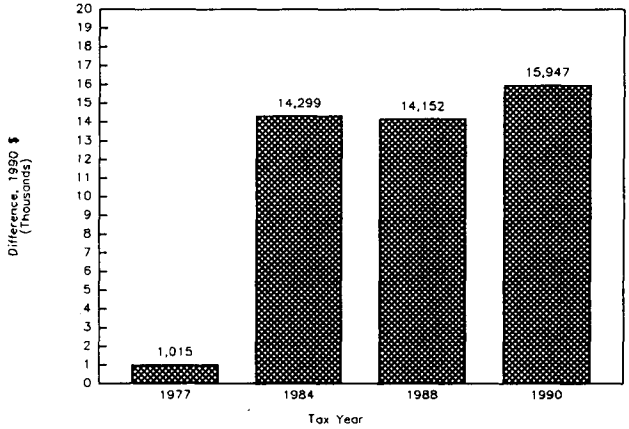
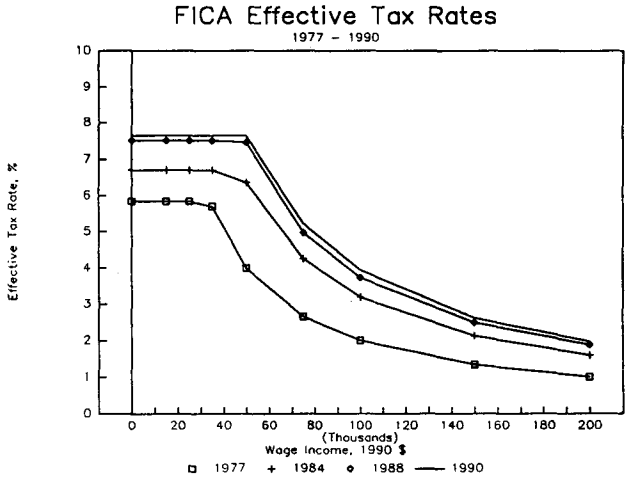


Figure E-6



Mr. CRANE. Thank you, Mr. Bloch.

The first to inquire is Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman.

I want to ask the panel generally, as the father of nine children, anybody who thinks that they can raise a child on $4,800 is sadly mistaken. I had three children in college, three children in high school, and three children in grade school at the same time. Now, do you think $4,800 is enough to pay for raising that child when the tuition at the university usually was well over $4,800? Does anyone on this panel think that $4,800 is a reasonable figure for raising a child, anyone? Mr. Bauer.

Mr. BAUER. Only in the rarified atmosphere of think tanks do you think that $4,800 is enough to raise a child.

You raise another interesting point. If you are a family with nine children and you are making $75,000 a year, in fact you are not upper class. That is the other problem with this debate of cutting off the benefits at a certain income level. For struggling Americans with nine children and that kind of income, without the credit, you are not going to have the benefits that you ought to have.

But your point is well taken, $4,800 does not come anywhere close to covering expenses.

Mr. BUNNING. Mr. Shapiro.

Mr. SHAPIRO. The $4,800 figure was developed in a survey by sociologists at the University of Chicago and Columbia University. It certainly does not apply to higher income people who are sending children to college. It is a national average. It is the average cost for an average-income family in America, which is a family with an income—a pretax income of roughly $35,000.

Mr. BUNNING. Let me ask you a basic question. Do you all feel that tax relief for families should take priority over the budget deficit and the approach that we are taking with the budget deficit? Or do you think that the budget deficit should take priority over relief for the tax for the family, tax relief for families?

Mr. BAUER. Well, Congressman Bunning, my opinion is that the two ought to go hand in hand. That American families also suffer from a deficit out of control, and we all know that that deficit, in contrast to the rhetoric of recent months, is, in fact, headed back up. My anticipation is that the Congress would fund this tax break with budget cuts, as well as other cuts to address the budget deficit. Our organization for one is certainly ready with a long list of programs that can be cut, we believe, without harming the American family or without harming those groups that are supposedly served by those programs.

Mr. BUNNING. Can I ask the two women that are testifying, do you feel that many working women feel their earnings are supporting government instead of family, instead of their family by working?

Ms. SCHLAFLY. Oh, well, I certainly do, Mr. Bunning. I think that when the wife and mother goes into the work force, such an extraordinary percentage of what she is making is going for taxes. I feel that taxes are the great burden on them, and I would hope that we can give relief to this kind of family, and your $500 tax credit is a very good way to start.

Ms. LAHAYE. I would like to add to that that I work with women who are very much family oriented and they are very aggrieved because they have had to leave their children and go to work. This would—a tax credit like this would get their attention immediately and they would see that this Congress really was family friendly and striving to help the family be stronger. So, yes, I believe that women would be better equipped to take care of their children and care for their family if we could give them this kind of a tax benefit.

Mr. BUNNING. One last question. The administration tax credit is limited to children under age 13. It is my experience that ages 14, 15, 16, 17, 18, and on up to 21 are the more expensive years for raising children and the payout at that time is almost at the height of what you pay for raising your children. Do you have that same experience?

Ms. LAHAYE. I have raised four children that have gone through that same stage, and they eat more, their clothes are more expensive, their education costs more, and everything they do is more costly. So a family needs greater help when they are in the teens.

Mr. BUNNING. Go ahead, Mr. Shapiro.

Mr. SHAPIRO. Congressman, while I think that the administration's approach to limiting the children's credit on the basis of age is not the soundest way to go about it, the economic basis of it is that as children age, their parents also are aging, and as the parents age, their incomes rise. So the logic behind it and the data behind it is that at a younger age, parents feel the greatest economic stress in raising their children.

Mr. BUNNING. Unfortunately, my time has expired. But the fact of the matter is that the income of those people as they age has not kept pace.

Mr. SHAPIRO. All people's incomes over the last 20 to 25 years, except for professionals and managers and owners of capital, have been growing very slowly.

Mr. BUNNING. Thank you.

Mr. CRANE. And baseball players.

Mr. CRANE. Mr. Christensen.

Mr. CHRISTENSEN. I want to thank this distinguished panel for coming. It is quite an opportunity to be able to visit with Mrs. LaHaye, Gary Bauer, Mrs. Schlafly, and some of the best tax policy minds around.

I have two questions. One is, Mr. Bloch, I was in a meeting about 1 year ago where your father was sitting in the room in Kansas City and Jack Kemp facetiously remarked that it was his goal someday to put your father out of business by way of a flat tax. I earlier spoke about someday being able to figure taxes on a 3 by 5 card and sending it in. How would that affect your business? You say you have 80,000 employees across this country during tax time. Could you just give me some quick thoughts on——

Mr. BLOCH. I think I can read the lines on that form from here, and I would say based on that it would be devastating to our business. But I think it is important to put that aside, and I try to do that when I think about a tax return such as that. My biggest concern about it is fairness. I just am afraid that a tax system like that would be terribly unfair. When we talk today and in the fu-

ture about middle-class tax relief and making sure the tax burden is distributed fairly——

Mr. CHRISTENSEN. Who would it be unfair to?

Mr. BLOCH. To the middle class.

Mr. CHRISTENSEN. If no one pays taxes under $38,000 in income, how would it be unfair?

Mr. BLOCH. I think what you would see is a tremendous shift in the tax burden from the wealthy onto the middle class.

Mr. CHRISTENSEN. I am sure we will have a lot of time to talk about this over the next year.

I wanted to ask Gary Bauer if you could give us information on how tax cuts for families would affect the economy and whether that effect would be similar to that of the capital gains tax cut. Would we see some pickup in the economy?

Mr. BAUER. I have been in Washington a long time, unfortunately. Over the years, I have come to have very little confidence in these projections, regardless of which side they are on. Trying to predict what literally millions of people will do with a few more dollars in their pocket is a very problematic thing. My common sense, however, tells me that the money has to go somewhere. Either some families will save the money, at which point lending institutions will lend it out in loans for economic activity, or they will spend the money and its circulation through the system, presumably, would have some positive impact on jobs, on economic activity, and produce revenue that could be taxed through the system. So my gut instinct tells me there will be a positive impact economically but I doubt if anybody is going to be able to prove it one way or the other.

Mr. CHRISTENSEN. My final comment would be to Mr. Shapiro. I listened to your comments and I read your testimony. Then you said it was endorsed by the New York Times and that told me exactly what to do. I thank you, Mr. Chairman.

Mr. CRANE. Next is Dr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

I keep hearing this flat tax talked about. Now, Mr. Bloch, I got a couple questions for you. I just heard from my colleague, Mr. Christensen, that for $37,000 you wouldn't pay any taxes. Now, Mr. Armey's proposal would add $186 billion to the deficit each year and would take away the deduction for home mortgage interest and would take away the deduction for medical insurance and would actually cost taxpayers under $200,000 more money than they are paying today, and people above $200,000 less.

Does that seem like a fair proposal to the American people?

Mr. BLOCH. I think it sounds terribly unfair. I think, if I understand the Armey proposal, certain types of income are exempt from tax, such as some unearned income.

Mr. MCDERMOTT. Yes.

Mr. BLOCH. I think people in this country are concerned about how much they pay in taxes today, and what they want is to be treated fairly. I think the initial appeal of a flat tax is what we are experiencing today in the country. It just sounds good. But I think when people really begin to understand it, as you do, Representative, and really see how will the wealthy be affected, how will the middle class be affected, and really understand what is going to

happen, I think that is when taxpayers say this is not good for this country and it is not good for me. I think if such a tax bill were enacted, it would be just a matter of time before the various deductions and credits that currently exist creep back into the system because they are there for a good reason.

I think the No. 1 goal we must have with our tax system is fairness. Yes, I can understand the argument for simplification. It would be great to have a fair and simple tax system. My fear is you can't have both. If you can't have both, the first priority has got to be fairness.

Mr. MCDERMOTT. So you are really saying that the reason this has appeal is because it is simple. It sounds great.

Mr. BLOCH. It sounds great.

Mr. MCDERMOTT. But the devil really is in the details.

Mr. BLOCH. Exactly.

Mr. MCDERMOTT. The Citizens for Tax Justice say if you make $30,000 under the Armey proposal, you would pay $1,700 more in taxes. But if you made $530,000, you would pay $44,000 less in taxes. To me, that seems like a proposal that is doomed from the outset if the American people ever understand that.

Mr. BLOCH. I think that is the key point. Once the American people understand that, I think they are going to say no, that is wrong.

Our tax system should be based on a person's ability to pay. The higher your income, the greater your ability to pay. That is my opinion.

Mr. MCDERMOTT. Let me ask Mr. Bauer, you have—I would like to understand your philosophy of what government ought to be about. I would assume that you only would collect taxes for the Army, for the military, for the defense, and is there anything else that you think government has a legitimate right to be in?

Mr. BAUER. My goodness, Mr. McDermott, you assume a lot. I think there are quite a few things that government can legitimately do.

Mr. MCDERMOTT. I want that list of cuts. I want the list of cuts. If you want to leap to that, tell me what you want to wade into.

Mr. BAUER. Sure. I would be happy to submit for your consideration a list of cuts. In fact, I suspect in the weeks ahead there are going to be so many cut suggestions that you will hardly know where to begin, because I suspect a lot will be on the table.

[The following was subsequently received:]

FAMILY
RESEARCH
COUNCIL

Gary L. Bauer
President

1995 GOVERNMENT SPENDING NEEDS FAR MORE OVERSIGHT

by
Robert L. Maginnis

The 1995 federal appropriation bills which were approved by the last Congress are filled with duplication, political favoritism, social agendas, and questionable grants. The alarming misuse of taxpayer money should encourage citizens to demand more accountability.

Consider some government spending already approved for 1995:

• The Corporation for Public Broadcasting may pay a single individual $438,000 for a once-a-week, 30-minute TV appearance.[1]

• Federally financed Howard University gets $5.5 million to prepare practicing attorneys to do pro bono work in Washington, DC.

• NIH will spend $2.5 million to build playgrounds for monkeys.

• DOT will spend $400,000 to help Russians build roads.

• The Pentagon will spend $18 million for new homes at an Army base that is losing one third of its existing personnel.

• The State Department will give Russians $15 million for "family planning."

• The State Department will spend $750,000 to study tropical bird migration.

• The EPA will spend $250,000 to control zebra mussels in the City of Chicago.

• The EPA will spend $70,000 to study a European fish in Lake Superior.

• HUD will spend $53 million for a sewage plant in Mexico.

• The Forest Service will spend $635,000 to build a visitor center on a remote and inaccessible by road peninsula on Alaska's panhandle.

700
Thirteenth St., NW
Suite 500
Washington, DC
20005
(202) 393-2100
FAX (202) 393-2134

DETAILS FROM 13 APPROPRIATION BILLS

1. Foreign aid in non-foreign bills: The appropriations bill for "The Foreign Operations, Export Financing, and Related Programs for the Fiscal Year Ending September 30, 1995" includes funding for most foreign aid programs. Foreign aid, however, can be found in other bills.

• The Federal Highway Administration was given $400,000 to provide technical assistance to Russia.[2]

• The Department for Housing and Urban Development (HUD) was given $52.5 million to finance the construction of a waste treatment plant in Tijuana, Mexico.[3] HUD is funding a second wastewater facility near Micicali, Mexico for $47.5 million.[4] (Congress also appropriated $1 million through the International Boundary and Water Commission to reimburse the City of San Diego for treatment of Tijuana sewage.[5])

• Funding for the Smithsonian Institution includes a $50,000 grant to the Mpala Center, Kenya for facility and equipment purchases.[6]

2. Suspect foreign aid.

• The State Department will provide $15 million for "family planning" to Russia in 1995.[7]

• It will give $50 million to the United Nation Population Fund (UNPF) with the intention that none of this money will be used to fund abortions in China.[8] The UNPF is expected to give $7 million for "voluntary family planning programs" in China.[9]

• The State Department will grant $750,000 to the Fish and Wildlife Foundation to study neotropical migratory bird conservation.[10]

3. Duplication of programs. Our government should look to eliminate redundancy. Consider:

• The Treasury Department's plan to build a training facility near Tuscon, Arizona. There will be a dormitory, a dining facility and $2.9 million in firearm ranges.[11] Just outside of Tuscon is the Army's Fort Huachuca, which has many modern firearm ranges. Treasury should arrange with the Army to use existing ranges rather than building duplicate firing facilities. After all, the FBI Academy's entire campus is located on Quantico Marine Base in Virginia where it has joint use of all ranges.

• The Department of Housing and Urban Development (HUD) was appropriated $175,000 for a special purpose grant to be given to Domestic Violence Prevention, Inc. in Bowie County,

Texas.[12] Why is housing money used for this project when the 1994 crime bill authorizes $324 million for the Family Violence Prevention and Services Act?[13] The crime bill also has $10 million for nonprofit organizations to establish projects that coordinate intervention and prevention of domestic violence, and authorizes $30 million for rural domestic violence and child abuse enforcement.

• The Department of Interior received $800,000 to monitor salmon on Alaska's Yukon and Kuskokwim Rivers.[14] The National Oceanic and Atmospheric Administration (NOAA) will spend another $700,000 to collect information on salmon in the Yukon River as well.[15] NOAA collects information on salmon at other locations as well.

• The Small Business Administration is directed to grant $3.25 million for three incubator facilities.[16]

• The Justice Department is appropriated $29 million for "Drug Courts" which is a program that provides drug treatment during and after incarceration for non-violent offenders.[17] This replicates ongoing programs both inside prisons and in many communities.

• The National Science Foundation was appropriated $2 million to establish in 1995 an interdisciplinary center to support research on violence.[18] The 1994 crime bill authorizes many programs to research violence:[19]

•• Title IV-Violence Against Women Act of 1994 requires the Attorney General to study campus sexual assaults, the "battered women's syndrome," the abusive spouse, and domestic violence.[20]

•• Title III-Crime Prevention includes research grants to investigate juvenile violence, drug use, and gang violence.[21]

•• Virtually every section of the crime bill requires at least one federal agency to either study or research special aspects of violence.[22]

• HUD will award housing money for six substance abuse programs and eight crime prevention programs.[23] The 1994 crime bill includes duplicate grant programs.

• Congress has already appropriated $20.4 million for federal support of the 1995 Special Olympics in New Haven, Connecticut and both the XXVI Olympiad and the X Paralympiad in Atlanta in 1996.[24] The GSA and HUD will contribute $3 million to the X Paralympiad. (The Paralympiad was established in 1960 to create awareness of athletes with physical disabilities.) The X Paralympiad will take place in Atlanta August 16-17, just after the Olympic Games. Some 4,000 athletes representing 110 countries are expected to participate. HUD's contribution goes to assist disabled veterans to participate.

• Congress appropriated $5.6 million for the taxpayer funded District of Columbia School of Law ignoring Mayor Sharon Pratt Kelly's recommendation to close the school. Two of the best law schools in the nation are in Washington, D.C. - Georgetown University and American University and another is in nearby Baltimore. Additionally, the appropriation bill lists the other reasons to close the school: it must dramatically expand its library before it can earn full accreditation; it must increase faculty salaries and other staff and student services; and the school needs a permanent facility of at least 125,000 square feet.[25]

4. Spending to remember former Congressional Leaders.

• The National Historical Publications and Records Commission is giving $2 million to the Thomas P. "Tip" O'Neill, Jr. Library at Boston College.[26] The money will be used to organize Mr. O'Neill's personal papers.

• Two million dollars was also granted to the Robert H. and Corinne W. Michel Congressional Education Fund.[27] Michel was for many years the House minority leader.

• The Merit Systems Protection Board granted $10 million to the Morris K. Udall Scholarship and Excellence in National Environmental Policy Foundation.[28] Udall was a liberal congressman and environmentalist from Arizona.

5. Other questionable expenditures.

• The Army recently announced that the 1st Infantry Division headquartered at Fort Riley, Kansas will be removed from the force. This means approximately 5,600 soldiers or a third of the post's population will leave. Meanwhile, Congress has appropriated $12.6 million to build 126 new homes at Fort Riley.[29]

• The 6th Infantry Division headquartered at Fort Wainwright, Alaska was deactivated in July, 1994. Cuts in the Army's presence in Alaska will be felt at both Fort Wainwright and Fort Richardson which is near Anchorage. Yet, Congress appropriated $5 million to build 72 new homes at Fort Richardson and $66 million to replace the nearby and jointly used Elmendorf Air Force Base hospital.[30]

• The Department of Agriculture's Forest Service will spend $635,000 to build a visitor center at Ketchikan, Alaska. Ketchikan is located on a remote peninsula reachable only by boat and small plane. Ketchikan county has a population of 14,000 inhabitants scattered among numerous small villages. The Department also gave $500,000 to Alaska because "many timber mills have closed."[31]

• The National Institutes of Health, National Center for Research Resources, was directed by the conference committee to reserve $2.5 million for playgrounds for monkeys used in research.[32]

• The federal government helps to fund Washington, D.C.'s Howard University. Part of the University's 1995 appropriations ($5.5 million) are for the creation of a Law School Clinical Center to provide legal assistance to supplement the Legal Services Corporation and to conduct training for practicing attorneys to perform pro bono (free) services.[33]

6. Did you know? Here are some of the various and sundry federal spending programs.

• $46 million to build and operate military child development centers, including one in Germany and one in Great Britain.[34] These federally subsidized centers are part of a growing network of child care facilities that include every military activity worldwide.

• $45 million will be spent by the Library of Congress for books for blind and physically handicapped people.[35]

• The Department of Transportation will give $26 million for employee bonuses and cash awards.[36]

• $2.7 million to the Pennsylvania Avenue Development Corporation.[37] This 34 person organization oversees construction projects along Washington's Pennsylvania Avenue.

• $27 million annual operating expenses for the U.S. Holocaust Memorial Council, which is a private organization that oversees the Holocaust Museum.[38] This relatively small but popular museum was first opened to the public two years ago. It was built with $168 million in private donations raised in just four years.[39] The Council continues to receive donations from many national and local organizations.

• Child Nutrition Programs include $500,000 in state grants for special dietary needs of children with disabilities.[40]

• $7 million for the private organization American Printing House for the Blind.[41]

• The State Department oversees a $533 million United Nations peacekeeping appropriation. This money can be spent with one stipulation: that American manufacturers and suppliers are given an "equal" opportunity to provide equipment, services, and materials to the United Nations peacekeepers.[42] The Senate amended this appropriation to transfer $350 million to unspecified "International Organizations" for peacekeeping activities.[43]

• HUD will grant the City of Chicago $250,000 to control zebra mussels which originally came from the Black Sea area of Europe.[44] The Department of Interior will continue to study zebra mussels at St. Croix, Virgin Islands.[45] The National Oceanic and Atmospheric Administration

was appropriated $3.7 million to research zebra mussels.[46] If the zebra mussel is truly endangering our oceans and lakes, then a more focused effort should be undertaken.

7. Legislating inside appropriation bills. Five appropriation bills contain social legislation.

• The Architect of the Capitol is directed to hire a "diverse labor force."[47] This means hiring quotas.

• The National Science Foundation is directed to award at least 20 percent of all grants to small colleges and universities that consist of "predominantly underrepresented groups" in science and technology.[48]

• When hiring investigators the John F. Kennedy Assassination Records Review Board is directed to give preferential treatment to former Office of Personnel Management employees.[49]

• The Office of Personnel Management is encouraged to promote "diversity." OPM's definition of "diversity" includes people of different sexual orientation.[50]

• The appropriation bill for the Department of Agriculture deletes Senate language aimed at ending the use of taxpayer funds to promote homosexuality.[51]

• Health and Human Services is directed to increase quotas for black nurses nationally.[52]

• The Federal Bureau of Investigation was appropriated funds to restore special agents "eliminated in prior years associated with background investigations."[53] A former marker for elimination based on a background investigation was identifying the candidate as a homosexual. The FBI Academy has started training for homosexuals previously rejected.

8. Please explain these appropriations. Many programs are funded without adequate explanation.

• The Department of Education is awarding $4 million to the Mary McLeod Bethune Memorial Fine Arts Center on the campus of Bethune Cookman College in Daytona Beach, Florida.[54] The facility will allow students to be trained for the fields of entertainment and hotel management.[55]

• The U.S. Institute of Peace gets $11.5 million.[56] The ten year old institute has received $76 million in federal grants. In 1991 it shifted from discussing peace to teaching conflict resolution in America's classrooms. There are more than 300 violence-prevention programs and 100 conflict resolution curricula available to America's 28,000 high schools and 78,000 grade schools.[57] The 1994 crime bill contains many grants for anti-violence programs.

• The Bureau of Mines is directed to do "essential Arctic research" in Anchorage, Alaska.[58] Anchorage is 400 miles south of the Arctic Circle and has no arctic characteristics like permafrost. Why not conduct the research nearer the Arctic Circle, perhaps at the University of Alaska, Fairbanks?

• The National Telecommunications and Information Administration is appropriated $1.5 million for the Pan-Pacific Educational and Cultural Experiments by Satellite Program.[59]

• Washington, D.C. received $720 million from the federal government for public education. The appropriation bill states, "the Board of Education has overspent its appropriation for personal services by millions of dollars while underspending its appropriation for other-than-personal-services by an equal amount. The chronic recurrence of such an imbalance suggests that the Board of Education habitually submits budgets to the Congress that the Board knows to be unrealistic and that the Board intends to disregard."[60]

• The Department of Housing and Urban Development will award 261 special purpose grants worth $291 million.[61] These include:

•• $450,000 to construct the Center for Political Participation at the University of Maryland.[62] The Center "is the first academically-sanctioned program in the country to support young leaders seeking elective office."[63] The advisory board includes actress Morgan Fairchild, Congressman Steny Hoyer, Congresswoman Connie Morella, *ABC News'* Sheila Kast, and the wife of Maryland governor Parris Glendening.[64]

•• $500,000 to the Maine College of Art for renovations to a Portland building.[65]

•• $1 million to develop the Center for Pacific Rim Studies in San Francisco.[66] The Center will do research on competition and offer training for professionals. It is focused on trade development, including foreign language and culture, legal systems, commercial practices and data links.[67]

•• $6.5 million for the Points of Light Foundation.[68] The *Los Angeles Times* found that the Foundation in its first four years spent $22 million on administrative expenses and $4 million on grants to service organizations. Expenses included $1.4 million for a kickoff celebration and more than $108,000 paid to the Hill and Knowlton public relations firm to promote the party, as well as a $160,000 salary for its top executive. In the first four years, it received $26 million from the government.[69]

•• $500,000 for the National Invention Resource Center in the City of Akron, Ohio.[70] The Center is part of the nonprofit Inventure Place which opens July, 1995.

•• $70,000 to study the European Ruffe in Lake Superior.[71] The Ruffe was introduced in 1986 to Duluth Harbor which is on Lake Superior. The Ruffe now makes up 65 percent of the harbor's fish population. Why is federal housing money being used to study the spread of this fish? Possibly some of the $450,000 appropriated for the Great Lakes Fishery Commission could be used to study the Ruffe.[72]

•• $750,000 for a center to coordinate academic training for physical therapists at the Veterans' Administration hospitals in Brooklyn, NY.[73]

•• $2.5 million for Project Social Care MB, Inc. to serve elderly Holocaust survivors in Brooklyn, NY.[74] There are about 2,000 Holocaust survivors in the greater New York metro area. Another organization, Selfhelp Community Services, has a $51 million annual budget and has the prime focus on helping survivors.[75]

•• $250,000 for port modernization at Davisville, Rhode Island.[76]

•• $300,000 to expand the science and mathematics complex at the University of South Carolina.[77]

•• $1.2 million for the Fire Safe Cigarette Act.[78] These funds go to the Consumer Product Safety Commission and the National Institute of Standards and Technology to measure the cigarette's ignition propensity.[79]

•• HUD special purpose grants also fund: 5 child care centers, the restoration of 5 theaters/museums, restoring or building 5 libraries, running a summer camp program, and building a bicentennial and media activities center for a city.[80]

9. AIDS money scattered among bills. Most AIDS money is found in the appropriations for HHS, but AIDS money is in other bills as well.

• The Department of Agriculture will grant Indiana $250,000 to study HIV/STD prevention in rural areas.[81]

• The Pentagon is being given $33 million to study AIDS.[82]

• HUD is appropriated $186 million for housing people with AIDS.[83] HUD also is awarding special purpose grants worth $4.3 million for other HIV housing facilities.[84]

10. Politics and agriculture appropriations. The 1995 agriculture appropriations appear to be based more on politics than merit. The top three states to receive agriculture grants earmarked by state were Arkansas, Iowa and Mississippi.[85] Arkansas received $17.7 million, Iowa received $11.9 million, and Mississippi received $10.45 million.

Senators from these states were on the conference committee for appropriations. Additionally, President Clinton is from Arkansas and former Secretary of Agriculture Mike Epsy is from Mississippi.

The U.S. Department of Commerce reports that the highest net farm income for 1991 came from California which ranked seventh in discretionary agriculture grants. Mississippi ranked 21 in net income and Arkansas was ninth.[86] But Arkansas received almost 300 percent more discretionary grant money than California, the highest farm income state. Arkansas grants included:

• $462,000 for a National Center for Agricultural Law Research and Information at the Leflar School of Law in Fayetteville, Arkansas.[87]

• $1.2 million for a new agriculture building and $946,000 for an Alternative Pest Control Center at the University of Arkansas.[88]

• $4.8 million for the Rice Germplasm Center, Stuttgard, Arkansas.[89]

• $1.1 million for the Arkansas Children's Hospital.[90]

CONCLUSION

Taxpayers should demand that the 104th Congress review and rescind appropriations that waste money or promote a political agenda.

***

Robert Maginnis is a policy analyst with the Family Research Council, a Washington, DC. -based research and advocacy program.

ENDNOTES

1. "Making Appropriations for the Departments of Labor, Health and Human Services, and Education, and Related Agencies, for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-733, September 20, 1994, p. 43.

2. "Making Appropriations for the Department of Transportation and Related Agencies, for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-752, September 26, 1994, p. 47.

3. "Making Appropriations for the Departments of Veterans Affairs and Housing and Urban Development, and for Sundry Independent Agencies, Boards, Commissions, Corporations, and Offices for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-715, September 1, 1994, p. 40.

4. Ibid.

5. "Making Appropriations for the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Programs for the Fiscal year Ending September 30, 1995, and Making Supplemental Appropriations for These Departments and Agencies for the Fiscal Year Ending September 30, 1994, and for Other Purposes," House of Representatives Conference Report 103-708, August 16, 1994, p. 83.

6. "Making Appropriations for the Department of the Interior and Related Agencies, for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-740, September 22, 1994, p. 54.

7. "Making Appropriations for the Foreign Operations, Export Financing, and Related Programs for the Fiscal Year Ending September 30, 1995," House of Representatives Conference Report 103-633, August 1, 1994, p. 3.

8. Ibid, pp. 20-21.

9. Ibid.

10. Ibid, p. 22.

11. "Making Appropriations for the Treasury Department, the United States Postal Service, the Executive Office of the President, and Certain Independent Agencies, for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-741, September 22, 1994, p. 26.

12. Conference Report 103-715, op. cit., p. 16.

13. "Title IV-Violence Against Women," "Violent Crime Control and Law Enforcement Act of 1994," Public Law 103-322, September 13, 1994.

14. Conference Report 103-740, op. cit., p. 31.

15. Conference Report 103-708, op. cit., p. 47.

16. Ibid, pp. 76-77.

17. Ibid, p. 97.

18. Conference Report 103-715, op. cit., p. 50.

19. "Violent Crime Control and Law Enforcement Act of 1994," op. cit.

20. Ibid.

21. Ibid.

22. Ibid.

23. Conference Report 103-715, op. cit., pp. 11-24.

24. "Making Appropriations for the Department of Defense for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-747, September 26, 1994, pp. 5-6; Conference Report 103-715, op. cit., p. 24; and Conference Report 103-741, op. cit., p. 50.

25. "Making Appropriations for the Government of the District of Columbia and Other Activities Chargeable in Whole or in Part Against the Revenues of Said District for the Fiscal Year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-671, August 4, 1994, p. 5.

26. Conference Report 103-741, op. cit., p. 10.

27. Ibid.

28. Ibid, p. 51.

29. "Making Appropriations for Military Construction for the Department of Defense for the Fiscal year Ending September 30, 1995, and for Other Purposes," House of Representatives Conference Report 103-624, July 27, 1994, p. 36.

30. Ibid, pp. 16 & 36.

31. Conference Report 103-740, op. cit., p. 43.

32. Conference Report 103-733, op. cit., p. 18.

33. Ibid, p. 38.

34. Conference Reports 103-747 and 103-624, op. cit.

35. "Appropriations for the Legislative Branch for the Fiscal Year Ending September 30, 1995, and for other Purposes, House of Representatives Conference Report 103-567, June 28, 1994, p. 11.

36. Conference Report 103-752, p. 77.

37. Conference Report 103-740, op. cit., p. 56.

38. Ibid, p. 56.

39. Rachel Kaplan, "Walls That Speak," *The Ethnic NewsWatch Inside*, December 31, 1993, Vol. 14, No. 4, p. 76.

40. "Making Appropriations for Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Programs for the Fiscal Year Ending September 30, 1995, and for other Purposes," House of Representatives Conference Report 103-734, September 20, 1994, p. 27.

41. Conference Report 103-733, op. cit., p. 35.

42. Conference Report 103-708, op. cit., p. 82.

43. Ibid, p. 97.

44. Conference Report 103-715, op. cit., p. 36.

45. Conference Report 103-740, op. cit., p. 20.

46. Conference Report 103-708, op. cit., p. 51.

47. Conference Report 103-567, op. cit., p. 3.

48. Conference Report 103-715, op. cit., p. 51.

49. Conference Report 103-741, op. cit., p. 52.

50. Ibid, p. 53.

51. Conference Report 103-734, op. cit., p. 33.

52. Conference Report 103-733, op. cit., p. 14.

53. Conference Report 103-708, op. cit., p. 34.

54. Conference Report 103-733, op. cit., p. 38.

55. "Bethune Cookman Awarded $16 Million for Arts Center Honoring Mary M. Bethune," *Jet*, October 26, 1992.

56. Ibid, p. 44.

57. Colman McCarthy, "A Global Lesson Plan for Peacemaking," *The Washington Post*, December 6, 1994, p. B-10.

58. Conference Report 103-740, op. cit., p. 28.

59. Conference Report 103-708, op. cit., p. 65.

60. Conference Report 103-671, op. cit., p. 18.

61. Conference Report 103-715, op. cit.

62. Ibid, p. 18.

63. Brochure from the Center for Political Leadership & Participation, The University of Maryland, College Park, Maryland, undated.

64. Ibid.

65. John S. Day, "Andrews Draws Ire Over Funding Bill," *Bangor Daily News*, September 15, 1994.

66. Conference Report 103-715, op. cit., p. 21.

67. Dr. John P. Schlegel, University of San Francisco, testimony before the Subcommittee on VA, HUD and Independent Agencies, Committee on Appropriations, May 3, 1994.

68. Conference Report 103-715, op. cit., p. 29.

69. "The Finer Points of Light," *St. Petersburg Times*, January 13, 1995, p. A-16.

70. Conference Report 103-715, op. cit., p. 23.

71. Ibid, p. 34.

72. Conference Report 103-708, op. cit., p. 44.

73. Conference Report 103-715, op. cit., p. 22.

74. Ibid, p. 15.

75. Tim Sullivan, "Group Offers Help to Aging Survivors of Nazi Terror," *Los Angeles Times*, September 11, 1994, p. A-8.

76. Ibid, p. 21.

77. Ibid, p. 23.

78. Ibid, p. 29.

79. Charles D. Whiteley, Consumer Protection and Competitiveness Committee on Energy and Commerce hearing, April 19, 1994.

80. Conference Report 103-715, op. cit., pp. 11-24.

81. Conference Report 103-734, op. cit., p. 16.

82. Conference Report 103-747, op. cit., p. 149.

83. Conference Report 103-715, op. cit., p. 9.

84. Ibid, pp. 16-18 & 21.

85. Conference Report 103-734, op. cit., pp. 7-21.

86. "Farm Assets, Debt, and Income, by State: 1990 and 1991," No. 1113, U.S. Department of Commerce, Statistical Abstract of the United States 1993, p. 661.

87. Conference Report 103-734, op. cit., p. 17.

88. Ibid, p. 10.

89. Ibid, p. 9.

90. Ibid, p. 8.

FAMILY
RESEARCH
COUNCIL

Gary L. Bauer
President

700
Thirteenth St., NW
Suite 500
Washington, DC
20005
(202) 393-2100
FAX (202) 393-2134

DEFUNDING TITLE X: A STEP IN THE RIGHT DIRECTION

The House of Representatives will soon vote on the Labor/HHS/Education Appropriations bill. The bill includes a provision to defund Title X, the federal family planning program, and transfer its allotted $193 million to two other block grants which aid mothers, infants, and communities.

Pro-abortion groups such as Planned Parenthood are crying "Foul!" They say that defunding the Title X family planning program will only increase abortions. (It is ironic that Planned Parenthood claims to be so interested in decreasing abortions when it performed ***more abortions*** than any other organization in the country -- 134,277 in 1993 and referred for another 80,743. And by the way, Planned Parenthood also received $33 million in Title X funds last year.)

But pro-family and pro-life groups know that cutting off Title X funding, while a small step, is an important first step in helping stem the tide of out-of-wedlock pregnancy which leads to abortion. And such a step is long overdue.

Title X's Legacy of Devastation

Title X of the Public Health Service Act should be defunded because it is a dismal failure. Enacted in 1970 as a categorical grant to fund family planning projects throughout the country, the program was supposed to help reduce the unplanned pregnancy rate, especially among teenagers. But while more teenagers have been exposed to these family planning "services" -- reaching more than 1.5 million teenagers this last year -- teenage reproductive health has drastically ***worsened*** in every category. This is Title X's legacy:

- **Out-of-wedlock births** -- ***Since the introduction of Title X, the teenage out-of-wedlock birth rate has doubled.*** The out-of-wedlock birth rate per 1,000 unmarried girls aged 15-19 rose from 22.4 in 1970 to 44.6 in 1992. When Title X began, only 3 in 10 teen births were out-of-wedlock; now 7 in 10 occur outside marriage.

- **Pregnancies** -- ***Since the introduction of Title X, the out-of-wedlock pregnancy rate among 15-to 19-year-old girls has doubled.*** In the same time span, the overall teenage pregnancy rate (marital and nonmarital) increased 23 percent, climbing from 95.1 per 1,000 girls aged 15-19 in 1972 to 117.1 in 1990. Not only did the overall teenage pregnancy rate increase, but a greater proportion of these pregnancies are now out-of-wedlock.

- **Sexually-Transmitted Diseases** (STDs) -- ***Sexually-transmitted diseases among teenagers are at an all-time high. In fact, teenagers now have higher rates of gonorrhea than any other 5-year age group between 20 and 44.*** Currently, one in four sexually experienced teenagers -- about 3 million -- becomes infected with an STD every year.

- **Abortions** -- ***Over the lifetime of Title X, the teenage abortion rate has more than doubled.*** In 1972, the abortion rate per 1,000 girls aged 15-19 was 19.1; in 1990, the rate was 40.6. While the abortion rate grew rapidly from 1972 to the early 1980s, the rate has apparently reached a plateau, hovering between 40 and 43 abortions per 1,000 teenage girls over the last 10 years. Interestingly, the women whom Title X clinics target -- low-income women, minorities, and unmarried young people -- have the highest abortion rates. And, the Alan Guttmacher Institute reports that half of all women having an abortion used contraception in the month during which they conceived.

Increased rates of teenage pregnancy, illegitimacy, STDs, and abortion are all products of increased rates of sexual activity among the young. And teen sexual activity is correlated to contraceptive counseling and the distribution of contraception -- primary duties within Title X clinics.

- For example, a 1993 Public Health Reports article found that adolescent males who had been instructed in sexual biology and birth control were more likely to engage in intercourse than were those who had received no instruction.

- Furthermore, research from Planned Parenthood shows that the number one reason, by far, that teenagers initiate sexual activity is peer pressure. By promoting contraceptive use among teenagers, Title X clinics reduce the number of outside forces bolstering teenagers' resolve to save sex for marriage.

- Even Dr. Robert Kistner of Harvard Medical School, one of the developers of the oral contraceptive, subsequently acknowledged that use of contraceptives among teenagers is stimulating higher levels of promiscuity: "About ten years ago I declared that the pill would not lead to promiscuity. Well, I was wrong," he said (Family Practice News, 1977).

Stop Subsidizing Illegitimate Programs

Beyond its correlation to worsening reproductive health indicators, there are additional reasons to remove Title X funding. First, ***Title X's authorization expired in 1985, and unauthorized programs should not be allowed to receive federal dollars.*** At a time when taxpayers are already paying too much money to the federal government, unauthorized programs such as Title X should be eliminated. Secondly, Title X has never been evaluated for effectiveness -- for 25 years, it has received increased funding without ever having to give an account of its record or be measured for effectiveness. Third, the federal government has no reason to run a categorical family planning program when state governments are capable of setting health care priorities within the parameters of alternative block grants.

Conclusion

Defunding Title X will not halt teenage pregnancy or out-of-wedlock births as we know them, but it is a first step in the right direction. Eliminating Title X sends a signal that the federal government should not be in the business of funding social experiments that have failed nor in granting federal sanction to the distribution of contraception for unmarried minors without parental consent. For the sake of future generations, Congress should vote to defund Title X without delay.

TITLE X'S IMPACT ON TEENAGE BIRTHS AND ABORTIONS

Year	Title X Funding (per fiscal year)	FP Enrollment	Number of girls aged 15-19	Pregnancy rate per 1,000 girls aged 15-19 (married and unmarried)	Rate of out-of-wedlock births per 1,000 unmarried girls aged 15-19	Abortions to girls aged 15-19
1970	n/a		9,517,000		22.4	
1971	6,000,000	518,000	9,741,000			
1972	61,815,000		9,985,000	95.1		191,000
1973	100,615,000	894,000	10,193,000	96.1		231,900
1974	100,615,000		10,350,000	98.8		279,700
1975	100,615,000	1,143,000	10,466,000	101.1	23.9	326,780
1976	100,615,000		10,582,000	101.1		362,680
1977	113,000,000	1,303,000	10,581,000	104.6		396,630
1978	135,000,000		10,555,000	105.4		418,790
1979	135,000,000	1,478,000	10,497,000	109.4		444,600
1980	162,000,000		10,381,000	111.0	27.6	444,780
1981	161,671,000	1,306,000	10,095,000	109.9	27.9	433,330
1982	124,176,000		9,809,000	109.8	28.7	418,740
1983	124,088,000	1,255,000	9,515,000	109.3	29.5	411,330
1984	140,000,000		9,287,000	107.9	30.0	398,870
1985	142,500,000	1,277,000	9,174,000	109.0	31.4	399,200
1986	136,372,000		9,205,000	106.7	32.3	389,240
1987	142,500,000	1,386,000	9,139,000	106.6	33.8	381,640
1988	139,663,000		9,029,000	111.4	36.4	392,720
1989	138,320,000		8,840,000	114.9	40.1	370,900
1990	139,135,000		8,645,000	117.1	42.5	350,970
1991	144,311,000		8,371,000		44.8	
1992	149,585,000		8,312,000		44.6	
1993	173,418,000		n/a		n/a	
1994	190,918,000		n/a		n/a	
1995	193,349,000		n/a		n/a	

Sources: The Alan Guttmacher Institute; U.S. Bureau of the Census; Division of Vital Statistics, National Center for Health Statistics, Centers for Disease Control; Office of Population Affairs, U.S. Public Health Service.

FAMILY
RESEARCH
)NCIL

Gary L. Bauer
President

700
Thirteenth St., NW
ite 500
V. ..ngton, DC
20005
(202) 393-2100
AX (202) 393-2134

THE FAILURES OF REFORM: WHY CPB, NEA AND NEH MUST BE ZEROED OUT

by
Robert H. Knight

Federal arts funding, much like the welfare system, has created a class of beneficiaries who are hostile to conservative, pro-family causes. Recipients of federal aid all too often become cheerleaders for big government, the family's natural enemy. Big government strips families of their incomes through confiscatory taxation and diminishes their autonomy through intrusive social welfare and educational programs designed to wean children from their parents (and parental values) at earlier and earlier ages.

The same taxpayers who suffer the indignity of seeing their own earnings used by bureaucrats to undermine their families also pay for a federally-subsidized artistic and media elite to cheer on their tormentors: the Corporation for Public Broadcasting, the National Endowment for the Arts and the National Endowment for the Humanities.

It is long past time that the federal arts and humanities endowments be de-authorized and de-funded. Spawned during the 1960s' Great Society years, these agencies, despite whatever good they have done, have damaged American culture, ripped off the taxpayer, waged war on the family and religion, and politicized the academy and the arts.

CURRENT PROPOSALS TO TRIM THE ENDOWMENTS ARE ILL-ADVISED AND COUNTER-PRODUCTIVE.

Merely cutting the budgets and stretching out the life of the agencies will cause more mischief. When Proposition 13 was enacted into law in California, hostile government officials began cutting back on essentials, such as police and fire departments, leaving the waste and fat untouched. The object lesson to the voters was that challenging government growth meant the onset of anarchy. Similarly, if the federal budgets for public broadcasting and the arts and humanities are merely reduced, the truly offensive offerings will be the last to be de-funded. Vengeful bureaucrats will trim where it will cause the most pain and where patrons would complain most loudly. A couple of years ago, when Congress stalled in passing an appropriations bill for the federal government, the Smithsonian closed its

doors, as did some national parklands, enraging taxpaying visitors. But the long-obsolete federal Helium Reserve suffered no loss of gas. Again, the message to the voters was: we will punish you if you don't lobby your elected representatives to reinstate our funding -- with increases.

SOME POLITICIANS THINK THEY CAN BUY PEACE BY APPEASING THEIR OPPONENT. INSTEAD, THEY CREATE A HARDENED ENEMY.

In terms of the federal endowments, the political price is actually higher for merely cutting instead of eliminating them. Recipients of federal aid are the natural foes of budget cutters and will continue to use their taxpayer-provided subsidies to wage political war on them. Hundreds of arts organizations are being lobbied to bring pressure on individual members of Congress to preserve art pork in their own districts.

A case in point is a letter from Independent Television Service Executive Director James Yee to public broadcasting advocates. The taxpayer-supported (and, therefore, in no way independent) ITVS was created in 1988 to provide new programming for public broadcasting. Yee urges his "independent colleagues" to "become involved in future efforts to drum up support for public broadcasting, especially with your local and national elected officials...." Yee warns that "an extensive informational outreach campaign will have to be waged." Such campaigns cost money, but are easier to mount when federal subsidies pour in to handle other costs.

The current House plan to phase out the endowments serves only to give welfare artists some time to restore their subsidies. Indeed, subsidy supporters have acknowledged, through their accord, that the phase-out plan is their best hope for saving the agencies and returning to business as usual.[1]

CUTTING BACK THE ENDOWMENTS WILL NOT LEAD TO SIGNIFICANT REFORM.

Congress repeatedly has slapped NEA on the wrist, and still the NEA sends money to The Kitchen, Franklin Furnace and other centers of blatantly offensive "performance" art that denigrates religion, families and traditional morality. Indeed, a *Washington Post* critic observed recently that the 1993 Biennial Exhibition at the NEA-funded Whitney Museum was "one long whinging [sic] whine of political correctness, suggesting as it did that the only art that counts is art produced by lesbians, inhabitants of barrios, sufferers of AIDS and others on the margin." Two years later, at the 1995 Biennial, "[h]omosexuality's still hot, especially the kinds involving punctures of the flesh, accessories of leather, bondage and cross-dressing, but so too are the subtlest of painterly abstraction. Nuances and nipple-rings are both themes of this exhibit, if it can be said to have any themes at all."[2]

NEA chairwoman Jane Alexander has boasted of using the endowment to promote homosexual themes[3] and has even defended a public bloodletting by an HIV-infected performer at an NEA-

subsidized venue.[4] Despite many assurances by past and present NEA officials that excellence and artistic merit are the criteria for grant allocation, this is clearly not the case. More than $9 billion in private giving sustains arts in communities all over America.[5] The NEA's $175 million is important more for its symbolism than for the actual dollars involved. An NEA grant validates an artist, and the government should not be putting its imprimatur on much of the anti-family, anti-religious propaganda that counter-culture activists brazenly categorize as art. The entertainment industry has revenues in the tens of billions of dollars each year. Time-Warner alone took in $15.9 billion during 1994. Clearly, Hollywood is in a better position to subsidize the endowments for arts and humanities than US taxpayers who struggling to get out from under $200 billion in annual deficits.

CORPORATION FOR PUBLIC BROADCASTING

In 1967, President Lyndon Johnson signed the Public Broadcasting Act creating CPB. The agency oversees the Public Broadcasting Service, which was formed in 1969, a year before the creation of National Public Radio. CPB's total appropriation in fiscal 1969 was $5 million. In 1992, Congress re-authorized CPB with a three-year, $1.1 billion appropriation. By 1993, CPB's annual federal appropriation was $318.6 million, which rose to $386 million for fiscal 1995. There are 349 public TV stations and 200 TV grantees receiving CPB funding.[6] PBS claims to reach 1.8 million teachers and 29.5 million students through educational programming and services, and 97 million Americans overall each week with some PBS programming.[7] National Public Radio is carried on 595 stations, and CPB awards money to 391 public radio grantees.

The basis for CPB's existence has always been an anti-free market philosophy. Proponents have said that the market is incapable of providing good programming, so the government must step in and do it, to the tune of hundreds of millions of dollars annually.[8] Yet the shows that register high ratings on PBS turn out to be the very programs that the public perceives to be excellent: *Sesame Street*, *Barney and Friends*, *The MacNeil-Lehrer NewsHour*, and *Masterpiece Theatre*, for example. All of these shows are generating more than sufficient revenue from sponsors, donors, grants and product marketing. They do not need taxpayer subsidies.

But there is other CPB programming that probably would fail to attract a sufficient viewing/listening audience or donor support. These programs are so bad that their creators must dig into the public purse. Subsidizing bad art is a donor's prerogative, of course -- unless the "donor" is the taxpayer, who has no choice. (For detailed examples, see FRC's Policy paper entitled "Public Broadcasting? Let's Free Big Bird.")

NATIONAL ENDOWMENT FOR THE ARTS

NEA was established in 1965 when President Johnson signed the National Foundation on the Arts and Humanities Act, which also created the National Endowment for the Humanities. NEA's initial budget was $2.5 million, but grew over the years to about $175 million annually (fiscal 1995 appropriation is $167.7 million). A fiscal 1995 rescission bill, HR 1158, would reduce 1995 funding to $162.5 million.[9] All told, NEA has spent more than $3 billion of tax money in its 30-year history.

The plan approved by the House Economic and Educational Opportunities Committee on May 10, 1995 would reauthorize NEA through fiscal 1998 but eliminate funding in fiscal 1999. Funding would be reduced by 40 percent in fiscal 1996, another 40 percent in fiscal 1997 and by 20 percent in fiscal 1998. The NEA would get no money in fiscal 1999.[10]

NEA would also face a $5 million cap on administrative expenses, which would entail an 80 percent reduction in budget for staff. Currently, NEA spends $24 million annually on administration.[11]

Beginning in 1996, grants to individuals would be eliminated, with all grants going to institutions. Eighty percent of annual appropriations to the state art councils would be in the form of block grants.[12]

A Senate bill (S 856) introduced by James Jeffords (R-VT) and co-sponsored by Nancy Kassebaum (R-KS), Alan Simpson (R-WY), Edward Kennedy (D-MA) and Claiborne Pell (D-RI) would reauthorize NEA for five years (FY 1996-2000) at gradually reduced funding levels. Forty percent of the NEA's program budget would go to "partnership" grants with the states, local and regional groups; 40% more would go toward organizations of "national significance;" a final 20% would go to direct grants to organizations, such as theaters or museums, and to individual artists.

Most significantly, the bill keeps intact much of the current peer review system, in which panelists award federal tax dollars to their friends and associates. It also locks in place the conditions under which the NEA would reject a grant over "obscenity." An artwork would have to be found legally obscene in a court of law before the NEA could move to recover funds. Given that a grant from the NEA automatically gives an artwork "artistic" significance no matter how offensive, the provision is meaningless in terms of curbing abuses of taxpayer funding.

The bill also directs the current NEA director to give "Distinguished Lifetime Service for the Arts" awards to "each of the former Chairpersons of the Endowment." This means that federal taxpayers would honor, among others, John Frohnmayer, the NEA chief whose tenure ended

when he was forced by President Bush to resign over NEA's continued funding of anti-Christian and pornographic works.

Finally, the bill creates an entirely new federal agency to nationalize standards for all public libraries and museums. The "Institute for Museum and Library Services" would be authorized for five years, beginning with a budget of $75 million in fiscal 1996 "and such sums as may be necessary for each of the 4 succeeding fiscal years," and would have grant-making authority. This is a potentially lucrative source to be abused by well-connected left-wing groups like the American Library Association, would give the federal government potential control over the nation's local public libraries, and would do to libraries and museums what the NEA has done to art -- redefine it using federal tax dollars to further a radical cultural and political agenda.

NATIONAL ENDOWMENT FOR THE HUMANITIES

NEH was established at the same time NEA was born, in 1965. The fiscal year 1966 budget was $5.9 million, and the agency had a staff of 13.[13] The agency expanded over the years until it reached a budget of $177 million in fiscal 1995.

Officials at the NEH are hardly contrite for sponsoring a widely-denounced set of national history standards that, among other things, emphasize the role of the Ku Klux Klan (17 references) and exalt Soviet advances in space while ignoring Albert Einstein, the Wright Brothers, Paul Revere, Robert E. Lee and the American moon landing.[14] The NEH also specializes in promoting cultural relativism, feminist studies and other Marxist and neo-Marxist theoretical quagmires on the nation's campuses.[15]

The current plan approved by the House Economic and Educational Opportunities Committee would reauthorize NEH with an annual 20 percent funding reduction through fiscal 1998 starting with the 1995 appropriation of $172 million (which includes a recent House-approved $5 million rescission). No funding would be allocated to NEH in 1999. The 5 percent cap for administrative expenses would also apply to NEH, as well as the termination of direct federal grants to individuals (scholars would continue to receive grants through recipient organizations such as universities). Eighty percent of appropriations would go to state humanities councils in the form of block grants. Senate bill S 856 would reauthorize NEH for five years at gradually reduced funding levels, beginning with $168.6 million in fiscal year 1996. Each state would get a minimum of $200,000 in funding each fiscal year. Grants would continue to be made to "groups, individuals, and State agencies or entities."

SUMMARY

Attempts to curry favor with the welfare broadcast media and arts groups are useless and only embolden the political enemies of budget cutters. So, we must ask budget-cutting Members of

Congress: why give the very people who will never love you enough subsidies to stay in business so they can continue taking shots at you? The federal arts subsidies must end once and for all.

***

Robert H. Knight, former Los Angeles Times news editor and Hoover Institution Media Fellow, wrote, directed and produced the FRC video documentary The Children of Table 34. He is Director of Cultural Studies at the Family Research Council, a Washington, DC -based research and advocacy organization.

ENDNOTES

1. Rod Dreher, "Panel Sets Cultural Funds Phaseout," *The Washington Times*, May 11, 1995, p. A-12.

2. Paul Richard, "From Shock to Doughnuts at the Whitney Biennial," *The Washington Post*, March 23, 1995, p. C-1.

3. Chris Bull, "See Jane Run the NEA," *The Advocate*, February 22, 1994, p. 35 at 38.

4. Jacqueline Trescott, "Art on the Cutting Edge: Bloody Performance Renews Funding Debate," *The Washington Post*, March 3, 1994, p. C-1.

5. Giving USA 1994: The Annual Report on Philanthropy for 1993, AAFrc Trust for Philanthropy. The report' notes that private support of the visual and performing arts reached $9.57 billion in 1993.

6. CPB Index in "Open to the Public," a brochure by the Corporation for Public Broadcasting, undated but referencing fiscal 1993.

7. "The Educational Power of Public Television at a Glance," Public Broadcasting Service fact sheet, February 1994.

8. "Public Broadcasting and You: Facts and Figures about Public Broadcasting in America," Corporation for Public Broadcasting, 1993.

9. Robert Marshall Wells, "Panel Quickly Approves Bill to Phase Out Arts Funding," *CQ*, May 13, 1995, p. 1331

10. Dreher, op. cit. and Wells, op. cit.

11. Wells, op. cit.

12. Dreher, op. cit.

13. Telephone interview by FRC Research Assistant Daniel Garcia with Steve Cherrington of NEH's Office of Planning and Budget on May 18, 1995.

14. Jennifer A. Marshall and Eric Unsworth, "Faulty Standards," in "Freeing America's Schools," *Family Policy*, Family Research Council, April 1995, p. 5.

15. See, for instance, The National Endowments: A Critical Symposium, Center for the Study of Popular Culture, Laurence Jarvik, Herbert I. London and James F. Cooper, editors, 1995, pp. 1-52.

FAMILY
RESEARCH
COUNCIL

Gary L. Bauer
President

700
Eleventh St., NW
500
Washington, DC
20005
(202) 393-2100
FAX (202) 393-2134

LEGAL SERVICES CORPORATION'S WAR ON THE FAMILY

by
Daniel S. Garcia

The Legal Service Corporation (LSC) is an independent, non-profit corporation funded by the federal government to the tune of $415 million a year. LSC's purported purpose is to provide poor people access to expensive legal services. But, actually, LSC has become a deep well for anti-family litigation. By using carefully-selected "test cases" in carefully selected courts, liberal activists have used the LSC to litigate their agenda, sidestepping democracy and the legislative process.

Since 1974, LSC has spent $5 billion working against the interests of the family on many fronts. Following are some examples:

PROMOTING ABORTION AND DIVORCE

The Legal Services Corporation Act, as amended in 1977 and in subsequent appropriations acts, prohibited LSC from being involved in abortion related cases. Nonetheless, LSC has remained firmly committed to abortion on demand and has worked around the law in an attempt to secure unlimited taxpayer-funded abortions. In several cases throughout the country, LSC programs have worked against waiting periods, physicians' consent, parental consent, parental notification and spousal notification.

In *Planned Parenthood Association, Inc. v. Department of Human Resources*, Oregon Legal Services represented Planned Parenthood in a challenge to a limitation on the number of elective abortions that the state's medical assistance program could fund. OLS argued that poor women should have access to an unlimited number of taxpayer-funded abortions.[1] LSC grantees took a similar line in a Pennsylvania case, arguing that such limitations were an unconstitutional infringement of a woman's right to have an unlimited number of abortions.[2] In another Pennsylvania case, an LSC grantee filed a class action suit to discard spousal and parental consent for minors.[3]

In testimony on the reauthorization of LSC, Linda Jones of Concerned Women for America of California testified that LSC programs have been involved in most major abortion cases. According to Jones, "The list reads like a virtual hall of fame for abortion rights litigation."[4]

LSC seems to be more interested in facilitating divorce in troubled families than in helping to repair them. An example of LSC's lack of commitment to keeping families intact is their view on mediation. The National Center on Women and Family Law, an LSC-funded center, argues that mediation, one important means of resolving domestic disputes, should be avoided because the woman is always at a disadvantage.[5]

EXPANDING WELFARE, SUBSIDIZING DESTRUCTIVE BEHAVIOR

LSC has also been active in blocking attempts to reform welfare and in increasing the number of people dependent on public assistance programs. In the case of *C.K. v. Shalala*,[6] LSC filed a class action suit with the ACLU and the National Organization of Women's Legal Defense Fund to block New Jersey's law capping welfare payments to mothers who have additional children while on welfare. LSC grantees argued that such a law was an unconstitutional violation of a woman's right to procreate at will. LSC grantees have filed similar suits against California, Massachusetts, Maryland, Rhode Island, Tennessee, Iowa, Kansas and Maine.

Lawsuits filed by LSC programs have also helped to subsidize the destructive habits of alcoholics and drug addicts. In recent years LSC programs have helped some 250,000 substance addicts obtain monthly disability checks.[7]

AIDING THE HOMOSEXUAL AGENDA

In the case of *Rush v. Parham*,[8] the Atlanta Legal Aid Society, an LSC grantee, tried to force the state of Georgia to pay for a sex change operation. The suit challenged the Georgia Department of Health's prohibition on Medicaid reimbursement for such operations.

The Legal Aid Society of Kentucky, another LSC grantee, represented a lesbian mother who contested the custody of a two-and-a-half-year-old child to the father, who had remarried. In the case of *S. v S.*[9] LSC-funded lawyers challenged the customary preference for the traditional family as the best environment in which to raise children.

In a 1986 New York case involving a lease agreement,[10] LSC grantees claimed that a "gay life partner" should be treated as a family member. Arguing that equal protection required that the gay partner be treated as a family member, attorneys from the Legal Aid Society successfully appealed to the New York Supreme Court, calling into question laws that favor and protect the traditional family.

PUSHING THE CHILDREN'S RIGHTS AGENDA

"Children's rights" is another area where LSC-funded lawyers have pursued an anti-family agenda. The notion that children have rights independent of their parents is a concept that undermines parental authority and opens the door to state interference in the raising of children. In the case of *Nafzinger v. Blum*,[11] LSC-funded lawyers successfully argued that minors who no longer wanted to live at home should get their own welfare benefits. The Legal Aid Society of

Central Texas, an LSC grant recipient, filed a suit to force public housing officials to rent apartments to minors.[12] In 1992, Legal Services of Greater Miami argued that children should have standing to sue their parents.[13]

GOING SOFT ON CRIME AND AIDING CRIMINALS

Criminals often find a friend in LSC. In a bizarre and disturbing case from Pennsylvania, Lehigh Valley Legal Services represented a convicted rapist in prison who was suing for custody of the child he fathered by the rape of a 13 year old girl. A psychologist found the rapist unfit to be a parent and determined that any child in his custody would be endangered. After a 3-day non-jury trial the judge ruled that the rapist had no parental rights.[14] In cases like *Duran v. Elrod*[15] LSC grantees have worked hard to make sure that prisons look more like country clubs than places to rid society of dangerous people. Such lawsuits have had the additional consequence of increasing the costs of incarcerating criminals, and putting many of them back on the street, often in neighborhoods where the poor become their main targets.[16] LSC-funded lawsuits have also made it difficult to evict drug dealers from public housing units and to keep them out in the first place.[17]

CONCLUSION

By advancing this radical, anti-family agenda, LSC has done far more to hurt poor people than to help them. The poor, as well as the rest of the country, can't afford LSC. In recent testimony to a House Judiciary Subcommittee Howard Phillips, former head of the Office of Economic Opportunity, said that the true cost of LSC should include the impact of actual, threatened and feared LSC-related suits as well as increased federal state and local government spending. According to Phillips, "viewed in this way, the LSC is properly seen as a central player in our current national deficit and debt problem."[18] Attempts to reform LSC have failed and it should be abolished. The poor are better served by state and local initiatives as well as private foundations and bar associations. These institutions have demonstrated the ability to adequately meet the legitimate legal needs of the poor. Non-federal contributions to LSC-type programs amounted to $255 million in 1994.[19] At a time when Congress needs to carefully assess budgetary priorities it makes no sense to continue funding LSC.

***

Daniel S. Garcia is a research assistant at the Family Research Council, a Washington, DC - based research and advocacy organization.

ENDNOTES

1. Kathleen B. deBettencourt, *Legal Services Corporation vs. The Family*, Office of Policy Development, Legal Services Corporation, March 1988, p. 24.

2. 297 Or. 562, 687 P. 2d 785 (1984); also see deBettencourt *op cit.*

3. *Roe v. Casey*, 623 F. 2d 829 (3d Cir. 1980).

4. Lisa Jones, Legislative Liaison, Concerned Women for America of California, Testimony before Legal Services Corporation Board of Directors, April 5, 1991.

5. deBettencourt *op cit.*, p. 15.

6. *C. K. v. Shalala*, No. 49, 519 (D. N.J. filed Dec. 1, 1993); also see *Clearinghouse Review*, vol. 27, No. 10 Feb. 1994, p. 1254.

7. Rael Jean Isaac "War on the Poor," *National Review*, May 15, 1995, p. 36.

8. 440 F. Supp. 383 (N.D. Ga 1977).

9. 49 U.S.L.W. 3781 (April, 1981); deBettencourt *op cit.* p. 28.

10. *Two Associates v. Brown*; also see deBettencourt *op cit.* p. 28.

11. *Nafzinger v. Blum*, No. 80-Cv-623 (N.D.N.Y., June 2, 1982).

12. *Marshall v. Housing Authority of Taylor*, No. A-91-CA-856, (W.D. Tex. filed Sept. 6, 1994).

13. Howard Phillips, "The Real Cost of the Legal Services Corporation: A Two Trillion Dollar Bypass of Electoral Accountability," Testimony to the House Judiciary Sub-Committee on Commercial and Administrative Law, June 15, 1995.

14. *The Morning Call*, March 2, 1995, p. B-3.

15. 760 Fed 2 756 (7th Cir. 1985).

16. Isaac, *op cit.* p. 36.

17. Isaac, *op cit.*, p. 35.

18. Phillips, *op cit.*

19. Kenneth Boehm, National Legal and Policy Center, telephone interview with Daniel. S. Garcia, Family Research Council, June 22, 1995.

Mr. BAUER. But there are, clearly, a number of things that it is legitimate for government to do. Defense, of course, is a top priority. A safety net under people who cannot deal with certain circumstances in their lives is something that I think conservatives and liberals do agree upon. I guess I would almost be tempted to turn it around, Congressman. Is there anything—is there anything in Washington, other than defense, that you are willing to cut?

Mr. MCDERMOTT. Let me turn this to my question. You say a safety net. We have millions of people homeless in this country. Do you think the government should be involved in trying to put money out to get subsidized housing for people so people can get out from living under bridges, families?

Mr. BAUER. Well, I think what we need to do is look at the fact that spending on the homeless has trended up for years and we seem to have more people living under bridges, not fewer. Ask what is——

Mr. MCDERMOTT. It is because the Reaganesque style went from $40 billion down to $8 billion in the amount of money this country spends on housing. It is no wonder there are people under bridges.

Mr. BAUER. I think if you take all the funds that deal with homelessness in one fact or the other, the figures are quite different than the figures you just gave.

What I would like to see is more effort by churches, the private sector, and government in a partnership with them, to help the homeless. I would like to see reform in our legal system so that we are not releasing on the streets people who are mentally ill and then pointing to them as they cannot function in society and suggesting that what we have is a homeless problem instead of an ACLU problem, which is what we have on that particular issue. I think we need to address things with drug addiction and alcoholism, which basically is at the core of why so many people seem to wander our streets unable to get jobs.

Mr. CRANE. Time of the gentleman has expired.

Mr. MCDERMOTT. We will talk later about your list. Thank you.

Mr. CRANE. Mrs. Dunn.

Ms. DUNN. Thank you, Mr. Chairman.

Mr. Bauer, I was very interested in your history of family-friendly tax proposals that were begun some years ago, and you mentioned in the eighties and then Rockefeller's commission later on. I would like you, for our information, to put together for us right now your best shot at a composite tax relief program that would best help the families of the Nation and middle class.

How would you—and also considering who holds the majority in this Congress and the political situation, what we could do.

Mr. BAUER. Right. Well, Congresswoman Dunn, I must submit that I am somewhat sympathetic to the flat tax approach because I think eventually that will solve a lot of problems and particularly if you set the personal exemptions and the dependent exemptions high enough so that middle-class families would essentially be shielded from a good bit of those taxes.

I don't know, however, given how much time it takes in the public policy process to build on an idea and raise it up so that people understand it, whether that is something, realistically speaking, we

can do in the next 6 months. I suspect it is more something that we are going to look at over the next couple of years.

Failing to do that, then, I am very much in favor of either a child credit of some level to be determined after looking at all the priorities that you have and the concerns about the deficit and so forth, or a further major increase in the personal exemption. As I know you have heard over and over again, the exemption really ought to be at the level of around $8,000 if it is going to keep up with the inflation that has occurred since the end of World War II. So the fact that it is around $2,500 now is far short of where it needs to be. I am certainly very positive about the possibilities of either moving that up or taking the credit approach, which I think is probably even better.

Ms. DUNN. Good. Thank you very much.

Mrs. Schlafly and Mrs. LaHaye, you touched on a sensitive issue to me, that is, the right of a mother to stay at home if she wishes to do so. There is a group of folks who have done work for a long time in this Nation who have never received the sort of respect I believe they should receive, and that is the volunteers.

My history is one of intensive volunteer involvement at a time when I was able to stay home with my children. I wonder if you could take a few minutes to talk to us about what can be accomplished as a volunteer.

The mother has a choice to stay at home. She wants to be using her talents. I found there are a great many leadership opportunities in that area and the results are always simply terrific. I just think we need to give a lot more respect to the volunteer. Could you speak to us about that?

Ms. SCHLAFLY. Well, thank you very much, Congresswoman, and my life is a whole life of volunteerism. I am a lifetime, full-time volunteer. I think what I have done is a record of what can be accomplished and what opportunities there are for good service and for leadership and all those things. Our whole organization is an organization of volunteers. So thank you for pointing that out.

In addressing the larger issues that are here, we heard a lot of talk about fairness, and I think that the $500 child credit is a step toward fairness, because I believe that families with children are the ones who have borne the biggest burden of the—of the shift, of the massive increase in government spending over the last few years. So I would urge you to do that.

If you want to go farther, a next good plan would be to repeal the Clinton tax increase of 1993.

Ms. LAHAYE. I will just add a word to that. I agree with what Phyllis Schlafly just said. We are also volunteers in Concerned Women for America. I will just have to say because of the burden on families, we have lost some of our volunteers who are excellent, but they have had to leave the volunteer life and go into industry where they have had to get a salary just to assist with the family expenses. So we will have stronger volunteerism when we really address the tax credit for children.

Ms. DUNN. I think, just as a followup, that the whole direction we want to go is to relieve the families and to provide them with a greater choice of what they want to do. It seems to me through the whole effort of volunteerism, a woman or a man's talents can

be used. If we can go a little bit more in this direction, then we can get back on the emphasis of volunteerism and how many good things it can do for us.

Ms. LAHAYE. Excellent. I agree.

Mr. CRANE. Mr. Collins.

Mr. COLLINS. No questions.

Mr. CRANE. Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman.

I want to commend these panelists that we have for talking about the family. So often on this committee we do not see those coming in speaking on behalf of the family. Regrettably, we hear so many that are supporting the type of policies that so often are damaging to our American families. So again, I commend you.

I might ask to begin with you, Ms. Schlafly. What societal benefits would you expect from a $500 per-child tax credit?

Ms. SCHLAFLY. Well, I think it is a proposition for fairness. I think the way the tax burden has been skewed over the last 40 years has been detrimental to families and unfair, and I think it is a step back in the right direction to recognize the importance of families.

Now, we also hear a lot about middle-class tax relief because they are a group that has been hurt very much with the increase in taxes, and I would like to say that I disagree completely with Mr. Bloch calling for refundable credits. In fact, I don't even think refundables should be discussed in a hearing about tax reduction. Refundables are not tax reduction; refundables are welfare. The earned income tax credit has been significantly expanded in the last few years and I—if you read the election any way, I think you read it as calling for a tax reduction. That is what we want, tax reduction.

Mr. HERGER. I appreciate that.

Mr. Bauer, do you have any comments?

Mr. BAUER. No. I would agree. I think Phyllis makes a really key point here. I mean, there is a debate that can be made about refundable credits, but it is not a tax debate. It is a welfare debate and it ought to be properly discussed in that regard. I think in all due respect to Mr. Bloch that there is going to be, by his industry, a great deal of resistance to simplified taxes for obvious reasons, which he has already pointed out himself.

Mr. HERGER. Mrs. LaHaye.

Ms. LAHAYE. There is already discrimination against women who choose to stay at home and take care of their children, so I think, as Phyllis said, fairness is the real key. Let's be fair to all and particularly those who have been discriminated against.

Mr. HERGER. Since your name has been brought up several times, Mr. Bloch, would you like to comment?

Mr. BLOCH. The only comment I would make is I think the $500 child credit is excellent and I am completely in favor of it. I do believe making it refundable would be desirable; not necessary, but desirable just because it will assist low-income people. But if the money is not there in the budget to do something like that, then I would be very happy with the way it is presented in the Contract With America.

Mr. HERGER. I am happy to hear that. I am not sure if I understood your earlier testimony to be such.

Mr. BLOCH. Yes.

Mr. HERGER. I appreciate your clarifying that. Thank you.

Mr. CRANE. Mr. Rangel.

Mr. RANGEL. Thank you.

I assume that everyone that supports the tax cuts also supports balancing the budget. I further assume that the way we have to pay for this is going to be by cutting back in spending. Ms. Schlafly said that in the past it was her opinion that the congressional committees would go in the back room when they were dealing with taxes and put the things there that Americans couldn't understand in fine print, and I know that you know those committees you talked about, one of them is Ways and Means, and I plead guilty. But I assume you also meant the Senate, as well, the Senate Finance Committee. Did you not?

Ms. SCHLAFLY. Oh, sure.

Mr. RANGEL. You meant liberals and conservatives, Democrats and Republicans, the whole batch of us, right?

Ms. SCHLAFLY. Well, the shift, the three-fourths devaluation in the worth of a child in the income Tax Code, by the decline in the child's exemption, was not a matter of public discussion before the eighties. It was not publicly debated and discussed before—or while and during the time it was taking place. That was my point.

Mr. RANGEL. I pled guilty. I am saying I assume you include as part of this——

Ms. SCHLAFLY. The Senate. The Senate is certainly part of the Congress, yes.

Mr. RANGEL. Because I think something like this is about to happen again, except I am not in the majority so I am going to be on your side and make certain that we shine some light on these things. Because if we are all in accord that we would want to make certain that we have less Federal spending, we are all in accord that the taxpayers should really have more of their disposable income because it is their hard work, then, it would seem to me if we are not going to increase the deficit, we ought to know where the cuts are going to be.

Now Mr. Bauer, you said that there are going to be so many proposals that we won't even know where to start. Ms. Schlafly and I want you just to start, just to give us an idea, because so many other people have said that as much as they want this sound tax policy because of the repugnant things that have occurred in the past, they wouldn't want to start and embark on something that is worse, which makes sense to everybody. But you never know if all we are going to get, Mr. Bauer, is you wait and see, we are going to do it because we promised we would do it.

Mr. BAUER. Right.

Mr. RANGEL. We deserve better than that. I mean, we want to shine some light on what our options are.

Mr. BAUER. Well, I mean, I am not in charge of the Federal budget, which probably gives you a great sense of relief.

Mr. RANGEL. No, no. Let me help you with that. We have no control over the interest on the debt, right?

Mr. BAUER. Hm-mmm.

Mr. RANGEL. We are not going to think about Social Security, right? You share with me later why we have to increase military spending because I know there is a sound reason for that.

Now, when you look at the rest of it, you are dealing with entitlements and it is not so bad that we reform even those things. I mean, just because we are spending money doesn't mean we are spending it correctly. But why will you hide from me what is on that list? Because I know that you are not in charge of the budget, but you have a pretty close working relationship with those people who are in charge now.

Mr. BAUER. Well——

Mr. RANGEL. At least you act like you do on television.

Mr. BAUER. Congressman Rangel, I am not going to give you that list in this hearing but I will be happy to supply it to you.

Let me give one example. If the Congress cut the discretionary spending at the Departments of Education, Energy, Labor, Health and Human Services, Housing and Urban Development, and Transportation, if you did that, if you cut it by 16 percent over the next 5 years——

Mr. RANGEL. My God.

Mr. BAUER [continuing]. You would raise $124 billion. You may decide that is not something you want to do.

Mr. RANGEL. I sure fire wouldn't let you say cut something across the board. I would say cut what is not working. Put more money in what is working, make it more efficient and productive. Nobody would say cut it across 15, 20 percent. That doesn't make any sense at all. There may be a couple good programs out there, notwithstanding 40 years of Democratic control.

Mr. BAUER. I am sure there are a couple of good ones. You asked me for——

Mr. RANGEL. Name a couple.

Mr. BAUER. You asked me a question and I can only give a couple hypotheticals. I guess what I am concerned about——

Mr. RANGEL. Ms. Schlafly and I are going to be waiting. Because from here on in for the next 40 years, we are going to have some light on the fine print.

Mr. BAUER. Right.

Ms. SCHLAFLY. Congressman——

Mr. BAUER. Congressman, let me say I guarantee you that the Congress will not have to wait as long for the details as it did on health reform, which it debated for 1 year before it had a bill.

Mr. RANGEL. But I am carrying this TV Guide thing in my pocket and it has the contract on it and there is no fine print on it. Now I have been carrying this card around since November.

Mr. BAUER. That is 2½ months.

Mr. RANGEL. OK. Just a little fine print and then I can join with you in some of these tax reforms.

Ms. SCHLAFLY. Congressman, I don't mean this to sound impertinent, but I really think you are the ones that got elected to address this problem. I don't think it is the task of Mr. Bauer and myself to come up with your cuts. I think that that is what you are all elected to do. Yes, I do think when business downsizes, the head of IBM may call in his managers and say, you are all going

to be cut 16 percent this year and find out how to do it. That is what we elected you to do.

Mr. RANGEL. I was really doing this for you. Strike out all that I have said. We will now do it in the backroom as we have been doing it and you will find out later where the cuts are coming.

Ms. SCHLAFLY. You can give us some options.

Mr. CRANE. The time of the gentleman has expired. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

Mr. Bloch, we are contemplating here a series of profamily tax changes, including a child tax credit, a marriage penalty revision, a simple IRA, an elder care credit, and an adoption credit. I was wondering in terms not as the think tanks but as the perspective of a middle-class person either with or without your help filling out their tax return, how would these changes affect tax simplicity? Would it still be easy for people to fill out their own tax forms?

Mr. BLOCH. I don't think it would make it simpler because what we are talking about, I believe——

Mr. ENGLISH. Sure.

Mr. BLOCH [continuing]. Are additional credits which mean additional computations on the form. So I don't think it will improve the effort to simplify the tax system.

Mr. ENGLISH. But in terms of the average person sitting down to fill out their forms, these individual provisions are not going to make it much more difficult.

Mr. BLOCH. Assuming the calculations are pretty straightforward, I don't think it would add a lot of complexity to the tax preparation process.

Mr. ENGLISH. Thank you very much.

Mr. Shapiro, in your testimony, you talk about targeting family tax relief to the 15-percent income tax bracket. I was wondering, if we do take that kind of a targeted approach, what sort of disincentive effects would there be for people entering the tax bracket above that?

Mr. SHAPIRO. Virtually none, Congressman, because the current deduction provides virtually the same tax reduction to someone in the 28-percent bracket, as this increase would provide now to people in the 15-percent bracket. That is, a $2,500 children's exemption is equivalent in value to a $700 per-child tax credit for someone in the 28-percent tax bracket. In effect, you could replace the dependent's exemption for both the 15- and 28-percent bracket with a $700 or $720 tax credit, and you would have much the same effect.

Mr. ENGLISH. Thank you.

Mr. Bauer, I enjoyed reading your testimony and listening to your presentation. You make the sage point that profamily tax relief is certainly not a panacea but that—potentially, tax changes that are good social policy, that are socially sensitive also have a spillover effect on economic growth. I wonder if you could amplify on that a little bit and also give me your assessment, given that the President has talked about limiting the credit to children under the age of 13, whether that is good social policy or whether, in fact, there isn't a very substantial need to provide tax relief for children above that.

Mr. BAUER. Congressman English, I am not sure how much I can elaborate on the economic impact. We did discuss it a little bit earlier. It seems rational to me and obvious to me that there will be a positive economic impact any time you allow the American people to keep more of their money.

Short of putting it under their pillow, it is bound to have some kind of a ripple effect when they use it. Banking it results in increasing the amount of money that can be lent out for productive economic activities, or spending it, obviously, results in a multiplication factor as the money passes through the system. So there is some impact, I just can't quantify it in a way that some economists, I think, pretend that they are able to quantify it.

On the issue of social policy and making the cutoff at age 13, that just doesn't make any rational sense to me. It makes some budgetary sense, if your fear is that you can only put so much money into this.

Mr. ENGLISH. You think that threshold is arbitrary?

Mr. BAUER. Yes.

Mr. ENGLISH. Ms. Schlafly, how do you feel about it?

Ms. SCHLAFLY. I agree with Mr. Bauer, yes, I think the age 13 is arbitrary and there couldn't be any argument for it, except the argument that you don't have enough money. Again, I feel that the family, the traditional family, has borne the biggest burden of the expansion of Federal spending and is entitled to a significant redress of that grievance.

Mr. ENGLISH. Thank you very much.

Mr. CRANE [presiding]. Mr. Hancock.

Mr. HANCOCK. Thank you very much.

There has been a lot of talk about how well the progressive income tax works, and there have been some people that don't like a progressive income tax. In fact, they go back to the area when it first was advocated, they don't even like the people who advocated it. But let's talk about compliance costs.

With our present tax law, especially for Mr. Bloch here, there are people who estimate that merely the compliance with our tax law is almost equal the amount of money that the government actually collects. Isn't that a little ridiculous, to spend that kind of money to—with this so-called voluntary tax law, rather than not coming up with some form of a flat tax, to where you could say, I had 100,000 dollars' worth of income and I owe $40,000, rather than having to do, like with my tax return, which I think had about 120 pages to it last year, and my CPA sent me a bill for $1,660, which I just paid. I borrowed the money to pay it, but shouldn't we address that a little bit, Mr. Bloch?

Mr. BLOCH. Your point is well taken. But I still believe that we have got to—we have got to prioritize things. I mean, some believe it would be great to have no income tax. But an income tax is something I think we must have in this country. So when you get to the realization that we do need an income tax, to me, the overriding objective has to be to make it fair.

Yes, it is possible to throw out fairness and say, well, let's just go for simplification, let's not have the bureaucracy and the necessary costs that are involved in the compliance area. But I think you would have something close to a tax revolt in this country if

people felt that they were not being treated fairly in the tax system. To me, that has got to be No. 1 one on the list.

Mr. HANCOCK. Well, it appears to me, though, that based on the level of telephone calls that I have been getting, that everybody thinks that they are not being treated fairly, and everybody else is. It still gets back to the saying: Exact from everyone according to his ability. I think we all know where that came from.

I think that the fair tax is to where that people—that the productive people benefit from being productive, rather than saying, no, if you are productive, we are going to take it away from you and give it to somebody else.

Mr. BLOCH. I would only offer one suggestion. That is, if there was a real need to simplify the tax system, if you felt that way, to me the best way to accomplish that is to leave the Tax Code alone for a while and not change it. Because I think that would give people an opportunity to——

Mr. HANCOCK. Thank you very much.

I have said we need a 5-year moratorium on tax law, period. I mean, to where the businesspeople, the individuals, understand what they are dealing with, and leave it alone.

Thank you very much.

Mr. BLOCH. If I could add one thing; I am afraid if the kind of flat tax that we discussed earlier were enacted, I think right after that time would be a period of tremendous change in the tax system, with credits and deductions reappearing in the Tax Code, which would really cause a lot of confusion on the part of taxpayers.

Mr. HANCOCK. One other thing that I would like to mention, though, in my time here. You mentioned tax relief for higher education as part of your statement, and I agree that we need tax relief for higher education. I would like to point out, though, that a tax credit or a tax deduction, in my judgment, is not really the answer. Because once you do that, immediately the colleges are going to raise their fee by whatever the amount of the tax credit is.

Wouldn't it be better to include as part of the so-called super-IRA, a method where people can accumulate the money from the time the baby's born, either on a tax-deductible basis, up until the child is 18, and then spend their own money, wouldn't that be a better approach than a credit which—every time I have seen the Tax Code come through with a credit, the supplier raises the price, the law of supply and demand. Wouldn't that be a better approach?

Mr. BLOCH. I think your concern is valid, and I don't know for sure but I think your suggestion may be very appropriate.

Mr. HANCOCK. I would appreciate if you would take a look at that. I would like to see a survey, say, with your customers, how many of those individuals would put up $50 or $100 a month toward an individual deductible education account for their children. That would be a very interesting thing for your company even to look at.

Mr. BLOCH. We will look at it.

Mr. HANCOCK. Thank you.

Mr. CRANE. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman.

I wanted to talk a bit about the proposed tax credit.

Before I do that, I just would like to say to Gary Bauer, and I read your testimony, I didn't hear your oral presentation, but you know, I don't think it is a fair division of labor to say you propose the tax cuts, Congress should propose the spending cuts. It seems to me that there is a responsibility all around; that each of us needs to look both at the tax side and the expenditure side; that you need to be as specific about expenditure cuts as you are about tax cuts.

You said that it is our business, the expenditure side. Why should we not ask those who come before us to be as specific as they are on expenditure reductions as they are on tax cuts?

Mr. BAUER. Well, Mr. Levin, I would only remind you that we are commenting on a tax cut proposal made by Members of Congress. We didn't come here today pushing the tax credit. Members of Congress have proposed a tax credit, we are here today testifying in support of it.

I have said several times, and I don't know how else I can say it again, we will supply the committee with suggested tax cuts. I just didn't come prepared today to give you a list of each one of those cuts.

My suspicion is, however, I must tell you, is that once again family assistance is being held to a higher standard when it comes to this issue than other spending in Congress. Just in the past week, the leadership in Washington has come to an agreement that we ought to bail out Mexico to the tune of $40 billion.

I don't recall anybody running to say where are we going to find the money if Mexico defaults on those loans that the American taxpayer is going to have to make up. It is only when we come here, talking about family tax relief, does everybody start yelling about where the cuts are.

Mr. LEVIN. Well, but, look, you have been involved for a number of years, and you know that there are struggles over such issues all the time. When it came to extension of unemployment compensation benefits for people, working families, bills were vetoed over the issue of where the funding would come from. So I don't think it is—it is a telling point to say it is only when it comes to children or to families that there is exacted that kind of a standard. That sure isn't where I come from. I think where it comes to families, if anything, there should be a lower standard of proof. But still there is a standard of proof.

Mr. BAUER. I totally——

Mr. LEVIN. We need as much guidance on expenditure cuts as we do anything else. I mean, you have been working in this field for a number of years. I think it is important for everybody who comes forth with support for reductions in taxes, no matter how meritorious, they have got to also come forth with specifics on where we cut programs.

So let me just ask Dr. Shapiro, because there was reference to your testimony earlier, where we talked about the tax credit. Take the typical family in the 28-percent bracket, it is true they have done—they do better with the exemption than in the lower tax bracket. But if you look at how they have fared the last 15, 20 years, isn't there a case for doing more?

Mr. SHAPIRO. Well, the 28-percent bracket includes some people who have been caught in the structural down draft of the economy, and others who have not. Again, when we look at the distribution of rates of growth of income, as people age—not looking simply at the median family income, which is just a line drawn through the data—when we track how fast people's incomes are rising as they age, through the seventies and eighties, the rates of increase in people's income after adjusting for inflation were, on average, less than 1 percent a year.

But when we look at those people who are classified by the Labor Department as professionals or managers, we find that their incomes continued to rise through the seventies and eighties at a post-inflation rate of between 4 and 6 percent a year. So that we do have 15 to 20 percent of the work force that has continued to be upwardly mobile at a robust rate—the rate that virtually everyone enjoyed in the fifties and sixties. Again, this was accomplished by a very sharp reduction in the rate of growth of incomes for people who are not professionals or managers. This is not a controversial analysis. It has become very clear through many statistical analyses, and nonstatistical analyses, that there is significantly increasing demand throughout the economy for people with high skills and high education and eroding demand throughout the economy for people with lower skills and less education.

This does not have to do with manufacturing versus services; rather, it has happened across the economy. On balance, the significant majority of people in the 28-percent tax bracket fall in the updraft part of the economy. But as I say, we would be perfectly comfortable with a tax reform for families with children which replaced the current deduction with a $700 or $720 per child tax credit for everyone in the 15- and 28-percent bracket. That would represent a significant increase in tax support for people in the 15-percent bracket, and roughly the same amount of support we are providing today for people in the 28-percent bracket.

I do want to say that, in our view, one of the failings of many of the proposals is that they provide a tax credit on top of the current deduction. Consequently, these proposals maintain at least in part the current arrangement which provides nearly twice as much tax relief, for a family with a child, if the family earns higher income than for families with lower incomes. The entire deduction should be replaced with a tax credit, which at least would provide the same tax support to raise a child for a family earning $20,000 or $30,000, as for a family earning $60,000, $70,000, or $80,000.

Mr. CRANE. The time of the gentleman has expired.

Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman.

I am impressed with Mr. Shapiro's liberal New York Times article and the fact that he likes taxes. If you change it, you want to replace it with something else and do away with something that is already being taxed. I suggest that families need a break and I think that your proposal doesn't give them that break. If you want to respond, you can.

Mr. SHAPIRO. Well, Congressman, it would provide significant relief for all families with incomes of $45,000 or less; it would be the equivalent of doubling the current children's exemption for those

families. It would, in effect, exempt from tax $4,800 per child, by providing a $720 tax credit, double the support for those families with children under the current system. That is clearly additional support.

Mr. JOHNSON. Well, I think we will have to argue that out. I think that the families in America perceive that they need tax relief, and tax relief doesn't include changing one for another. I think that is what has happened in the past.

Mr. Bauer, I might be able to help you a little bit on your question, when you are asked what the Federal Government ought to be doing. If you remember, George Washington said we ought to take care of foreign affairs and defend the country and carry the mail, none of which I think we are doing very well today. If that were all we were doing, perhaps we wouldn't be having this tax argument.

I like what you are doing and I think that it is our responsibility to come up with cuts. Your proposal of a cut across the board is not unreasonable. As a matter of fact, maybe we ought to do away with whole agencies, which might help take care of some of the problems you mentioned.

Mr. BAUER. I didn't want to send anybody into shock by actually suggesting that, so I thought I would go with a more moderate 15-percent cutback, which still had a rather emotional reaction.

Mr. JOHNSON. Well, thank you, and I think of the paperwork people have to go through just to take care of their taxes, entering kids in school, getting them a driver's license, even getting a chance to vote, is just government bureaucracy run amuck.

So I thank you all for your comments, and I don't have any further questions.

Mr. CRANE. Mr. Ramstad.

Mr. RAMSTAD. I, too, want to thank the panel for being here today.

I like your spirited defense, Mr. Bauer. It is true, I mean, nobody does back flips around here when we are talking in terms of raising spending in these various areas. All of a sudden we want to provide some tax relief for families and try to cut down the size and scope of government, which I think was the very clear mandate on November 8, and we are being cruel and heartless. I think what the distinguished chairman of the Budget Committee pointed out Sunday needs to be reemphasized. We are not talking really about cuts as normal people in the real world understand them but rather about reductions in the level of spending. Instead, say that over the next 7 years, to balance the budget, we must increase spending by $2 trillion instead of $3 trillion. I think that perspective is a proper one with which to operate.

Let me ask you, Mr. Bauer, your evaluation of the administration's proposal wherein tax relief for families phases out for those families with incomes over $60,000. Do you think this limitation is fair and appropriate?

Mr. BAUER. Well, I don't——

Mr. RAMSTAD. I will ask the other witnesses to comment as well.

Mr. BAUER. I don't think it is fair and appropriate, but I, obviously, look at these issues with I think a different prism than the folks in the White House. In my view, there seems to be a tendency

to turn every one of these issues into a class struggle, that instead of focusing on tax relief for families, let's pit one group of families against another group.

My view is that as long as families at different economic classes are arguing with each other, they lose the sight, they lose the target of how much money is going into Washington out of the pockets of every American family. So I would hope that somewhere along the line, the White House, in fact, would read the election results a little more closely and see that it was not an election about class differences, it was an election among other things, I believe, where the American people were saying families are overtaxed and we want something done about it.

I think the cutoff at $50,000 is totally arbitrary, in addition to everything else, and as was pointed out earlier, for larger families it makes no sense whatsoever. A family of eight or nine children making $50,000, $55,000, is not a high-income family.

Mr. RAMSTAD. Thank you.

Ms. SCHLAFLY. Congressman, I will comment on that. I would point out that there is no phaseout for wealthy families of the DCTC, the dependent care credit. That is, if you hire somebody else to take care of your children, it doesn't make any difference how rich you are, you get the exemption.

At the same time, there is a phaseout at the present time for the per-child exemption. So the in-home mother doesn't even get that.

I think we did have the tax revolt that Mr. Bloch talked about. It was November 8, 1994. People are calling for tax reduction and they want tax reduction across the board and they want tax reduction on families. They don't want more welfare and they don't want more rearrangement of the taxes. They want it cut.

Mr. RAMSTAD. Thank you.

Anybody else care to comment?

Mr. Bloch.

Mr. BLOCH. I would only say that I think it is a question of what can be afforded. If more than the $60,000 level can be afforded, I think that would be great. Because I think there are a lot of people making $70,000 or $80,000 who may be considered middle class, who could use that cut very well and view it as great tax relief.

Mr. RAMSTAD. Well, my time is up. But let me just finally comment that given the cuts that will be forthcoming, the real cuts, and provided in the national savings account prior to passing the tax relief, we will be able to provide more, I can assure you. At least the majority of the members of this committee did read and hear loudly and clearly the American people speaking on November 8, and I think your assessment, Mrs. Schlafly, is exactly correct.

Thank you.

Mr. CRANE. Thank you.

Mr. Zimmer.

Mr. ZIMMER. Thank you, Mr. Chairman.

I think one reason why the debate over changes in the Tax Code is so contentious is because different people come to the question with different goals that they want to achieve. Mr. Bloch and Mr. Shapiro seem interested mostly in redistributing income through the changes in the Tax Code. The other members of the panel are interested in helping the family.

There are those mainly in the economics profession, but others as well, who see it as an opportunity to increase growth by stimulating or encouraging savings and investment, or as Dick Armey and others would say, removing the penalties for savings and investment. These are at loggerheads with each other as goals. I would like to use the time that I have to explore some of these tensions.

First of all, Mr. Bloch, you deal with individual taxpayers one by one. Do you believe that their decisions on whether to save and invest are influenced by the Tax Code?

Mr. BLOCH. I think the customers that we see day in and day out, who I would describe as middle and lower income individuals and families, are generally looking at trying to make ends meet. I remember years ago we offered a service as a test to provide financial planning assistance to our customers. The overwhelming response we got to that offer was—I would love to have some advice as to how I can plan for my financial future, but really today I am just trying to make ends meet. So I don't think many of them really spend a lot of time thinking about what are the best financial investments and what are the tax implications of these investments, for example.

Mr. ZIMMER. Could the converse of that observation be that most savings and investment is done by people who are wealthier than lower and middle-income classes, and that perhaps if they were allowed to keep some of the returns on investment they might create better jobs, more jobs, higher paying jobs for your clients?

Mr. BLOCH. I am not an expert in that area, but I do believe that our clients feel that some form of tax relief is important. As they look at their future, it would give them a great deal of confidence to know that they receive some kind of a benefit in the tax system. That could provide them with a greater sense of optimism about the future.

Mr. ZIMMER. Mr. Shapiro, last week Congressman Gephardt told me that he didn't think that the Tax Code had much of an impact on people's savings and investment decisions. Do you share his view?

Mr. SHAPIRO. I can give you the general consensus of economists, and it is one I share. Tax rates do have an effect on overall savings decisions and investment decisions. That is, the quantity. But the effect is fairly modest.

What seems to drive people's savings rates—and we are in the midst of a historic collapse of the personal savings rate for about 10 years or 12 years—what seems most to drive increases in people's savings is increases in their incomes. People save more when their incomes are rising quickly. The reason that we saw such a disappointing result in the early and mid-1980s to a series of savings incentives was that it occurred at a time in which most people's incomes were not rising.

It creates a very serious, vicious cycle for the long-term health of the American economy. That is: American growth and productivity can't increase until the rate of increase in investment accelerates. Investment can't accelerate until national savings increase. But the personal savings rate, at least, is driven by rates of growth

of people's incomes, which depend on growth in productivity. So we have a vicious cycle.

The only way out of it that I know, that would be within the reach of government, over the short-term, is very significant reductions of the deficit. Because the deficit represents national dissaving. In 1993, the national savings rate was 1.1 percent. It is impossible for America to have any hope for a prosperous future with a national savings rate of 1, 2 or 3 percent.

Mr. ZIMMER. Well, I agree with that proposition. I agree with the need to reduce the deficit, but I think you will defeat your purpose if you do it by increasing taxes.

Thank you.

Mr. CRANE. Before we adjourn this panel, I would like to yield to our distinguished colleague from Washington, Ms. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman.

I am sorry that the gentleman from New York is no longer present, because I hoped to alleviate some of his concerns that the business we do here in cutting taxes and cutting spending will be done behind closed doors. I want to suggest that there is a difference, a very definite difference, between the 103d Congress and those that preceded, and this 104th Congress. I will just also suggest that in April 1993, it was his majority party who closed the doors of this meeting room and opposed to a unanimous vote on the minority side. During that set of meetings we received the highest tax increase in the history of the United States, and certainly information was not available there.

As a result of that situation, there was a bill developed that would require open meetings and open hearings. That piece of legislation was passed as part of the rules of the new Congress of the United States on January 4, 1994—or 1995.

I will commend Congressman Zimmer, who helped to cosponsor that legislation, along with me and many, many other Members of this House. It did pass on the floor 434 to 0. We will not again be bothered by closed doors of the Ways and Means Committee, or any other committee meeting or hearing in this Congress. So I suggest that the people of the United States are going to get the information that is used to develop the logic behind all of these tax cuts. I appreciate all of your testimony today.

Thank you, Mr. Chairman.

Mr. CRANE. I, too, want to express appreciation to all of you. Your input has been very valuable and with that, we will adjourn this panel.

I would like to call up next, Marshall Wittmann, Midge Decter, and Michael Pitts.

Mrs. JOHNSON [presiding]. Welcome.

Marshall Wittmann, if you will proceed.

STATEMENT OF MARSHALL WITTMANN, LEGISLATIVE AFFAIRS DIRECTOR, CHRISTIAN COALITION

Mr. WITTMANN. Thank you very much, Madam Chair.

On behalf of the 1.4 million members of the Christian Coalition, we wish to express our appreciation to the committee for this opportunity to testify today on this critical item in the Contract.

We strongly believe that this hearing is unique. Unlike many who have testified before this committee in the past, we are not asking for something. Our request is not for a new spending program, a new entitlement, or a new subsidy. Rather, we are here today urging that American families simply be allowed to retain something that belongs to them: Income they have earned through their own sweat and toil.

It has been said that the family is the first and most effective Department of Health and Human Services. As you know, in the past few years, much has been made of the issue of family values. Yet we do not expect, nor do we want, the Federal Government to legislate family values. But we do urge that Washington value the family.

Unfortunately, far too often the government subsidizes family dissolution and taxes family stability. It is time for this dynamic to end. The Christian Coalition views the $500 per-child tax credit as the most significant provision in the Contract With America, and it has our strong support.

Allowing families with children to retain a larger share of their hard-earned income will be a first step toward freeing American parents from the national treadmill of working long hours at the expense of time with their children.

There is a genuine crisis of family income. Yet the tax bite out of earnings has soared. Unfortunately, the impact of today's high taxation level on families is not solely a financial one. Rather, it has an equally disturbing ramification on the time which parents can spend with their children, which has been referred to as the family time famine.

As more and more families are forced to have two sets of income, in part to meet the growing tax liability, the time parents can share with their children is dwindling. We believe that the $500 per-child tax credit, although a modest step, is a step toward increasing family budgets so that families will have greater freedom in structuring the balance between employment and the family.

President Clinton has proposed a child credit of up to $500 for children, but imposes an arbitrary age limit of 13 years. We believe that the President's proposal is insufficient.

When a child reaches age 13, expenses do not decline. They actually increase for such big-ticket items as educational expenses, braces, and clothes. It does not take a Washington policy wonk to figure this out. Just ask the parent of a teenager.

The Christian Coalition submits that this tax credit should be paid for with spending cuts and not by raising taxes on other taxpaying Americans. You and your colleagues can count on the support of our organization in this year's important undertaking to dramatically limit government. Cutting government is a necessary step toward returning control over spending decisions on children's health, education, and well-being to parents and communities. This is the family dividend of budget reduction.

Thank you very much.

[The prepared statement and attachment follow:]

STATEMENT OF MARSHALL WITTMANN
LEGISLATIVE AFFAIRS DIRECTOR, CHRISTIAN COALITION
BEFORE THE
WAYS AND MEANS COMMITTEE, U.S. HOUSE OF REPRESENTATIVES
JANUARY 17, 1995

On behalf of the 1.4 million members of the Christian Coalition and their families, we wish to express our appreciation to the Committee for the opportunity to testify today on behalf of family tax relief. Family tax relief has been a critical priority of our organization, and we applaud you, Chairman Archer, for holding these important hearings.

We strongly believe that this hearing is unique. Unlike many who have testified before this Committee in the past, we are not asking for something -- our request is not for a new spending program, a new entitlement or a new subsidy. Rather, we are here today urging that American families simply be allowed to retain something that belongs to them -- income they have earned through their own sweat and toil working in our factories, running their own businesses, teaching in our schools, working in our hospitals, and patrolling our neighborhoods. We are here in support of allowing parents, not bureaucrats, to determine how best to spend their income on behalf of their children.

As President Clinton acknowledged in his 1994 State of the Union address, "[w]e can't renew our country until we realize that governments don't raise children, parents do." Indeed, the family is the most vital institution in our society. It is where the next generation of Americans will be raised and nurtured. The family is the first and most effective Department of Health and Human Services. If the family is strong, many legislative initiatives -- confronting the rising juvenile crime rate, instituting educational reform to address the nation's declining test scores and rising behavioral problems in the schools, reforming our welfare system to discourage out-of-wedlock births -- will have a greater chance of success.

In the past few years, much has been made of the issue of family values. We do not expect, nor do we want, the federal government to legislate family values. However, we do urge that Washington *value* the family. Unfortunately, far too often, the government subsidizes family dissolution and taxes family stability. It is time for this dynamic to end.

Christian Coalition views the $500 per child tax credit as the most significant provision in the *Contract With America*. Allowing families with children to retain a larger share of their hard-earned income will be a first step towards freeing America's parents from the national treadmill of working long hours at the expense of time with their children, only to fail to meet the standard of living of the prior generation of one-parent wage-earners. There is a genuine crisis of family income. For the past two decades, income for the average American family has remained stagnant. Yet the tax bite out of their earnings has soared.

Working to Support the Government, at the Expense of Our Children

In many families today, both parents work by necessity, not by choice. A 1988 *USA Today* poll found that 73 percent of two-income families would prefer to have one of the parents stay home if they could afford it. Unfortunately, many parents don't realize just how much of their earnings are going to support the government, and not their families. In 1948, the average American family paid only *3 percent* of its earnings to the federal government; today, this same family pays 24.5 percent of its income to support our expansive federal government with its massive programs. When local, state, and indirect federal taxes are considered, well over a third of the average family's income -- *37.6 percent* -- goes to the government. Moreover, the Tax Foundation has shown that the average family's expenditures for federal, state, and local taxes are higher than what they spend for food, clothing, and housing combined.

The fact is that the government is the ultimate beneficiary of the long hours our nation's mothers and fathers are working. The Heritage Foundation compared the earnings of families today with

those in 1948, and found that two-thirds of a working mother's income in a typical double-income family goes to pay the increased federal taxes that families pay, and not towards putting food on the table or saving for retirement. If the federal tax burden on the average American family returned to 1948 levels, the average primary earner today would earn only $6,687 less than the double-income family's current post-tax income. Since the average working mother today earns $19,453, only one-third or $6,687 of her earnings increase the family's income over the 1948 level. The other two-thirds of her earnings go to pay the increased federal taxes that have been levied since 1948.

Families with children have particularly felt the impact of today's high taxation level, for two reasons. First, the personal exemption, which in 1948 protected 68 percent of the average family of four's earnings from taxation, has not kept up with inflation and higher income. If the exemption had been indexed for inflation, it would today be between $7,000 and $8,000. Second, today's high Social Security payroll taxes do not take into account the number of children in a family. Therefore, the impact of these taxes on a wage earner with four children will have a greater impact than on an employee earning comparable wages who has no dependents. Moreover, these payroll taxes have risen dramatically, consuming approximately 15.3 percent of gross income, in order to fund programs providing retiree benefits, disability insurance, and Medicare.

In addition to the higher taxation level and wage-growth stagnation, the cost of family expenses has risen dramatically. As the 1991 final report by the National Commission on Children, chaired by Senator Jay Rockefeller, showed, the cost of buying a home took 44 percent of a family's income by the mid-1980s, compared to 25 percent in 1970; buying a new car increased to 48 percent, rather than 35 percent in 1970; and tuition at a private college consumed 38 percent of the average family's income, compared to 28 percent in 1970.

Mr. Chairman, unfortunately, the impact of today's high taxation level on families is not solely a financial one. Rather, it has an equally disturbing ramification on the time which parents can spend with their children -- what has been aptly referred to as "family time famine." As more and more families are forced to have two sets of incomes, in part to meet their growing tax liability, the time parents can share with their children is dwindling. Children today are given 40 percent less time and attention by their parents than were children in 1965, with parents spending approximately 17 hours per week with their children compared to approximately 30 hours per week in 1965. This precludes parents from playing a greater role in their children's development.

Moreover, family time in general is becoming increasingly scarce. Parents often have to work piggyback shifts or simultaneous shifts. Coordination of schedules between parents, children, and nannies has become a fine art these days. The family meal at dinnertime is a thing of the past. Scheduling time to help children with homework is often difficult. Relationships with neighbors and a sense of community in neighborhoods are disappearing. We believe that the $500 per child tax credit, although a modest step, is a start towards increasing family budgets so that families will have greater freedom in structuring this balance between employment and family.

The $500 per Child Tax Credit Will Provide Important Relief to America's Families

Legislation to provide a $500 per child tax credit is long overdue. Four years ago, in 1991, the National Commission on Children, of which Governor Bill Clinton was a member, urged the adoption of a $1000 refundable child tax credit (as well as the abolishment of the personal exemption for children in order to reduce the costs of the tax credit) in an effort to strengthen families.

The $500 per child tax credit also has the broad support of the American people. A 1993 poll by Fabrizio, McLaughlin & Associates revealed that 59 percent of Americans favor enactment of a $500 per child tax credit even if it means cutting entitlements other than Social Security. Moreover, the level of support rose to 67 percent when the respondents were told that two-thirds

of the tax relief would aid families earning less than $50,000 per year.

Although a $500 tax credit does not meet the Children Commission's recommendation of a $1000 per child tax credit, it would still provide significant relief to our nation's families. For example, the $500 credit would reduce *by one third* the federal tax burden, which includes both income and social security taxes, of a family of four with an income of $18,000 per year.

President Clinton has proposed a child tax credit of up to $500 for children, but imposes an arbitrary age limit of 13 years. We believe that the President's proposal is insufficient. When a child reaches age 13, expenses do not decline -- they actually increase for such big ticket items as additional educational expenses, braces, and clothes. It does not take a Washington policy wonk to figure this out -- just ask a parent of a teenager. Moreover, the President's proposal would preclude families earning over $75,000 from being entitled to the credit, despite the fact that these families already pay a progressively higher income tax, which means the credit has a diminishing impact.

Since the effect of this credit decreases as family income increases, there is no need for means testing criteria. A family of four earning $40,000 per year would only see its tax liability reduced by 10 percent; a family of four earning $200,000 per year would see its tax liability reduced by 1.5 percent. Due to this progressive reduction in impact on wealthier families, means testing is not necessary, and Christian Coalition strongly urges the Committee to resist any efforts to institute such a requirement.

Mr. Chairman, it is also important that we not lose sight of the real-life benefits which this tax credit will provide to low-income families. For instance, a family of four earning $17,000 per year may still have a tax liability, despite receiving the Earned Income Tax Credit and taking appropriate deductions. By providing this family with an additional $1000 in tax relief, it would assist them in eliminating their tax liability entirely. Moreover, it has been projected that 4.7 million families would incur no tax liability as a result of this credit.

It is estimated that 50 million families will profit from this tax credit, 90 percent of whom have incomes less than $75,000 per year. Moreover, this credit will provide the average congressional district with approximately $59 million in tax relief each year, to assist an average 117,000 children per district (see attached table summarizing the projected tax relief for Ways and Means Committee Members' districts). In Chairman Archer's district, the parents of approximately 141,271 children would benefit from $70,635,500 in tax relief. In Congressman Gibbons' district, the parents of approximately 99,247 children would benefit from $49,623,500 in tax relief. Clearly, the number of children and their parents served, as well as the real-life benefits, merit enactment of the credit.

We realize that some Members may be concerned about the costs involved in providing a $500 per child tax credit, but it is important to remember that this is not another entitlement or subsidy. We are merely asking that parents who are taxpayers be allowed to retain a larger share of their own income to help support their families. Moreover, although the federal government spends approximately $13.7 billion per year for Aid to Families With Dependent Children (AFDC), a welfare program which subsidizes single-parent families, it does very little to further, and even penalizes through the tax code, what it should be encouraging: the two-parent nuclear family.

We are aware of the budgetary impact of this proposal. Christian Coalition submits that this tax credit should be paid for with spending cuts. We cannot burden future generations with the mounting national debt, and we believe that we have good credentials in the deficit reduction fight. Last year, we actively supported the Kasich budget which paid for tax relief. We were in the forefront of the effort to pass the bipartisan Penny-Kasich amendment. Moreover, we don't believe that higher taxes should be levied on other Americans in order to pay for this credit. The funding should be taken from wasteful spending in the federal government budget, and not the budgets of tax-paying Americans.

Mr. Chairman, you and your colleagues can count on the support of our organization in this

year's important undertaking to dramatically limit government. We are not summertime soldiers in the deficit reduction battle. Entire departments, agencies and programs should be reevaluated, eliminated, cut, or sent back to the states. We realize that bold cuts in government spending will need to be taken. Cutting government is a necessary step towards returning control over the spending decisions on children's health care, education, and well-being to parents and communities. This is the *family dividend* of budget reduction.

Thank you again for the opportunity to present our views today. Christian Coalition is pleased that the Committee and Congress are seriously committed to providing tax relief for America's families. We hope that this proposal will have bipartisan support, uniquely uniting liberals and conservatives. Enactment of a $500 per child tax credit is a necessary and important measure that we hope will gain swift passage.

PROJECTED TAX RELIEF FOR WAYS AND MEANS COMMITTEE MEMBERS' DISTRICTS*

Member	Number of Eligible Children	Projected Tax Relief Per Year
B. Archer, TX	141,271	$70,635,500.00
P. Crane, IL	143,836	$71,918,000.00
B. Thomas, CA	130,982	$65,491,000.00
C. Shaw, FL	60,815	$30,407,500.00
N. Johnson, CT	114,695	$57,347,500.00
J. Bunning, KY	130,811	$65,405,500.00
A. Houghton, NY	121,460	$60,730,000.00
W. Herger, CA	113,046	$56,523,000.00
J. McCrery, LA	120,161	$60,080,500.00
M. Hancock, MO	112,250	$56,125,000.00
D. Camp, MI	123,960	$61,980,000.00
J. Ramstad, MN	139,540	$69,770,000.00
D. Zimmer, NJ	132,994	$66,497,000.00
J. Nussle, IA	123,116	$61,558,000.00
S. Johnson, TX	137,856	$68,928,000.00
J. Dunn, WA	138,841	$69,420,500.00
M. Collins, GA	139,487	$69,743,500.00
R. Portman, OH	135,699	$67,849,500.00
P. English, PA	113,128	$56,564,000.00
J. Ensign, NV	117,892	$58,946,000.00
J. Christensen, NE	126,081	$63,040,500.00
S. Gibbons, FL	99,247	$49,623,500.00
C. Rangel, NY	72,898	$36,449,000.00
P. Stark, CA	130,767	$65,383,500.00
A. Jacobs, IN	107,244	$53,622,000.00
H. Ford, TN	92,859	$46,429,500.00
R. Matsui, CA	110,893	$55,446,500.00
B. Kennelly, CT	102,938	$51,469,000.00
W. Coyne, PA	87,209	$43,604,500.00
S. Levin, MI	125,130	$62,565,000.00
B. Cardin, MD	118,927	$59,463,500.00
J. McDermott, WA	75,747	$37,873,500.00
G. Kleczka, WI	114,365	$57,182,500.00
J. Lewis, GA	94,211	$47,105,500.00
L. Payne, VA	105,742	$52,871,000.00
R. Neal, MA	122,431	$61,215,500.00

*Source: The Heritage Foundation, Washington Should Turn Bipartisan Talk of Family Tax Cuts Into Action (Sept. 27, 1994).

Mrs. JOHNSON. Thank you, Mr. Wittmann.

Ms. Decter.

STATEMENT OF MIDGE DECTER, MEMBER, BOARD OF FELLOWS, JEWISH POLICY CENTER, ON BEHALF OF THE NATIONAL JEWISH COALITION

Ms. DECTER. Thank you very much, Madam Chairman.

As you know, I am here representing the National Jewish Coalition as a member of the Jewish Policy Center Board of Fellows, and I am very grateful for this opportunity to testify.

What a curious condition we Americans nowadays find ourselves in. Here we are, people completely at ease about engaging in such technologically advanced activities as driving automobiles, traveling in airplanes, using computers, while at the same time we find it necessary to engage in a heated national debate about whether and how to deal with the family, which is, after all, the very bedrock of our existence. That this is a very serious fix to be in, is undeniable.

For one thing, we can no longer even agree among ourselves about what is a family. Some decades back, you may remember, a White House conference on the family, attended by experts and activists from all around the country, foundered on this very point of difficulty.

The arguments then were quite heated and have, if anything, grown more heated since. Is a family, as tradition would have it, a mother, a father, and their offspring? Or is it two mothers and their artificially inseminated children? Or is it two fathers and their adopted children? Or is it any group of people who happen to be living under the same roof?

This new inability to live in a natural, unthinking relation, to what is the very ground of our being, is a symptom, as well as the source, of a serious kind of social dislocation. Now it would be grossly unfair to declare as many people nowadays do, that government policy is largely responsible for this dislocation. Government policies are only a part of, indeed, are themselves often merely an expression of the culture in which they are formulated. For many years now, that culture has not, to put it mildly, been friendly either to the formation of or to the proper appreciation of families.

Among those who have so cleverly been dubbed "the chattering classes," getting married and having children has come to be understood as little more than another stage on the long bumpy road to self-fulfillment. That is no doubt why the average age for marriage in this society has risen substantially and why divorces have become commonplace.

Moreover, for at least a quarter of a century, a powerful antinatalist wind has been blowing across the land. This wind has been blowing from two main directions. First there is the women's movement, which in its more radical formulations characterizes marrying and having children as no more than a means of bringing about the oppression of women, ensuring their enslavement to the species, as they say. In its milder form, urges women to demand that motherhood impose upon them no special obligations. Almost simultaneous with the rise of the women's movement has been that of the environmental movement, which has among other things

warned that human population, particularly of the Americans variety, is destroying the Earth. The only way to hold off the apocalypse, say the members of this movement, is by whatever means necessary to achieve zero population growth.

Moderated though both of these movements have over the years become, at least rhetorically, antinatalism, the antinatalism they set blowing through this society, has gone very hard indeed on American families. For it is more difficult to lean against a social wind than to protect one's self from an actual hurricane.

I am mindful that we are not here today to discuss American culture, although indeed you have heard from experts in economics and family economics, which I am not one. But it seemed to me important to place government tax policy where it rightly belongs, not in the realm of revenue collection or economic policy, but rather as an expression of a society's relative valuation. Thus, while government did not create this antinatalist and thus antifamily pressure, it has by not resisting, by not holding firm to the terms and needs of ordinary middle-class life, added to it.

One of the ways in which the government has contributed to the pressure on stable working families has been an antifamily bias written into the Tax Code. As you may know, I am testifying before you today as a member of the Jewish community, a community the strength of whose families has long been the subject of song and story, not to mention many jokes. The Jewish sense of family, of course, derives from the most foundational teachings of Judaism, indeed, from the very earliest chapters of the Book of Genesis, which as scholars have said, are nothing other than a blueprint for the family.

No doubt certain social factors such as the fact that for so much of their history, Jews were forced by circumstance to remain tightly bound in intimate communities, have contributed an extra measure of family centeredness. Be all that as it may, and although perhaps more mindful than other communities within this society of the special blessings attendant on our membership in it, and rightly so, Jews are at the same time of course not immune from its predicaments. Thus, despite the fact that in today's America, family life remains relatively strong among us, relatively, alas, is the operative term here.

While no society that regards children as something to be equally afforded with, say, housing and automobiles, can long remain healthy, for Jews, an ever-dwindling minority in this society, this is of course doubly the case. One often hears it quipped in discussions of welfare and illegitimacy that what the government pays for, it gets more of. In the same way, it could be said that what the government taxes, it gets less of.

It seems to me vital to understand that this is not simply an economic issue, as I said before. It is also a matter of granting or withholding of public approval. Consciously or unconsciously, taxation is one of the means and far from the least of them, through which a society expresses its relative valuation.

In the days when the representatives of those "chattering classes" viewed marriage with something, shall we say, less than full-floated approval, it was objected that the income tax was unfairly

discriminatory against the unmarried. As we have seen, the government all too hastily conceded that point.

How many voices in this chamber or elsewhere in this city were raised to say, "Yes, we discriminate in favor of the married, and we are right to do so." People who marry and bring up children in stable homes are entitled to special consideration.

Discrimination, of course, is a bugaboo word, just like unfairness is today. Everyone here conceded very much too rapidly, in my opinion, to the idea that, no, no, whatever we do, we must not be unfair. People have been known to fear being called discriminatory, or unfair, or even to be associated with a whisper of the word. Thus, have culture and government policy come together.

In declaring our support for the American Dream Restoration Act, we are saying nothing less than that the government must restore its original, rightful role, as discriminator on behalf of families.

The amount proposed for the child tax credit is by itself hardly enough, after all, to put really significant money into the pockets of middle-class families. It would not pay the mortgage, say, or even begin to touch the problem of college tuition, a neuralgic problem in this society these days. But it would be giving these families something they need and lack, far more than money. It would be giving them confirmation. Confirmation that society wishes them, nay, needs them to live as they are living and values them highly for doing so.

People need to be confirmed. They cannot make up their own lives, or what is more important, bring up their children out of whole cloth all by themselves without support from the society around them. Ever since the educated young of the sixties made it fashionable to sneer at the conditions and necessities of ordinary every day life, the members of the American middle class have taken a terrible moral beating. Their sensibilities have been trampled. Their way of living sneered at, their children constantly seduced in their schools as well as by popular culture into alien modes of dress, thought, speech, and behavior.

While sympathy of all kinds has been extended to those who traduced their standards of decency, which are after all still the putative official standards of this society, they are the ones who keep on being denounced as either heartless or mindless.

After the recent election, you may know, Peter Jennings declared that the electorate had been having, "a tantrum." Had ordinary Americans in fact been having a tantrum, rather than as was the case, engaging in a legitimate exercise of their franchise, it would have been small wonder, in my opinion.

The American Dream Restoration Act then is nothing less than a proposal to extend a much-needed and much-deserved act of recognition to all those who continue to live by the rules, who make families and work to support them, and by so doing excise the single most essential underpinning of a democratic society. This country can no longer afford not to afford such a bill.

Let me close by thanking you, Madam Chairman, and the members of this committee, for permitting me to testify here today.

[The prepared statement follows:]

STATEMENT OF MIDGE DECTER, MEMBER BOARD OF FELLOWS, JEWISH POLICY CENTER ON BEHALF OF THE NATIONAL JEWISH COALITION

Mr. Chairman and members of the Committee, what a curious spectacle we Americans would nowadays make for that proverbial visitor from outer space. Here we are, people completely at ease about engaging in such technologically advanced activities as driving automobiles, traveling in airplanes, watching television, using computers, while at the same time we find it necessary to engage in a heated national debate about whether and how to deal with the family, which is, after all, the very bedrock of our existence. We are, in short, completely at home with the complexities of technology and completely at sea with our own natures as human beings.

How we got this way is a long and complicated story--too long and too complicated for our purposes here today. But that we are in a serious fix is undeniable. First of all, we can no longer even agree among ourselves about what *is* a family. Some decades back, you may remember, a White House conference on the family, attended by experts and activists from all around the country, foundered on this very point of difficulty. The arguments then were quite heated, and have if anything grown more heated since: is a family, as tradition would have it, a mother, a father, and their offspring; or is it two mothers and their artificially inseminated children; or is it two fathers and their adopted offspring; or is it any group of people who happen to be living under the same roof? And even if we were to reach consensus on the answer to this question--which would not be easy, because there are interests as well as emotions involved--we would still find ourselves engaged in a possibly even more deracinated public debate about what should be the family's role in the ordering of our society. As if whether the family or our public as well as private entanglements with it were a matter of public choice, like, say, instituting military conscription or raising or lowering interest rates. In any case, our inability to live any longer in a natural, unthinking relation to what is the very ground of our being is the symptom as well as the source of a very serious social dislocation.

Now, it would be grossly unfair to declare, as many people do, that government policy is solely responsible for this dislocation: government policies are only a part of--indeed, are themselves often very much merely an expression of--the culture in which they are formulated. And for many years now, that culture has not, to put it mildly, been friendly either to the formation of, or to the proper appreciation of, families. Among those who have so cleverly been dubbed "the chattering classes", getting married and having children has come to be understood as merely another stage on the long, bumpy road to self-fulfillment, usually following one's settlement into a satisfactory or promising work life. In other word, making a family has come to be seen as merely another of life's options. That is why the average age for marriage in this society has risen substantially and why divorces have become commonplace.

Moreover, for at least a quarter of a century, a strong anti-natalist wind has been blowing across the land, resulting in a disturbingly low birth-rate. This wind has been blowing from two main directions. First there is the women's movement, which in its more radical formulations characterizes marrying and having children as no more than bringing about the oppression of women--insuring their enslavement to the species--and in its milder form urges women to demand that motherhood impose upon them no special obligations. And almost simultaneous with the rise of the women's movement was the environmental movement, which declared that human population, especially of the American variety, was destroying the Earth. The only way to hold off the apocalypse was, by whatever means necessary, to achieve zero population growth.

Moderated though both of these movements have become--or shall we say, now pretend to be--the wind of anti-natalism they set blowing through this society has gone very hard indeed on American families. *It is more*

difficult to lean against a social wind than to protect oneself from a hurricane.

I am mindful that we are not here today to discuss American culture, but it seemed important to me to place government tax policy where it rightly belongs: not in the realm of revenue or economic policy, but rather as an expression of society's relative valuation. Thus while government did not create this anti-natalist pressure, it has, by not resisting, by not holding firm to the terms and needs of ordinary middle-class life, added to it. One of the ways in which the government has contributed to the pressure on stable, working families has been an anti-family bias written into the tax code. Over the past 45 years, experts tell us, families with children have come to be taxed more than any other group of Americans.

As you may know, I am testifying before you today as a member of the Jewish community, a community the strength of whose families has long been a subject of song and story. The Jewish sense of family, of course, derives from the most fundamental teachings of Judaism, indeed, from the very earliest chapters of the book of Genesis--which, as one scholar has said, are nothing other than the blueprint for the family. From there, and on down through history, a key principle of Jewish faith and Jewish practice has been that a man has an obligation to marry, marriage being that which turns his energies from destructive to creative. No doubt certain social factors--such as the fact that for so much of their history Jews were forced by circumstance to remain tightly bound in intimate communities--have contributed an extra measure of family-centeredness.

Be all that as it may, and although perhaps more mindful than other communities within this society of the special blessings attendant on our membership in it -- and rightly so -- Jews are at the same time of course not immune from its predicaments. Thus in today's America, when we state the fact that family life remains relatively strong among us, "relatively" is, alas, the operative term. Furthermore, I would be so bold as to say that the ideas and attitudes feeding into that sense of the family and its attendant childrearing as a merely voluntary arrangement for pleasure and convenience hold a special measure of danger for Jews: we are people who have willy-nilly had to incorporate into our collective consciousness the fact of the murder of one million babies who, but for the privilege of finding ourselves in this blessed country, might have been our own. Thus while no society that regards children as something to be equally afforded with, say, housing and automobiles can long remain healthy, for Jews this is doubly the case. One often hears it quipped in discussions of welfare and illegitimacy that what the government pays for, it gets more of. In the same way, it could be said that what the government taxes, it gets less of. It seems to me vital to understand that this is not simply a financial issue; it is also a matter of the granting or withholding of public approval. Consciously or unconsciously, taxation is one of the means -- and far from the least of them -- through which a society expresses its relative valuation.

In the days, hopefully now receding from us, when the representatives of those "chattering classes" held marriage, shall we say, in less than high esteem, it was objected that the income tax was unfairly discriminatory against the unmarried. And, as we have seen, the government has all too hastily conceded the point. How many voices, in this chamber or elsewhere, were raised to say, "Yes, we discriminate in favor of the married, and we are right to do so -- people who marry and bring up children in stable homes are entitled to special consideration"? "Discrimination," of course, is a bug-a-boo word; people have been known to fear more than anything else to be associated with it. Thus culture and government policy come together.

In declaring our support for The American Dream Restoration Act, we are saying nothing less than that the government must restore its rightful role as a discriminator in behalf of families. The amount proposed for the child exemption is in itself hardly enough to put really significant money into the pockets of middle-class families; at the same time it is also

no doubt more than the government can afford at this point without taking funds away from some other of its accustomed outlays. Nevertheless, it would be giving these families a value far more important than money. It would be giving them confirmation: confirmation that society wishes them, nay, needs them, to live as they are living, and values them highly for doing so.

People *need* to be confirmed. That is why they live in communities. They cannot make up their own lives out of whole cloth or, what is more important, bring up their children, without support from the society around them. Ever since the educated young of the 1960s made it fashionable to sneer at the conditions and necessities of ordinary, everyday life, members of the American middle class have taken a terrible moral beating. Their sensibilities have been trampled, their way of living sneered at, their children seduced, in their schools as well as by popular culture, into alien dress, thought, and behavior. And while sympathy of all kinds has been extended to those who traduce their standards of decency -- which are, after all, still the putative official standards of society -- they are the ones who keep being denounced as either heartless or mindless. After the recent election, Peter Jennings declared their electoral behavior to be no more than a "tantrum." Had they in fact been having a tantrum, rather than, as was the case, engaging in the legitimate and responsible exercise of the franchise, it would have been small wonder.

The American Dream Restoration Act, then, is nothing less than a proposal to extend a much needed and much deserved act of recognition to all those who continue to live by the rules, who make families and work to support them, and by so doing, comprise the single most essential underpinning of a decent democratic society. This country can no longer afford not to afford it.

Let me close by thanking you, Mr. Chairman, and the members of this committee for giving me the opportunity to testify before you today.

Mrs. JOHNSON. Thank you very much.
Mr. Pitts.

STATEMENT OF T. MICHAEL PITTS, EXECUTIVE DIRECTOR, CHILDREN'S RIGHTS COUNCIL

Mr. PITTS. Thank you, Madam Chairman, members of the committee. I appreciate the long hours that you have spent here today. I will try to be very brief.

My written testimony has been submitted and I ask that it stand as is. I just wanted to say some things as I sat through the committee today, some important points that came upon me.

I may not have the membership that my brother does, or the eloquence of words that my sister at the table does. But I would say this, that the Children's Rights Council for the past 10 years has been very concerned with family formation and family preservation. From the Department of Health and Human Services to the Justice Department, we know certain things are true, that if parents wait until the age of 20, if they have high school educations and jobs before they marry, and have a child, the child has less than an 8-percent chance of living in poverty at any time during its life. Yet government policy continues to discourage two-parent families and family formation. There is no debate about it.

I sat here last Tuesday and heard Minority Leader Gephardt say that not only was this the finest committee in the Congress, but that there is no debate that there is a marriage tax penalty. I think Christopher Dodd said a number of years ago in a Senate speech that the kind of programs we subsidize only stimulates the results that we get.

In this situation, we have a basic problem in America and it is that families no longer form. Even when they do, they don't stay together. Now, sometimes families form and problems arise, people don't get the deal they thought they were getting. It is tragic. But what is even more tragic is the number of issues that people have to consider before marrying.

Years ago, when my parents married, they considered how many children they would have, where they would live, what school district was best. Today we have a plethora of problems that plague society. When I went to marry, I sat in the Back Bay of Boston with my friends and we discussed what it was going to be like. One of the discussions came around to, "Gee, how are you going to handle your taxes going up."

It is a real consideration, in a day and age where the dollar gets less mileage than it got in previous years, where government continues to tax and tax and tax and gives less in services to those people who actually pay for the services.

Now, we know we have to pay for every tax cut, and I don't want to go out there and run up the debt, as some people would say is the wise thing to do just to form families. But I do know one thing is clear, that we can't afford not to give this tax cut to parents when they decide to marry.

I just want to leave you with a couple statistics that I think are quite telling, and these are the kind of problems we get when we don't follow through on our spoken policy of family formation. The Justice Department, those nice people down the street, say that 30

percent of all children born, are born to unmarried women. Among the African-American community, it is 68 percent nationwide, spiking to over 80 percent in certain areas, basically in urban environments.

Children raised in two-parent families rarely experience poverty, less than 8 percent. Even after divorce and separation, we know if both parents stay actively involved in the child's life, they are less likely to live in poverty.

Sixty percent of America's rapists, 72 percent of our adolescent murderers, and 70 percent of long-term prison inmates, grew up without two-parent involvement. We can't be surprised that families disintegrate when the very policy that government supposedly stands behind, family formation, is then in turn punished through the Tax Code.

While I don't think that we can wait to pass this tax cut, I think it must be done over several years. I think we need to be fiscally prudent and responsible. But I think we need to pass it and I think we need to pass it now.

In closing, I would say that this is not only the view of myself and the Children's Rights Council, but from each one of your districts we have collected petitions. American voters sent a strong message last November. It was that we wanted something done and we wanted something done about our taxes.

Each one of these people that signed these are people who believe in family formation and family preservation. All this nice verbiage basically boils down to this: Give us the tax cut we need to form families and stay families so that government doesn't have to take care of our children.

I thank you for the opportunity to be heard today and especially in consideration of the late hour and all the tax experts that appeared before me.

I would be glad to answer any questions if you have any, and we at CRC remain willing and available to any member of the committee or the Congress who would like our assistance. If there is anything that we can do for you, we would be glad to.

Thank you.

[The prepared statement follows:]

Testimony Before
Committee on Ways and Means
United States House of Representatives
104th Congress - 1st Session
Honorable Bill Archer (TX) - Chairman
Tuesday, January 17, 1995

T. Michael Pitts - Executive Director • Children's Rights Council
220 I Street N.E. • Suite 200 • Washington, D.C. 20002
202/547-6227

Government's Punishment of the American Two-Parent Family

Introduction:

Mr. Chairman, I appreciate the opportunity to be heard before the Committee that Minority Leader Gephardt described as the "best Committee in the Congress. . . ".

Many witnesses have appeared before the Committee, submitting literal avalanches of paperwork, statistics, research and memoranda defending their position. I come before you armed only with the petition signatures of thousands of Americans. The petitions simply say, government should stop punishing the formation and preservation of the two-parent family. These signatures are those of American voters. The same voters that gave Congress a mandate to change welfare for the better, discourage welfare dependence and to stop arguing about family values and start to value families.

Implicit in that mandate is the desire of the American public for government to stop intruding into family life and punishing the American two-parent family. Mr. Chairman, the Earned Income Tax Credit and the Marriage Tax-Penalty punish family formation and hurt our family preservation efforts.

It is undisputed among parties, between ideologies, and among the public, that family formation and preservation should be our society's goal. Still, government has continually enacted laws and made regulations that punish the formation of the two-parent family. Welfare, namely AFDC regulations, is filled with incentives that discourage Americans from our goal of forming long-lasting and healthy families. We have literally created a system in which our macro-level goals are subverted by perverse micro-level incentives.

Welfare:

Today's welfare state was created at a time when unemployment and extreme poverty were increasing exponentially. Currently, the federal government administers over 75 programs designed to aid poor and low income families. Many of the programs overlap creating a maze of eligibility requirements, benefits programs and transition to self-reliance projects. This highly complex set of programs from AFDC to Urban Community Aid Programs present obstacles to self reliance. The myriad programs raise the question, "is government's job to care for a citizen or to care about a citizen".

Causes of Welfare Dependence - Including the Marriage Tax-Penalty:

Social engineers and scientists of both the left and the right have written extensively on the cause of welfare dependence being poverty. Poverty, however, is a mere symptom of a much larger problem, the failure of our society to promote family formation and preservation. Despite our knowledge that children born to two-parent, in-tact families are less than 8% likely to live in poverty, the government continues to punish family formation through wayward tax

disincentives.[1] The decision to marry is a hard one, based upon the evaluation of many personal and social considerations. No young couple should have to weigh the intrusion or punishment of the federal government in the decision to marry by means of levying a tax upon their union. In a day and age when financial resources are ever more consumed by rising taxes, higher costs and more demand to provide for one's own retirement, the marriage tax-penalty is truly a great consideration. That government punishes the achievement of a recognized and pronounced goal is absurd.

We should not be surprised that family formation is subverted by government assistance programs thus creating poverty and therefore cyclical welfare dependence. Barbara Defoe Whitehead, a noted social researcher wrote, "It is risky to ignore the issue of changing family structure and the associated problems. Overall, child well-being has declined, despite a decrease in the number of children per family, an increase in the educational level of parents and historically high levels of public spending"[2]. The Marriage Tax-Penalty is at its heart an evil and disruptive mechanism that is a contributing factor to social decay.

Both Minority Leader Gephardt, you, and your fellow Republicans on this Committee acknowledge that the Marriage Tax-Penalty is a problem. Mr. Chairman, I urge this Committee and this Congress to correct this long-standing problem.

Earned Income Tax Credit (EITC):

Currently, EITC has the unintended consequence of rewarding the over-reporting of income to maximize benefits. This is often done as a self-corrective measure by citizens in an attempt to correct the marriage tax-penalty. Currently, many working-class couples are ineligible for EITC but, by simply splitting into two equally dysfunctional fragments, both become eligible. This is part and parcel of government's enactment of programs that have unintended consequences. Again, we should not be surprised when family preservation is subverted because of micro-level incentives not matching our macro-level goals.

Caring for Welfare Dependents:

We know that a child held too close to the breast becomes dependent and not self-reliant. Yet government continues to hold our poor and needy too closely, making them dependent on the continued assistance of the government through welfare programs. Government must encourage welfare recipients to quickly transition back into the workforce. However, there exists disincentives to work in the current welfare bureaucracy.

Disincentives to Self-Reliance:

Monetary and Non-Monetary Transfers: Federal programs that provide assistance without requiring a value exchange do not encourage self-reliance. Welfare recipients must provide a service for their benefits to promote a sense of self-worth and accomplishment. While these types of aid are designed to contribute to an individual or family's standard of living, Health and Human Services (HHS), the Government Accounting Office (GAO), the Census Bureau and other agencies within the government all show that direct assistance has little effect on promoting self-reliance. In fact, those Americans that we look to as role models, Abraham Lincoln, Mary McLeod Bethune and others all grew-up in poverty and still achieved success. Government aid programs did not assist these people in their rise to greatness, family, work ethic and self-reliance did.

---

[1] Kids Count Data Book, Annie E. Casey Foundation & Center for the Study of Social Policy - 1993. If parents wait until the age of 20, have jobs, complete high school and marry, their children are less than 8% likely to live in poverty at any time in their life.

[2] Dan Quale Was Right, Atlantic Monthly Magazine, April, 1993.

Promoting Self-Reliance: Welfare programs continually have perverse, if not unintended consequences. We continually make a devil's deal with welfare recipients -- if you do not work, we will pay you. When welfare cheats are caught working they are simply required to repay grafted moneys and services out of future benefit payments. Instead of being made to transition off of welfare into the jobs they held they are simply told to quit working in order to receive future benefits. The best training for placement and advancement in the workforce is the old fashioned job. Still, few government programs are directed at job assistance and work requirements. Work is always better than non-work. Yet, a teenage mother's welfare benefits package is often much greater than the benefits derived through social security after forty to forty-five years of work. We should not be amazed that welfare recipients find the dole more attractive than work. Sen. Christopher Dodd once said, "Whatever social behavior government rewards and subsidizes, we end up with more of that behavior. . .". Programs that give assistance without real work or service requirements promote inactivity and regressed work ethic.

Aid to Economically Disadvantaged Communities: While these programs are intended to stimulate local job growth and general opportunities, there is little belief that such programs directly benefit the poor Americans they are designed to help.

Solutions to Welfare Dependence:

Eligibility: One of the greatest deterrents to welfare dependence is never entering the welfare state. This need not mean that government not care *about* an economically disadvantage person. It need only mean that government not care *for* the poor or disadvantaged.

While there is great hyperbole about cutting-off benefits to certain dependents and its "punishing" of children, we must balance our cures with an evaluation of the disease. Literally, in the case of welfare and children, our medicine is often more fatal than the disease of poverty. Eligibility, therefore, must be re-evaluated cautiously.

Before the advent of the welfare state, families took care of their own without the intervention of government. If parents were unable to care for a child physically or financially, other family members stepped-in to provide relief. The idea that a government that can't deliver the mail can deliver on family support is unreasoned.

Eligibility must therefore be limited to only the most extreme cases.

Teenage Parents and Eligibility: It is unquestionably the law in every state that children are the undisputed dependents of their parents until the age of 18. Yet, federal welfare programs subvert state law, providing separate moneys, housing and other benefits to teenage mothers and disrupting the rights and responsibility of the family. Teenage parents should be excluded from eligibility for welfare programs as long as their exists a family that is capable of caring for the child and minor parent without government aid.

Kinship Care: In keeping with rhetoric from the left and the right about the importance of family, the federal government should deny eligibility to any potential recipients who have available, capable and willing family members to care for the children. The use of the Kinship Care network in determining welfare eligibility is not only significantly financially appealing, but it is socially, morally and ethically responsible.

No child has ran-away from home, committed suicide, joined a gang or used drugs because they suffered from too much good parenting, supervision or familial involvement, in fact, just the opposite is true.[3]

Accountability:

AFDC and other programs are intended for the benefit of the dependent children. Adults receive the benefits and are expected to participate in programs in support of the children's needs. Failure, or refusal to participate in required programs or to spend the cash payments for the benefit of the children should be seen as evidence of child neglect or abuse. Such irresponsible behavior clearly indicates that children in such welfare situations do not benefit from the program as is happening with increasing frequency.

All recipients should be required to reimburse the value of benefits received. Currently, only child support paid by non-custodial parents is used for reimbursement after a $50 per month pass-through. The custodial parent and welfare recipient must also should the responsibility of supporting their children. Job placement and retention or community service of forty hours per week will give these recipients the necessary training, develop the requisite work ethic and instill a sense of self-reliance and productivity desperately needed. There is no better qualification for entry-level work placement than job/volunteer experience.

Reforming Welfare Now:

Mr. Chairman, the American public drastically changed the face of this great institution for one reason, they want government to work for the people. I urge this Committee to abolish the Marriage Tax-Penalty and correct the failures of the EITC with the dispatch that the American people demanded last November. Not only do I encourage this action on behalf of the millions of American families punished by these penalties, but for the countless millions of children affected by these bad laws. Congress need not debate family values to the exclusion of valuing families. It must value families to promote family values.

---

[3] The Justice Department states that more than half of all children will spend part of their childhood in a home without a father. 30% of all children are born to unmarried women. Among African-Americans the figure is 68% nationwide, spiking to over 80% in certain urban areas. Children raised in two-parent families rarely experience poverty (even if both parents are involved after separation and divorce). Children who grow-up in single-parent homes are 83% likely to experience poverty. 60% of America's rapists, 72% of adolescent murderers, and 70% of long term prison inmates grew up without two-parent involvement.

Mrs. JOHNSON. Thank you, Mr. Pitts, for your eloquent statement.

I thank the panel for your very thoughtful input.

Mr. Christensen will inquire.

Mr. CHRISTENSEN. I agree with Madam Chairman. I am very impressed, Mr. Pitts. Thank you for coming, Mr. Wittmann, Ms. Decter.

I want to ask a question concerning a statement that was brought up in the last panel by Mr. Shapiro of the Democratic Leadership Council. He said that it was probably "not the soundest way to go about it," referring to not allowing the $500 per-child tax credit from the administration's point of view to families with children ages 13 on up.

I wanted to know what your feelings were on that. Maybe you could enlighten us a little bit on that, Mr. Wittmann, Mr. Pitts.

Mr. WITTMANN. Well, Congressman, it bedevils us. Perhaps this is the kind of idea that is discussed at a Renaissance weekend. As we said in our statement, that is probably an idea only a Washington policy wonk could figure out playing with numbers. But as we indicated in our testimony, clearly the expenses for moms and dads doesn't decline at age 13.

Ms. Decter and I were discussing beforehand in Jewish families, actually at age 13, there is a major religious event, the bar mitzvah that usually incurs expenses. But seriously, there are expenses that continue to increase for children age 13 and above. Our view is simply this: That moms and dads have seen the depreciation of the standard deduction for children over the last 40 years, and this is only a modest step and it shouldn't be cut off at arbitrary ages.

Mr. CHRISTENSEN. Any thoughts, Ms. Decter?

Ms. DECTER. Well, it is an absurdity in a situation in which ordinary parents in this country understand that the—it is the better part of prudence for their children if they get bachelor degrees. How anyone can imagine that having a dependent child age 18 is less expensive than having a dependent child age 8 is someone who is either nice and young or childless or has a lot to learn yet.

Mr. CHRISTENSEN. Well, I would agree. I have had a hard time figuring out where the administration would come up with that proposal. I sure don't think it does the American family justice, who we are here trying to fight. I know I was sent here on November 8 to fight for that working family, to fight for that middle-income earner who has been under the burden of confiscatory taxation and regulation over the last several years. We are going to win this fight. We appreciate your testifying.

Ms. DECTER. Now he is not even permitted to smoke.

Mr. PITTS. Mr. Christensen, I would just state I am not a soothsayer. It is not one of my many talents. I think my talks with the administration were that they were trying to drive home the point that we need to spend a lot of time focusing on the early, formative childhood years. If we give kids a decent start in life, they are more likely to be successful as adults. But I do agree that the administration did not go far enough. The cost expenditures for a teenage child are greatly increased over that of an infant child.

I have a little boy Noah whom I am really pleased with. But I know as he gets older there will be many things I will have to pro-

vide that aren't necessarily luxuries, like a suede jacket or $100 sneakers. I know there will be such things as a better book or a CD–ROM drive for computers so he can take a look at multimedia events. I think we need to increase the age cap. Up until the age of 18, I think it is a responsible thing to do.

Mr. CHRISTENSEN. Thank you, Madam Chairman.

Mrs. JOHNSON of Connecticut [presiding]. The gentlelady from Washington, Ms. Dunn, will inquire.

Ms. DUNN. Thank you, Madam Chairman.

I have one simple question. We have had a wonderful advantage today with several panels testifying on the child tax credit and the family incentive that we have discussed in the Congress. I wonder if each of you might think out loud for our benefit and tell us how you would construct a family-friendly tax cut program. Mr. Pitts?

Mr. PITTS. I would think that the $500 credit is the first step. I think we need to take a look at when our families were strongest last. I refer to the year 1948, in my estimation. It is a magical number. But we were doing pretty well then. If we take a look at the tax incentives for parents to stay home, to parent children, to be there in their formative years, we can see that we have greatly devalued the benefit the two-parent family has in staying intact in the young years especially.

I do not diminish your idea about volunteerism, Ms. Dunn. I think a lot of mothers and fathers who stay home with their children in the formative years spend that time being active, whether it be at the PTA or home school network or the Sierra Club. It makes no difference what they are involved in. I think it is important the children see their parents being involved in the community.

I think in large part we need to take a look at the structure in which the Tax Code allows us to get back to that situation by which parents can actually stay home. It need not be the woman. It could be the man. I don't think it matters which parent stays home. All I care about is that children see productive parents leave the house every day, earn a living, display a work ethic and come home, instead of seeing two parents leave the house and come home almost literal strangers.

I think we have a problem in America when bus drivers and day care workers, as wonderful as they may be, spend more time with their children than the parents do. I think we need to have more parental supervision. I think it will cure a lot of ills.

In my time working on the streets or in social programs, not one child has come to me and said, "I ran away from home or joined a gang because, darn it, I was being loved too much, my parents were too involved." Those things never happen. So I think we need to get the family back involved in the family.

Child care is good. We can do a lot of things to assist single parents, but we have to go back to what we know works and that is the two-parent family.

Ms. DUNN. Thank you. Mr. Wittmann.

Mr. WITTMANN. I would echo what has been said before.

I would also add that over the last 40 years, we have seen this depreciation of the exemption.

One of the great frustrations I think right now, and probably over on the campaign trail just a few months ago that you ran into, is the stagnant family income over the last 20-some odd years. The question has been raised, where are the spending cuts? It is an interesting proposition. I was thinking about it.

Over the past 40 years when Washington has spent the money of moms and dads, no one asked the moms and dads how are they going to change their spending to accommodate the increase in Federal spending. I think the basic point is that we have to look at things from a new paradigm. Spending is going to take place for education, for welfare, and for health. The question is, who does the spending. Do bureaucrats do it in Washington or do moms and dads do it in their homes? Because when it comes to the end of the day and as one who worked in the bureaucracy, no bureaucrat loves my children more than I do. Only moms and dads can make the best decisions about their spending, and I think that that is what the voters are saying to Washington, let us make those decisions.

Ms. DECTER. I would like to add something. Excuse me. I have been sitting here all day listening to the testimony and it was most interesting. I noticed that everybody got caught up short, with the possible exception of Alan Reynolds who doesn't care about these things and says he is no philosopher on the issue of fairness.

I am sorry that Mr. Rangel, who is a compatriot of mine from New York, is not here, because he brought this up, too. I would be delighted to give him the spending cuts list, and unlike Gary Bauer, I would be willing to tell you right now that we should shut down the Department of Energy, the Department of Education, the endowments. I mean, I would be delighted to give him a list. But it seems to me that everyone got thrown off the track a little bit by exceeding to the idea that whatever else happens we must have fairness, which means that those who have less money must not perceive that those who have more money are getting a break. I don't think that that is a sound economic principle.

There was talk before about what has interfered with the savings rate of Americans, and obviously what has interfered with the savings rate of Americans is taxing at the margin. Marginal taxation has done that. Everyone in the entire economy would benefit if the economy grew, and we know what is necessary to make economies grow, and it is not egalitarianism. The poor would do better in an expanding economy. In order for the economy to expand, the rich also have to do better. That is the way it is. It seems to me that by now that should be established as a fact of life. So again, I think it is very important that this society honor two-parent families and their children who live stable, companionate, loving lives. I don't think it matters if they make $30,000 a year or $80,000 a year.

Mrs. JOHNSON of Connecticut. Thank you, Ms. Decter. In view of the time, I would like to move on to Mr. Neal of Massachusetts.

Mr. NEAL. Thank you very much, Madam Chairperson.

Welcome. I thought that your testimony was certainly enlightening today. Let me ask you, since we talked about the issue of real income and we connected that to a two-parent household and we connected the idea that there should be no difference in affection in the household between those that make $30,000 and $80,000 a

year. The hard truth of the matter is, however, that the people that make $30,000 a year with one income are finding it harder year after year after year. As a result, the woman in the household, typically during the last 10 or 15 or 20 years, has found it necessary to seek work or to enter the workplace and that, certainly in my region, New England, has allowed for the maintenance of income to remain where it is.

Let me just throw this out to the three of you because I think it is worthy of some focus and discussion. What about the morality of taking American manufacturing jobs offshore for lower wages? What about corporate decisions across America during the last 10 years that have literally helped to destroy urban areas? Does Corporate America bear any responsibility for some of these decisions where they seek wages in the vicinity of $1 an hour or $1.25 an hour? What does that do to the dignity of the individual and the human being who sees that job leaving despite the fact that productivity standards have gone way up in America, primarily because people are working harder all the time?

I have four children, so nobody here corners the market on trying to raise a family. My wife works, as well. My point is that all Americans find it harder and harder to keep that family together, that family time that is so critical.

My broader question is: What about those decisions to move those jobs offshore that have driven people in New England and old cities like Lawrence and Lowell and Worcester and Boston and Springfield? Is it just to see those manufacturing areas devastated in the name of profit-making?

By the way, I don't come from the left of my party. People would consider me to be in the center of the Democratic Party. But I am troubled by these decisions in recent years. I think you three are well-positioned to speak to it.

Mr. PITTS. Let me start off because I, too, am from Massachusetts. I lived in Boston. I, too, have been troubled by seeing my peers in longtime manufacturing jobs, their wages decrease exponentially, I believe, over the last decade, jobs moving out of New England in droves.

But I am not an economist. I went to school and I studied philosophy, theology, and law. These are the areas that I know and some would argue I don't know them very well. But what I do know is this: That there is always dignity in work and there is always dignity in family.

I was thinking the other night about this debate on the War on Poverty, has it had an effect. One thing I did realize is that there are some great figures in American history that grew up in what could only be described as abject poverty and turned out to be wonderful people. The fact that parents feel a need to keep up with the Jones' next door I think is unfortunate in our society. But what I would say is that there are a number of issues that have contributed. But the issue that I came to speak about today and I think that is squarely before the committee is tax relief for families.

Mr. NEAL. But is it not tied to the broader question—I don't mean to interrupt—is it not tied to the question of family time if the woman has been compelled to go to the workplace?

Mr. PITTS. I don't know that they are, first of all, compelled. I don't think both parents need to work all of the time. I think we have this idea that we have to wear designer clothing, that our children have to have——

Mr. NEAL. How old are your children?

Mr. PITTS [continuing]. That they have to have video games. I have a 2-year-old.

Mr. NEAL. A 2-year-old. Let me tell you what it is like to get ready for the cost of college and say two parents don't have to work.

Mr. PITTS. Having recently completed my education, I am concerned about the cost of education. I go to bed at night and I worry about Noah getting a college education. I worry about him getting a high school education. More importantly, I worry about him getting values and parenting and supervision so that he won't become a gang member, so that he won't do drugs, so that we won't have an out-of-wedlock birth in the family. These are things that I think will become essential in helping him become a successful adult.

Ms. DECTER. Look, it is not a new invention that women have needed to work. Women have needed to work down through the ages. There is some kind of ideological formulation that suddenly they have been—and it is a misfortune if they are forced to do it. Government cannot account for all human misfortunes. It is a misfortune if a certain industry becomes obsolete because it cannot compete with other industries; then new ones come to take its place. This is a process that has been going on in this country over the centuries.

Mr. NEAL. What has been taking the place of the manufacturing industry in America?

Ms. DECTER. Highway 128. You are in Massachusetts. That is one of the things that has been taking its place.

Mr. NEAL. Highway 128 has lost more jobs in the last 5 years than any other sector in the Massachusetts economy.

Ms. DECTER. But it is—I know there are women who need to work. As I say, there have always been women who needed to work and there were always widows and orphans who needed to work, and this is very—and this is something worthy of enormous sympathy, help, respect, and every other thing. But it is not the same thing as making light in the name of justice and equality—of making light of what it is families are and do. I maintain that the American culture has been doing that. It is not only women who—a family with an income of $30,000 a year. The women in the household where the family income, where the husband is earning $85,000 a year also needs to go to work because they feel they are not respected.

I have two daughters—three daughters, actually; one doesn't live in the United States so she doesn't have the problem—who are home raising my beautiful, wonderful, marvelous grandchildren. Everywhere they go, they feel obligated, especially since they live in this town, which is a terrible place for women, they feel obligated to apologize for the fact that that is what they are doing. That is the influence of the culture, and lawmakers have got to be very careful to examine themselves and make sure that they aren't simply taking on these fashionable attitudes.

Mrs. JOHNSON of Connecticut. Thank you. Mr. English will inquire.

Mr. ENGLISH. Thank you very much, Madam Chairman.

I wanted to explore with the panelists the issue of the growing burden of taxation in America on working families, on family structure, and the effects of changes in that family structure over the last 20 or 30 years on the equity of the tax system. I know that is a very broad subject. But for example, we have touched on the fact that more and more families are needing two incomes. To some extent, I think that the growth of taxation has contributed to that trend. Also, it has had the perverse effect of moving a great deal of activity traditionally done within the family out of the family, into the market economy and into the clutches of the tax man.

I think that we have all talked to constituents who have had a great deal of difficulty making ends meet and that the second income in the family is heavily consumed by the expenses of child care, associated expenses, and taxes. I wanted each of you to comment on what you consider the implications of this and how significant it is for the family structure and ultimately for American culture.

Mr. WITTMANN. One thing that we mentioned in our testimony was the concept of the family time famine. Moms and dads are only able to spend considerably less time with their children because of the fact that one of those wage earners is spending a large part of their income, up to two-thirds, paying the tax liability that has increased over the last 40 years.

No professional care giver can replace the love of a mother or father. I think that most child psychologists would attest to that. That is one thing that is going to have ramifications in the future as moms and dads have less time to spend with their children and in tending to their needs and all the things that come with childhood. But the thing to keep in mind is that no government, no matter how well the service is delivered, can replace the mom and dad. No program can be shaped so expertly to replace a mother's or father's love and attention to their child. I think we are going to pay a price for less parental time with their children down the road. We probably already are. So I think that the ramifications are not just financial ones. They are cultural ones that impact upon the next generation.

Mr. ENGLISH. Ms. Decter, would you care to comment on the cultural implications? Would you agree that the growing tax burden is having some impact on family structure?

Ms. DECTER. Well, obviously it is among those who are struggling to make ends meet, certainly it is. But there is something else to be added into the equation. One of the things, I think, that happened last November 8 was that people are angry. They are angry not because the tax structure is unfair or favors the rich. I think that is a very serious misunderstanding. There is not a whole lot of envy in this society, especially compared with other societies—excuse me, in Europe and so on. What there is is bitter resentment on the part of people who work hard that they are spending—that so much of their money is being taken to support people who are not working at all.

This is a very critical issue, it seems to me. It is the issue that is called welfare or the great society or something. But I think it can be spelled in very simple terms, which is I am breaking my back in order that that woman can hang around and have an apartment of her own and babies or in order that that guy can hang out on the street corner. That is where the bitterness and the anger is coming from. That is why I think the issue of—that is the issue of justice as people—as working people in this country see it.

Mr. ENGLISH. Let me beg the Chair's indulgence in a followup. Do you feel that the changes in the family structure that are at least partially the result of growth of taxation, particularly on the vast middle class, are having an impact on the ability of families to act as incubators for culture?

Ms. DECTER. Oh, of course. That is part of it. Of course it does. That is only one part of it. I mean, the schools are acting against it. Every—everywhere you look, there is some official agency or public display or celebration or something which is militating against this which the tax structure is just one part, but it is an essential part.

Mr. ENGLISH. Thank you very much.

Mrs. JOHNSON of Connecticut. I thank the panel very much for your presentation today. I do have one question that I would like to pose.

I am very pleased that this panel is finally going to address some of the problems in the Tax Code as far as families are concerned and reverse some of the disincentives that have placed such a heavy burden on families and penalized marriage and family formation. I also would like to point out that a lot of this is bipartisan. In the past, some of my Democratic colleagues, particularly my colleague Barbara Kennelly from Connecticut, has been a strong proponent and has worked very, very hard to try to do something about the marriage penalties. We are all concerned, however, with the cost of tax changes. Since the deficit does impose very significant, both direct and indirect, burdens on families, it is important that we try to proceed through this package in a way that assures that we can pay for it.

One of the things that has interested me today is that the three proposals before us cut off the tax credit at different levels of income. Now, I strongly oppose treating children of 12 different from children of 13. But I do think we have to think very seriously about whether a $500 credit is as important to a family with a $200,000 income as it is to a family with a $125,000 income, both of which are Republican proposals, or to a $75,000 income, which is the Speaker's proposal.

In my own part of the country, $75,000 is not a lot of income to some families. We are a very high cost part of the country. In a family with a policeman and a teacher, you can easily be over that income level, and with two children that is a real struggle. So I think trying to look realistically, both at the short-term burden of the deficit on families and the long-term burden for us as a society, I am personally looking at where the most appropriate cutoff might be—$200,000, $150,000, $225,000?

Do you have any thoughts on that? Should we take seriously the responsibility to accommodate the child credit for very high-income people as we do for middle-income people?

Mr. WITTMANN. Congresswoman, if I could just add, I personally would even eliminate the $200,000 cutoff. First and foremost, 90 percent of the money goes to families earning less than $75,000, so I don't really think that you save that much money by extending the cutoff over $200,000 or even eliminating the $200,000 cutoff.

Second, our grave concern is that the term wealthy will become very fungible in Washington. Wealthy could be $75,000 in the President's mind and it can be a very fungible, slippery slope, if you will, and soon we will find ourselves with no tax relief or minimal at all. So we would strongly urge the Congress to go actually the route of what the Senate budget bill had last year, which was not a means test. Because, No. 1, you don't pick up that much money, and No. 2, our fear is that there will be a slippery slope by which the number will keep dropping.

Mrs. JOHNSON of Connecticut. I do appreciate both those arguments, Mr. Wittmann, as sound. It is, however, a matter of $13 billion. As we get into the other provisions in this Tax Code and the fact that while we talk about relieving the earnings penalty for seniors, we actually don't relieve it for seniors from 60 to 65, which is probably peak earning years that you don't want to penalize. So when you look at what we are able to accomplish in this package and really aren't able to accomplish as well as we want to, I do worry about that. But certainly both of the arguments you make are solid and sound, if any of the other panel would like to comment.

Mr. PITTS. I would say this, Madam Chair, if I may, that I read a couple of months ago, Marian Wright Edelman said that if it is wrong for a teenage child to have a child out of wedlock, it is wrong for a Hollywood star with millions of dollars.

I don't want to sound like I am giving anything away to the wealthy. It is not my agenda. However, I think that we can't punish family formation discriminantly. If family formation is good for the poor, it is also good for the wealthy. In that regard, I would agree with my brother that the cap is somewhat ridiculous in the sense that family formation is always good.

One of the things that I would encourage Members to take a look at is something I haven't heard much of and that is the uncalculated savings of other expenditures. Like I said, we know that when families form, they have a less than 8 percent chance of living in poverty. The more we encourage marriage through the removal of the marriage tax penalty, I think the more we will see families form, and I think the more they will preserve, the more we put the Tax Code in a more family and child-focused format.

With all of that comes savings in drug treatment programs, in prison buildings, and the number of other social ills that, in my opinion, as I look at society, are a direct consequence, if albeit an unintended consequence, of not forming families. I think there is tremendous savings to be made by giving a tax cut if you can call it that. I see it as a penalty, removing the tax penalty, for family formation.

Ms. DECTER. Well, I am not a policy expert, but I am a housekeeper. I know that if there is something I want to afford, the first thing I do is figure out what it is I can afford to give up in order to do that. It seems to me that this is something that has not really been seriously done before, and as I sense is about to be seriously done. I think if it is truly seriously done, probably no one has yet estimated how much saving there will be and what could be afforded on that basis. But, obviously, nothing more should be done than what can be afforded. That is clear.

Mrs. JOHNSON of Connecticut. Yes. We will have to look broadly at this as we move forward and be sure that we don't provide more benefits to one group than to another.

Thank you very much for your testimony, and I hope in 6 months you will be pleased with our work. Thank you.

Mr. WITTMANN. Thank you.

Mr. PITTS. Thank you very much, Madam Chair.

Ms. DECTER. Thank you.

[Whereupon, at 4:22 p.m., the hearing was adjourned to reconvene on Wednesday, January 18, 1995, at 10 a.m.]

TAX PROVISIONS IN THE CONTRACT WITH AMERICA DESIGNED TO STRENGTHEN THE AMERICAN FAMILY

WEDNESDAY, JANUARY 18, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 10:03 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

Chairman ARCHER. Will you ask our guests to take their seats. This is our second day of hearings on provisions that are designed to strengthen the American family, and we will focus on the Family Reinforcement Act, H.R. 11.

This act would provide refundable tax credits for adoptive parents and for families who provide custodial care for invalid parents and grandparents at home. It is a very important part of the bill that has not received a great deal of attention in the press, so I am delighted that we will be having this hearing devoted to it today. As a parent myself, and also as a grandparent—and those numbers seem to grow every year or two—I can speak personally of the joys which children bring into a family. I now have seven children and eight grandchildren, with two more grandchildren on the way, and they are the greatest blessing that can come to any human being.

Sadly, there are many families in America who face difficulties sharing the enrichment of parenthood. For them, the financial barriers of adoption are too great to overcome.

Today, the average cost of adopting a child can range from $10,000 to $12,000 in fees and legal expenses. For families of modest means, this dollar figure can translate into a childless home. For the children who need a home, this can mean an intolerable wait. To address this dilemma, the Family Reinforcement Act, as part of the Contract With America, would allow these families to claim refundable tax credits of up to $5,000 for legal adoption expenses.

Later on today, we will turn our attention to tax relief for families who care for parents and grandparents at home. It is time for us and the Tax Code to recognize the financial strains placed on families who provide custodial care to invalid parents and grandparents. The Family Reinforcement Act begins by permitting families to claim a refundable tax credit of $500 for each parent or grandparent in need of custodial home care.

We have many expert witnesses today, some who have come to share their personal experiences with us, and we look forward to their testimony.

Now I would recognize Mr. Ford for any opening comments that he would like to make on behalf of the minority.

Mr. FORD. Thank you, Mr. Chairman. As we receive testimony on the adoption credit contained in the Contract, I would like to encourage my colleagues to focus on the group of intended beneficiaries who are in dire need of these incentives. An adoption credit has always received support from the Democratic side of the aisle, as indicated in 1991, when a credit was included in the Family Preservation Act, a legislative proposal that was vigorously pursued on the Human Resources Subcommittee.

In 1991, as well as today, we had limited resources for this relief; thus, we focus any relief on those children who traditionally would not otherwise be adopted, children with special needs. As we move forward with this proposal today and hear from witnesses, Mr. Chairman, I would impress upon my colleagues how important it is that we retain this portion of the credit, should our limited resources require a reduction of dollars, and allocate those dollars to the areas where they are definitely needed. Let us not lose the opportunity to do something very meaningful in this area at the expense of doing all things for all people.

As we consider this legislation, Mr. Chairman, I look forward to working with you and my colleagues on this committee in making this tax relief a reality for the families who badly need the funds and the resources to make sure that those adoptions do, in fact, take place where those dire needs exist in this country.

Thank you, Mr. Chairman.

[The opening statement of Mr. Ramstad follows:]

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON FAMILY TAX REFORM
January 18, 1994

Mr. Chairman, as a strong supporter of the Contract With America's provisions for adoption and eldercare assistance, I look forward to this second day of hearings on the importance of providing needed tax relief to American families.

The Contract's Family Reinforcement Act (H.R. 11) would establish a refundable tax credit of up to $5,000 for adoption expenses such as adoption fees, court costs and attorney fees.

Mr. Chairman, I am very familiar with the often exorbitant costs of adoption. My own sister and brother-in-law chose to adopt two wonderful children from Korea, as well as one from the United States. As experts will tell you, the expense of international adoptions is even greater than that of domestic adoptions.

Across the country, there are many middle income families that want nothing more than to provide a loving home for an adopted child, but are afraid they simply can't afford it.

By enabling more people to adopt, we can give more children the opportunity to be reared in the stable environment of a two-parent family. Increasing the number of adoptions in America may, in turn, cut future costs to the taxpayers by reducing the number of children on welfare or in the juvenile justice system.

As a member of the bipartisan Congressional Coalition on Adoption, I know that pro-adoption policies are advocated by Members of Congress across the political spectrum. I hope they will all come forward to support this provision.

By the same token, the Contract's $500 refundable tax credit for individuals who care for a parent or grandparent at home also will serve to relieve an often heavy financial burden on Americans.

Families that have made the sometimes difficult decision to care for a loved one at home should be commended. Not only do their extraordinary efforts help keep families together, but they lower our nation's health care costs by reducing the number of people who require nursing home care.

Once again, Mr. Chairman, I am very pleased to be hearing today not only from experts on adoption and eldercare, but from a number of private citizens who can tell us whether the Contract's initiatives to reduce the tax burden will make a real difference in their lives and the lives of their families.

I thank you all very much for being here today and look forward to your testimony.

Chairman ARCHER. I thank you for your comments and am pleased that we can work together on this provision on a bipartisan basis.

We have before us today our first panel, five of our colleagues in the House. Welcome to the Ways and Means Committee. We would encourage each of you to limit your verbal comments to the committee to no more than 5 minutes. Any written statement that is lengthier than that will be inserted in the record, without objection.

We will be pleased to receive your input, beginning with the Honorable Robert Dornan of California.

STATEMENT OF HON. ROBERT K. DORNAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. DORNAN. Mr. Chairman, permission to paraphrase a little Shakespeare, Julius Caesar. This committee is really the big time. It does bestride the Hill like a giant colossus, and we mere mortal Congressmen do walk through its legs and peek about and conduct our affairs.

This is the committee that rewards or punishes Americans with economic incentives on their 1040 form. I have done my own income tax without the help of H&R Block or anybody else for 47 years, since I was 14 years of age and had my first job. Each year—because the memory does wane and rules change a lot, each year I will take the 1040 guidance booklet and read the brief changes in the front. Even in the brief changes, it says what you cannot and can deduct as an exemption or a deduction. One of the things that has jolted me for years is that you can deduct an abortion, but you cannot deduct an adoption.

This was not always so. At some point over the last four decades, when our Grand Old Party was in the minority, somebody in this very beautiful chamber struck the tax deduction for adopting a special needs child. I have done research on that and I will submit it to the committee at some point, but I have been able to find out this: that when the 1985 adoption fact book was published, 1985, Federal tax law permitted up to a $1,500 deduction for adopting a special needs child. This runs a whole range of areas of needs for children, but let's say a Downs syndrome child. This deduction was then repealed and efforts to include any deduction and deductions for all types of adoptions have stalled in Congress after Congress.

Now, I hesitate to claim that it was all buried in the abortion debate, but I asssume the liberal reasoning was that by having a tax deduction for the adoption of any child, people would always want the perfect child and therefore would not adopt the special needs child. As is the way with the Ways and Means Committee driving economic and social policy, they said, if we only give the deduction for special needs children, that will up the adoption rate for special needs children and that will take it away for the other.

But, as the years evolved, here we were with this option to encourage abortion financially, but not to encourage adoption. Absolutely absurd.

I am going to submit my statement for the record. I see that there are very few minority members here, and I can only assume that they are out trying to adopt consultants for the 1996 election cycle or something. But I wish that they would reflect upon how

peculiar it was that this foot-dragging went on on this, and point out one set of statistics in closing.

According to the National Committee for Adoption, there are 1.5 million American couples wanting to adopt. While each year there are over 1.5 million children being terminated by abortion, only 50,000 new children are made available for adoption. That means that for every fortunate couple that begins a loving relationship with a selected child, another 40 couples wait in line.

Just think of how similar those two statistics are. If every pregnant mother carried her child to term, there is a loving, waiting couple there to nurture that child into adult life and provide who knows what spectacular benefits to the United States of America.

When I was asked by those forming the Contract With America for my suggestions, an adoption tax credit was it. I suggested a $1,500 exemption; we are now properly up to $5,000. Most adoptions cost between $8,000 and as high as $20,000, and I have only, to all of our Members, majority and minority, to point out the uplifting and sometimes very tragic stories of Americans going to a collapsing Romania, a tragic Russia, adopting children, anywhere in the world to bring them back to this Nation and raise them as American citizens.

This is one tax issue that has waited a long time to come to fruition; I pray for victory.

[The prepared statement follows:]

Testimony of Rep. Robert K. Dornan

House Ways and Means Committee

Adoption Tax Credit

==========

Mr. DORNAN. Thank you, Mr. Chairman and members of the committee. It is a pleasure for me to be here today to talk about the importance of including tax relief for adoptive families through the Family Reinforcement Act.

The expenses associated with adopting a child, whether domestically or internationally, have escalated dramatically in the past decade. In fact, despite a lack of research in the area of adoption, we know that some adoptions can cost upwards of several, if not tens of thousands of dollars. This is an overwhelming financial burden for families considering adoption.

As a result, many prospective adoptive parents have to work two or three jobs or take a second mortgage on their home just to pay the bills associated with an adoption. And many low-to middle-income childless couples, no matter how hard they try, are simply incapable of absorbing the exorbitant costs of adopting a child -- not to mention adopting more than one child. Along with the emotional stress of being infertile or otherwise incapable of having a child of their own creation, they must face the reality that adoption is possible only for those who can afford the long list of expenses. Unfortunately, our tax code offers no relief for these couples, many of whom end up in severe financial debt simply because they long to become parents.

Just as families who give birth to a child may receive tax relief for some medical expenses, adoptive families need to be relieved of some of the financial burdens associated with their child's adoption through meaningful tax legislation. That is why it is so important for Congress to enact this legislation that includes tax relief in the form of a $5,000 refundable tax credit for adoption-related expenses. This is a relatively small investment that will give thousands of children the security of a caring home.

For years, adoptive families have been looking to Congress for leadership on this issue. During the past two congresses I have myself introduced similar legislation so that adoptive families could receive some financial relief. I am hopeful that with dynamic new leadership in the House, we can finally facilitate the "adoption option," as so many like to call it. This much-needed provision will go a long way toward making adoption an affordable choice for thousands of America's families.

Thank you again, Mr. Chairman, for giving me the opportunity to testify today. In light of the many couples wanting to provide a loving home for children waiting to be adopted, I am very grateful to the Republican leadership for including this in the "Contract with America."

Chairman ARCHER. Thank you for your testimony.

Our next witness is the Honorable Chris Smith from New Jersey.

Congressman Smith, we would be pleased to hear your testimony.

STATEMENT OF HON. CHRISTOPHER H. SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. SMITH. Thank you very much, Mr. Chairman.

First, I would ask that my full testimony be made a part of the record.

Mr. Chairman, I would like to thank the committee for holding this very important hearing and inviting me and my colleagues on this matter that is critical to helping middle-class families, and especially kids—the adoption tax credit.

As you may know, I have been a very strong advocate of the loving option of adoption since coming to Congress in 1980. I have authored and cosponsored a number of adoption bills that would have provided tax credits or deductions for adoption expenses. Most notably, I have introduced in the past two Congresses what we call the Omnibus Adoption Act, a comprehensive bill that would create and reform a number of adoption-related services, including maternity homes and maternal health certificates, graduate education on adoption issues, and a national data collection system. In fact, the adoption tax credit provision of the Family Reinforcement Act was taken directly from this Omnibus bill.

I would also point out, parenthetically, at times we had in excess of 100 Members from both sides of the aisle who were cosponsors. In previous years, I have been before this committee, asking that this legislation be enacted; and unfortunately, that never came to fruition; but thankfully, we are on the verge of doing that.

Mr. Chairman, according to the National Council for Adoption, Americans adopted 51,157 children in 1986. Other sources suggest that by 1993, approximately 56,000 children were adopted in that year. In addition, the latest figures available show that approximately 6,500 foreign-born children are adopted by Americans annually. This number reflects an increasing trend toward foreign adoptions because children simply are not available in the United States.

Despite these recent incremental increases, Mr. Chairman, adoption as a whole is down. Only 25 years ago in 1970, Americans adopted 89,200 children, yet in the same 25-year period, the number of out-of-wedlock births has steadily increased and the number of children in foster care reached a staggering 407,000 children in 1990, nearly a 50-percent increase since 1985. According to the American Public Welfare Association, these children account for 99 percent of the population that is dependent in this country.

Mr. Chairman, according to the National Council for Adoption, approximately 5 percent of all unmarried teens place their child for adoption. Let me say that again. Only 5 percent of all unmarried teens place their child for adoption, while about 40 percent abort their child and 45 percent choose to parent their child.

In like matter, a 1982 study by Dr. Christine Bachrach indicates that only 6 percent of all babies born to all unmarried American mothers were placed for adoption. So that the data is about the

same, 5 to 6 percent of unmarried mothers put their children up for adoption. That study also showed, however, that this breaks down dramatically—there is a very modest number of people who are actually putting their children up for adoption—breaks down dramatically according to race, with black mothers placing their babies for adoption only 0.4 percent of the time, while white mothers place their children a little over 12 percent. Unfortunately, while black children constitute about 14 percent of the child population in America, they account for more than 30 percent of the children in foster care and more than 38 percent of the children that are awaiting adoption.

Clearly, Mr. Chairman, there are needy children that are out there waiting to be adopted.

Meanwhile, as my friend Mr. Dornan pointed out, there are between one and one-half and two million couples who would like to adopt, but very often they are encumbered by the fact that the up-front cost of the adoption is too cost prohibitive.

Let me also point out that these families would like to adopt children with AIDS, with terminal illnesses; children that have Downs syndrome and spina bifida.

Mr. Chairman, the concept of the adoption tax credit is very simple. Middle-class families could receive up to a $5,000 tax credit to offset the up-front, one-time adoption expenses. The credit is means tested so that families earning between $60,000 and $100,000 would receive a partial credit.

The tax credit will bring children and families together. The costs are relatively small, but the benefits are limitless.

The Republican staff of the Budget Committee last year estimated that the adoption tax credit would cost about $900 million over 5 years; a modest price for helping to bring homeless children and loving parents together. In return for our relatively small investment, Mr. Chairman, thousands of children could have the opportunity to live with the security of a caring family, and thousands of families would be able to afford opening up their loving homes to these needy children. Unfortunately, and I repeat, the only obstacle to many of these families and these children getting together is the up-front expenses of the adoption.

Let me just also point out, Mr. Chairman, that no one suffers more than the innocent child because of the financial hurdle that this current situation places on these families. These children are kept out of these homes simply because of these up-front costs.

Let me also point out, Mr. Chairman, because I know my time is coming to an end, that evidence suggests that the benefits of adoption to all concerned, including the birth mother, are overwhelmingly positive. In fact, some research indicates that those women who do choose to make an adoption plan for their children will be less likely to live in poverty, more likely to complete high school, and less likely to have additional unplanned pregnancies. We must provide Federal support for these pregnant women and all pregnant women who lack the means to pay for prenatal and maternity health care, and that is something I think this committee needs to look at, as well.

Mr. Chairman, there has been editorial support for this. The Boston Globe recently chimed in very strongly in favor of this adoption

tax credit. It is an idea that has not reached the floor in the past. Again, it is an idea that had bipartisan support, but did not get the push from the chairman and from others to make it to the floor, so it would be enacted into law.

I thank you. I thank you strongly personally for your leadership in helping to make this a possibility and to make it a reality in the very near future.

[The prepared statement and attachment follow:]

WASHINGTON OFFICE
2373 Rayburn House Office Building
Washington, DC 20515-3004
(202) 225-3765

CONSTITUENT SERVICE CENTERS
1720 Greenwood Avenue
Hamilton, NJ 08609
(609) 890-3800
TTY (609) 890-7223

427 High Street
Room 1
Burlington City, NJ 08016
(609) 386-6534

100 Lacey Road
Suite 38A
Whiting, NJ 08759
(908) 350-2300

Congress of the United States
House of Representatives
Washington, DC 20515-3004

CHRISTOPHER H. SMITH
4th District, New Jersey

COMMITTEES:
FOREIGN AFFAIRS
Ranking Member—Western Hemisphere Affairs
International Security, International Organizations and Human Rights
VETERANS' AFFAIRS
Ranking Member—Hospitals and Health Care
COMMISSION ON SECURITY AND COOPERATION IN EUROPE
Ranking Commissioner
TASK FORCE ON AGING

Testimony by Rep. Chris Smith
Before the Ways and Means Committee
on The Family Reinforcement Act
January 18, 1995

First, I'd like to thank the Committee for holding today's hearing and inviting me to testify on a matter critical to helping middle-class families -- the adoption tax credit.

As many of you know, I have been a strong advocate for the loving option of adoption since coming to Congress in 1980. I have authored and cosponsored a number of adoption bills that would have provided tax credits or deductions for adoption expenses. Most notably, I have introduced in the past two Congresses the Omnibus Adoption Act -- a comprehensive bill which would create or reform a number of adoption-related services, including maternity homes and maternal health certificates, graduate education on adoption issues, and a national data collection system. In fact, the adoption tax credit provision of the Family Reinforcement Act was taken directly from my Omnibus bill.

According to the National Council for Adoption, Americans adopted 51,157 children in 1986. Other sources suggest that by 1993, approximately 56,000 children were adopted per year. In addition, 6,500 foreign-born children were adopted by Americans in 1992. This number reflects an increasing trend to look towards foreign adoptions.

Despite these recent incremental increases, Mr. Chairman, adoption as a whole is down. Only twenty-five years ago, in 1970, Americans adopted 89,200 children. Yet, in that same twenty-five year period, the number of out-of-wedlock births has steadily increased and the number of children in foster care reached a staggering 407,000 in 1990 -- a nearly 50% increase from 1985. According to the American Public Welfare Association, these children account for 99% of the population of dependent children in the U.S. The National Council for Adoption estimates that only 10% of the children in foster care will eventually be placed for adoption.

According to the National Council for Adoption, Mr. Chairman, approximately 5% of all unmarried teens place their child for adoption, 40% abort their child, and 45% choose to parent their child. The remaining pregnancies end in miscarriage.

A 1982 study by Dr. Christine Bachrach indicates that only 6% of all babies born to all unmarried American mothers -- of all ages -- were placed for adoption. Dr. Bachrach further determined that this number breaks down dramatically by race, with black mothers placing their babies for adoption 0.4% and white mothers 12.2%. Unfortunately, while black children constitute about 14% of the child population, they account for more than 30% of the children in foster care and more than 38% of the children awaiting adoption.

Clearly, there are needy children out there waiting and hoping to be adopted.

Meanwhile, an estimated one to two million infertile and fertile couples and individuals want to adopt children. And these loving couples and individuals are waiting by the listful to adopt children regardless of race; children with terminal illnesses, like AIDS; and children with special medical needs, like Downs Syndrome and Spina Bifida.

Mr. Chairman, the concept of the adoption tax credit is simple. Middle class families could receive up to a $5,000 tax credit to offset up-front, one-time adoption expenses. The credit is means tested so that families earning between $60,000 and $100,000 would receive a partial tax credit. The tax credit will help bring children and families together.

The costs are relatively small; but the benefits are limitless. The Republican staff of the Budget Committee last year estimated the adoption tax credit would cost $900 million over five years -- a modest price to pay for helping to bring homeless children and loving families together.

In return for our relatively small investment, Mr. Chairman, thousands of children could have the opportunity to live with the security of a caring family. And thousands of families would be able to afford opening up their loving homes to needy children. Unfortunately, all too often, the only obstacle to getting these families together is the up-front adoption costs.

For instance, when a family with an already-tight budget is faced with the average cost of more than $14,000 to adopt just one child, up-front finances become an insurmountable hurdle. In fact, it is not altogether uncommon for these costs -- which often include prenatal care for the birthmother and child, counseling for the adoptive families, and legal fees -- to reach more than $25,000. [I have attached to my testimony, a copy of the average costs for domestic and international adoption as reported in the National Council for Adoption *1989 Adoption Factbook* for a detailed list of these expenses.] While these families have a wealthy reserve of love and can meet the monthly costs of raising another child, the one-time, up-front fees have often proven prohibitive to the rest of the process.

Mr. Chairman, no one suffers more than the innocent child because of this financial hurdle. But society suffers as well when we neglect our responsibilities to our children. And children without families are all of our responsibility.

There can be little doubt that a child who grows up in a stable family environment can be a more productive, healthy adult. Congress -- to its credit -- has long recognized this relationship and supported means to reach this laudable end. Immunization programs, lunch programs, and Head Start are all fine examples of how we try to help enrich the lives of our children. Now it's time to take care of the most basic of needs and help parentless children move into homes.

Adoption is truly a loving option. Evidence suggests that the benefits of adoption to all concerned, including the birth mother, are overwhelmingly positive. In fact, some research indicates that those women who do choose to make an adoption plan for their children will be less likely to live in poverty, more likely to complete high school and less likely to have additional unplanned pregnancies. We must provide federal support to these pregnant women and all pregnant women who lack the means to pay for prenatal and maternal health care.

Mr. Chairman, adoption also provides a child who might otherwise face a bleak or less than positive childhood the prospect of having loving parents, a stable home, a higher standard of living, and enhanced career opportunities as the child matures into adulthood. In fact, according to the 1982 National Survey of Family Growth, only 2% of adopted children lived in poverty compared to almost 62% of children living with mothers who have never been married. A study in the *Journal of Personality and Social Psychology* in 1985 by Kathlyn Marquis and Richard Detweiler noted that adopted children frequently enjoy more socio-economic advantages than those raised by their unmarried birthmothers. We must make it easier for these children to find families.

The *Boston Globe* noted on January 3, 1995 in its editorial supporting the tax credit provision of the Family Reinforcement Act that Congress needs to move affirmatively in this regard. *The Globe* said and I quote:

> "The credit also signals that the federal government is serious about promoting adoptions, just as tax deductions for charitable giving and mortgage interest indicate support for gift-giving and home ownership."

Mr. Chairman, I have been dedicated to this much-needed proposal for years and know that I have been joined in this regard by hundreds of my colleagues from both sides of the aisle. I was pleased that the Republican leadership recognized the importance of this proposal and included it in the legislative agenda of the first 100 days. I urge support for this proposal and would like to briefly address one additional topic.

I would also like to take this opportunity, Mr. Chairman, to express my support for the eldercare tax credit provision in the Contract with America. Again, this is a proposal which I have long supported. As society ages, more and more families will have to face the difficult questions of how to care for aging relatives. Currently, 12.5% of our population is aged 65 and older. By 2030, when the baby boomers peak as seniors, fully one-fifth of our population will be aged 65 and older.

Many aging adults, particularly those suffering from Alzheimer's and other dementia, cannot lead a quality life without assistance. And this assistance is often more than seniors' housing communities can offer. These seniors need full-time individualized care such as can be received in a nursing home facility or at home. In fact, last year, the Alzheimer's Association reported that more than one-half of all working Americans have either provided long-term care for their friends or relatives or believe that it will be likely in the future.

Keeping your aging parents in your home has other advantages as well, for your children and your family as a unit. Older Americans have a wealth of experience and knowledge to share with their younger relatives and friends. Children can only benefit from the cohesion which the presence of an extended family offers.

But, as in adoption, it is often a highly prohibitive cost which prevents a family from this loving option. The $500 eldercare tax credit can go a long way toward this worthy goal.

I look forward to working with you to assist families, children, and their elderly relatives in forming loving and stable relationships. You can count on my active and wholehearted assistance in gaining swift approval of these family friendly proposals.

Domestic Adoptions

Core Costs:

Maternity home care for birthmother @ $40-80 per day (3 months of pregnancy and 10 days post partum)		$5,000
Normal prenatal and hospital care for birthmother and child		5,000
Preadoption foster care for infant		600
*Counseling for adoptive parents (20-40 hours of home study and post placement supervision @ $30-70 per hour)		2,400
Legal fees		1,000-1,400
	TOTAL	14,000-14,400

Special Considerations:

Cesarean Section		additional 2,000
	TOTAL	16,000-16,400
Interstate Adoption		additional 500
	TOTAL	$14,500-14,900

International Adoptions:

*Counseling for Adoptive Parents (home study and post placement supervision)		2,400
Legal fees		1,000-2,400
Travel		1,500-5,000
Fee to foreign agency		2,000-3,000
	Additional TOTAL	$6,900-12,800

*For each couple who is approved for adoption, the agency must do a home study for 1½ couples.

Chairman ARCHER. Thank you for your input.

Our next witness is the Honorable Barbara Vucanovich from Nevada. We would be pleased to hear your testimony.

STATEMENT OF HON. BARBARA F. VUCANOVICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEVADA

Mrs. VUCANOVICH. Thank you very much, Mr. Chairman.

Mr. Chairman and members of the committee, I appreciate your allowing me to be here today to speak in strong support of H.R. 11, the Family Reinforcement Act. Today, America's families are facing their greatest crisis. Everywhere you turn, there is something discouraging the family unit. Our past policies have failed our families and our children. We need to redirect our efforts and construct a policy that strengthens and encourages the family. This is where America's future lies.

H.R. 11 is significant. It is much-needed legislation which provides refundable tax credits for adoption expenses, as well as caring for elderly family members. It takes a strong first step in aiding an already overburdened and overtaxed middle class that cares for two segments of the population that seem to be easily overlooked—children and seniors.

H.R. 11 includes a $5,000 refundable tax credit for adoption expenses. If we are to work to strengthen the American family, then helping lower and middle-income families adopt should be addressed. The expense of adopting a child has eliminated the possibility of these families adopting, yet these income groups comprise the largest percentage of our population. Our refundable tax credit offers all parents a chance to enrich their lives and the lives of needy children.

Parents choosing natural childbirth usually have health insurance to help them financially. Adopting a child does not mean the costs are any less. Instead, in most cases, the costs involved are substantial. The adoption tax credit provision contained in H.R. 11 is a significant step in encouraging couples of all income levels to adopt children.

I have a valued friend who is raising two adopted children, now in their teens. He and his wife are wonderful parents and have raised their children to be intelligent, thoughtful, and well mannered. They will grow up to be assets to our society. However, he has often commented on the expense of adopting. At the time, he and his wife were just making ends meet financially, and they struggled to bring these children into their home. Detailed testimony of his personal experiences with adoption will be inserted as part of the record. I would urge all of you to read his story.

An adoption tax credit such as the one proposed in H.R. 11 would have greatly benefited this family. Those who are willing to sacrifice so much should not be financially penalized. Families such as these are the foundation of our society.

H.R. 11 also includes a provision for a $500 refundable tax credit for families who care for an elderly parent or grandparent in their home. We are a nation that is seeing its population growing older, and we are facing the largest population of seniors ever in our history. Unfortunately, out of financial necessity, many families have

to place their loved ones in retirement homes. It is wrong when we encourage families to place elderly family members in retirement homes because the costs are paid by Medicaid, yet we do nothing to help a family that wants to stay together.

Later this afternoon, you will hear testimony from Nancy Summerfield of Reno, Nev., about how she cared for her mother with Alzheimer's disease in her home. She sacrificed personally, professionally, and financially. We should do what we can to assist everyone like Nancy who made the tough choice to keep her mother with the family.

Although this tax credit will not automatically solve every American's cost problem, it is a significant step in recognizing the needs of many American families. Encouraging elderly parents to stay in the home benefits all generations. At a time when family values are increasingly important, this tax provision will be beneficial to all Americans, not just the taxpayer.

As the team leader of the working group charged with producing profamily proposals, I have worked to develop this bill since its inception. H.R. 11 recognizes the need we have in society to keep our families strong. If we can keep our families intact, we strengthen the future of America. A strong America will lead to a brighter future for everyone.

Thank you very much, Mr. Chairman, for the opportunity to testify.

Chairman ARCHER. Thank you for your testimony, Mrs. Vucanovich.

Our next witness is the Honorable Stephen Buyer.

We welcome your testimony, and are pleased to have you with us this morning.

STATEMENT OF HON. STEPHEN E. BUYER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. BUYER. Thank you, Mr. Chairman. I would like to congratulate you on your rise to the Chair. I also appreciate the accommodation, testifying here on the $500 tax credit, when I was unable to testify yesterday, and I appreciate that.

Mr. Chairman, American families are in fact hurting as we seek to bring family tax fairness to the Tax Code. I believe the families have shouldered the brunt of the unfair Tax Code, which continues to take more money from their pockets, leaving less for families.

In my hometown of Monticello, Ind., and across northern Indiana, people continue to ask that government work for them, not against them. Mr. Chairman, I am always careful not to judge—whether it is your district or, likewise, any of my colleagues' districts—but not to judge the dimension of America through my own district. But I recognize that working families do need tax relief. They deserve the peace of mind which comes from knowing that the government is on their side, delivering on promises made. Mr. Chairman, I believe that this is a historic opportunity to do just that.

I stand before you, sitting here, in unwavering support of the $500 per-child tax credit for American working families. American families feel, and rightfully so, that their government is working against them, not for them.

I referred earlier to an unfair Tax Code due to the inequities that have not been addressed over the years. Over the past four decades, the Federal tax burden on a family of four has increased by over 300 percent. In fact, in 1950, only 2 percent of a family's income went to Federal taxes; today, 25 percent. When it is all said and done, local, State, Federal taxes take an average 38 percent of the families' income.

Mr. Chairman, the 1993 budget included one of America's largest tax increases. Current policies of this administration will create additional costs and increase taxes to my district in Indiana by over $1,500 per person. My district felt the jolt of these tax increases as much as anyone. In fact, the fifth district of Indiana saw income, Medicare, and the State tax increases cost residents over $126 million, and the gas tax increase took almost $78 million out of their pockets; and that is not counting the Social Security tax increases and the marriage penalty. I believe it is a sad statement that Hoosier families in my district now spend more on taxes than they spend on food, shelter, and clothing combined.

The $500 per-child tax credit is true middle-class tax relief that helps scale back the heavy burden imposed on families. Hoosier families need this tax relief, like many across America. Almost 130,000 children in my congressional district alone would be eligible, with an annual dollar value of almost $65 million. While there are some who seek to discredit this proposal of including $500 per-child tax credit of those earning less than $200,000, this tax credit will benefit over 51 million children; 45 million of these earn—belong to families that earn less than $75,000 per year. That means 90 percent of this tax credit will benefit hard-working families. The Contract With America proves that we are standing up for children and fighting for working families.

Earlier you mentioned your being a father. I am not a grandfather, but as a father of two, Mr. Chairman, I know very well the cost also of raising a family, like many of you. The two-income family is now at an all-time high in our country. The spouse who might otherwise stay at home is now instead supplementing the family's income just to make ends meet. No longer is a second income a luxury; it has become a necessity.

The fifth district of Indiana, which I represent, the rural, the economy is largely dependent on agrabusinesses, services, manufacturing, and small business. The median income is less than $28,000. The per capita income is around $12,000. Simply put, my district is middle-class America and the heartland of America. The $500 tax credit means that nearly $25.5 billion annually will remain in the hands of parents across this Nation to spend or save as they see fit. It enables a family of four to have $80 or more every month for groceries, school clothes for their children, or savings for education. This empowers families to make more of their own choices.

Since November, there has been one trial balloon after another on tax credits and changes in the Tax Code. I believe the family is the foundation of our society, Mr. Chairman, and it is my best judgment that we must start at the foundation and a $500 working-family tax credit is the best place to begin.

Thank you so very much.

Chairman ARCHER. Thank you for your testimony.

Our next and last witness on this panel is the Honorable Jerry Weller.

We are pleased to have you before the committee and pleased to receive your testimony.

STATEMENT OF HON. JERRY WELLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. WELLER. Well, thank you, Mr. Chairman, members of the committee. Thank you for inviting me here today to testify in strong support of H.R. 11, the Family Reinforcement Act, of which I am a chief sponsor.

Families in my district and American families across the Nation feel that they are under siege from a government that has grown unresponsive and, in fact, antagonistic to their day-to-day struggles. We, in Congress, must act quickly and decisively to restore, encourage, and protect this most basic unit of our society.

H.R. 11 is important legislation that provides much-needed tax relief to poor and middle-income Americans who work feverishly to keep their families intact. The bill incorporates refundable tax credits for adoption expenses and in-home care provided to elderly family members.

For years the extreme costs associated with adoption and in-home care have gone unnoticed by Congress. The burden has landed squarely on the shoulders of honest, hard-working Americans who have made the conscious decision to place the needs of family above their own desires. We have the chance, by enacting H.R. 11, to send a clear message that we respect these decisions and want to enable others to do the same.

H.R. 11 includes a $500 refundable tax credit for families who provide in-home care for a disabled parent, grandparent, or spouse. As the population of our Nation is growing older, the need for this credit is increasingly urgent.

For instance, one of my constituents, Patti Overight of Burbonnais, Ill., would have benefited from this provision. Patti's mother, who has suffered from Alzheimer's disease for 10 years, and her husband required daily care. Consequently, Patti would travel multiple times each day to care personally for the couple. The time and cost involved left Patti and her family financially and emotionally strapped.

Another constituent, Eileen Johnson of Minooka, Ill., has her grandmother, who suffers from dementia and is bedridden, living with her and her family. The cost of having her grandmother live with her is borne by Eileen in the form of inflated electric bills, which are a result of special health care equipment, supply costs, and medication costs.

The elder care tax credit would provide some long-overdue tax relief to Mrs. Overight, Mrs. Johnson, and the numerous other families who are caring for ailing family members. According to the Congressional Research Service, in-home care may reduce current expenditures made through Medicaid and the Medicare expenditure deduction.

As I have already suggested, H.R. 11 also includes a refundable adoption expense tax credit. This dollar-for-dollar credit to offset

expenses up to $5,000 is phased out for taxpayers whose adjusted gross incomes are from $60,000 up to $100,000.

The adoption tax credit will help many couples who cannot have children biologically, but are also unable to afford the cost associated with adopting a child. David and Mary Przybylski of Frankfort, Ill., are a working-class couple who felt strongly that they wanted to provide a loving environment to children who would have no opportunity to escape the orphanage life they had been living. They saved for years so they would have the money necessary for all the expenses involved and their desire to adopt three Polish orphans. While they were successful in their efforts, the cost incurred by David and Mary totaled about $25,000. To meet this excessive cost, the Przybylskis were forced to borrow from their families and are still paying them back.

David and Mary do not hesitate to say that they would do it again, but the adoption tax credit, H.R. 11, would go a long way to help loving couples like them who are eager to adopt children. Moreover, the extent to which the tax credit provides homes for children in State programs should reduce State foster care costs.

Mr. Chairman, thank you once again for allowing me the opportunity to testify in support of this historic legislation that is an important step to restoring our commitment to America's families.

Chairman ARCHER. Thank you for your testimony, Congressman Weller.

Mr. WELLER. Thank you, Mr. Chairman.

Chairman ARCHER. It is my understanding that none of my Republican colleagues have asked to inquire. There may be one or two inquiries on the Democrats' side.

If I might, I would like to ask any Democrats that wish to inquire to raise their hand.

Three. So we will take you in order. Charlie Rangel will inquire.

Mr. RANGEL. I want to thank those Members that have taken time out to testify on behalf of the refundable tax credit to encourage and make it easier to adopt. Obviously, the only one left is Bob Dornan, and I would want him to tell his colleagues that the lack of questions certainly does not indicate a lack of interest. I hope perhaps we can get together and see how many other people, in view of all the complexity involved in this Contract, can get together and make certain that the kids are not forgotten; and two, I want to thank you, Bob Dornan, for the passion that you bring to this issue—and probably most other issues, some that I disagree with. But those that I do agree with we won't mention because it would hurt my reputation, as well as yours, for people to know this.

But I do want to state for the record, it is so important that we as a nation, as a civilized nation, try to bring human beings together, especially to remove the stigma of adoption. The only people who have no feeling at all about the stigma are the adoptive parents who have forgotten completely that their children were adopted, and of course, the children themselves that were the beneficiaries of this type of love, knowing that they were selected, even as other children were not expected. So to make it easier for people to get together to love is certainly something that falls right into the family value concept.

Congressman Smith touched on the subject of at-risk children and hard-to-place children, and unfortunately, I have to really study these terms, because they mean me and people who look like me. I would want you to know that as we look at the problems of adoptability that one of the major problems that average Americans have is that the children who are placed for adoption come from communities where most of the people around them can't afford to adopt; and two, the unwanted children come from communities that, if you take a look at it and forget black and white, are the areas of the highest poverty, the highest unemployed, the highest high school dropout, the highest drug addiction, the highest crime, the highest violence, and the highest number of people who go to jail. So there is no wonder why the children are at risk or hard to place.

I hope that we, Bob, can work together to alleviate those conditions and to use, not tax credits for the problems we face in our community, but to use education credits to make certain that these kids have hope that they don't have to have children in order to have expectations in America.

If you take a look at the kids from these communities that are employable, that are working, they are not making the babies, they are not doing the drugs, they are not doing the violence. So we can create an atmosphere where, just like family values say, kids say, I can't mess around because it would ruin my life. If they have no life expectations to ruin, then the question is, what difference does it make?

In working with you over the years, Bob, I know that you understand exactly what I am talking about. I know it is consistent with your views, and I want you to know I support 100 percent the legislation you and others have sponsored over the years. I hope I can depend on you to interpret to other Members what they really mean when they say at-risk and hard-to-place children. Thank you, Mr. Chairman.

Mr. DORNAN. Mr. Chairman, could I respond to my colleague?

Chairman ARCHER. Yes.

Mr. DORNAN. One of the reasons I have gotten along so well with you, Mr. Rangel, over the years is you know I sincerely mean it when I say you are the preeminent voice on Capitol Hill and across America on fighting back against the scourge of drugs in our country and what it has done to literally turn some neighborhoods into what would more properly resemble a war zone.

Your excellent remarks give me an opportunity to discuss a statistic buried in the statistics that I and Mrs. Vucanovich and Mr. Smith have used that really shows the literal potential to turn around some of the social problems in our country by adoption, and why it is truly an investment in the future of our country; and it has to do with families and young children born of African-American heritage. In one of these studies—and unfortunately, all the studies on adoption are not really current; they are not the last 2 or 3 years. This one is over 10 years old. It says that as you break down the numbers of 5 to 6 percent of unmarried teens placing their children for adoption, you see a dramatic difference by race. African-American young mothers place their babies for adoption at less than 1 percent—far less, 0.4 percent—and with white

mothers, 10 years ago, it was 12.2. Again, I don't know how that is skewed by those of Hispanic heritage or not.

Unfortunately, black children constitute 14 percent—again, this is 10 years old—of the child population; probably more now. They account for 30 percent of the children in foster care and more than 38 percent of the children awaiting adoption. Well, as a grandfather of nine and a father of five, I can tell you that in my family, if we had had the opportunity to adopt—and we did try to go for a number six and were told the odds are impossible against you because you interfere with childless couples who are dying for their first child. Among my five, I had four redheads and a brunet. I can tell you that if that brunet were an adopted child of African-American heritage, he would have blended into my family equally as well as my brunet trying to be raised with four redheads.

When I would go to the beach, I am lathing on sunblock on the four redheads and my brunet is running in, getting a nice tan. I think we are going to have to push, push, push for Americans of Caucasian heritage to adopt black children. Otherwise, it becomes a heart-breaking situation—particularly older children 2, 3, 4, up to 12 years of age where parents come in and the white children are adopted out and the black children are left heartbroken.

We are going to have to resolve this problem, and it seems so sad that the first step we have to take is to give a small tax break, even one that seems big of $5,000, when the expenses are sometimes $20,000 or more.

Let me just conclude by saying, a few months ago, I am at a soccer game for one of my grandkids in San Juan Capistrano. Here is a beautiful 4 year old watching her brothers who were stars of one team. I said, What a beautiful little girl; what is her name? They said, Alexandra. The mother says, I adopted her on my birthday in Russia, this gorgeous little Alexandra. I thought, with all the American children that need to be adopted, this poor mother had to go into Russia to get this beautiful little girl.

That one story, as I listened to it, tells the whole tale of why this tax exemption is so needed. We can't have Americans running to this hell hole of a situation that exists in Romania after the Communist collapse there and have these little American children just wasting away, craving for love, in our homes around this country.

Let's you and I work together on it, Mr. Rangel.

The CHAIRMAN. The gentleman's time has expired.

Mr. Jacobs.

Mr. JACOBS. Thank you. Chairman Archer and I have some things in common. First of all, we do not take PAC contributions. Second, we both complete and submit our own income tax returns, as you do. Third, we are both either from Texas or Indiana, which I want to mention in the case of Steve Buyer. Thank you for coming.

Bob, I just wanted to say for the record, I take a great deal of pride in having cast a vote against the 1986 tax act for a number of reasons. I will only mention two. One is that somebody from some network came in—I guess he may have interviewed Bill, too; I don't know—interviewed the members of the Ways and Means Committee who made out their own taxes. His first question to me

is, Don't you find it awfully complicated? I said, It was no problem at all until they simplified it in 1986.

But the most egregious offense, it seems to me, in that so-called Tax Reform Act—it was precisely that Act that repealed the provision you are talking about. I considered that an unqualified outrage. The motive for it was that a nun with her rosary beads wouldn't have been safe that last night when they were trying to make the numbers work for a 28-percent marginal rate. Everything went over the side for it. I would hope that all of us would take a closer look at that, because that was clearly a case of getting the cart before the horse. I commend your concern about this.

I might add that when President Bush was elected, I was standing in my workshop out in Indiana, and I listened to his first news conference. One of the first things he said was that he wanted to restore this exemption.

Bob, that was beautiful.

That is all.

Chairman ARCHER. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman. I want to thank all my colleagues for their testimony this morning. I regret that their schedules prevented several of them from staying here for questioning. As has been pointed out by Mr. Ford, there is bipartisan support for the credits concerning adoption and custodial care, and Democrats and Republicans look forward to working together in order to advance these proposals.

I would like to make just a couple observations, and I welcome any comments from our colleagues.

There is an anomaly that we confront. There are more parents who want to adopt than there are children available for adoption. The only exception for this is hard-to place children. The previous provisions that were in the code recognized that fact and provided special help for difficult children because of their physical conditions or other problems of age, et cetera. I would hope that as we look at this particular provision, in establishing a new entitlement in the code, that we look at trying to make sure that the relief goes to provide the best benefit for those children who otherwise would find it difficult to be adopted.

The second point I would just like to make—and I welcome your comments—is that I find it somewhat ironic, that as we are looking at this total tax provision and establishing new entitlements for custodial care and adoption, which I fully support, which will provide an entitlement for families with income up to $172,000, we are eliminating the entitlement program that is most important for low-income people, AFDC.

Many of us understand that welfare needs to be reformed, but in the process, the recommendation is to eliminate AFDC as an entitlement program. Yet we are creating new entitlement programs here for adoptive care and custodial care. We should be working to establish entitlement programs for our poor people as well as middle-income people.

Mr. DORNAN. I wouldn't want to play one off against the other. I have to admit my concentration has been on this, not on the other; and that is why we are all here, I guess, to work this out. This one literally screams out to be revisited and brought back into

our House code. I hope on the House floor we don't play one against the other but argue each on its separate merits.

Mr. CARDIN. Bob, I agree with you completely. I don't want to play one group off against the other.

It is somewhat disappointing that the recommendation is to eliminate an entitlement for the poor and create a new entitlement here today. That is one of the issues I hope we can work on, Republicans and Democrats, and come forward with proposals that are fair to all Americans.

Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, Mr. Chairman, for appearing before the committee.

Mr. MCDERMOTT of Washington. Mr. Chairman.

Chairman ARCHER. I am sorry, Jim; I didn't see your hand up. Dr. McDermott will inquire.

Mr. MCDERMOTT. Like Mr. Cardin, I regret that some of the Members who testified didn't stay, because I think you raise some very interesting issues.

Like Ben, I see some real ironies because many Members who are here testifying today were voting against the family leave bill several years ago—which is a bill to deal with the issue in many families of taking care of a family member. When we proposed in this committee a $400 elder care tax credit in 1991, it was laughed off as too little by the other side. So we add $100, and it is now OK.

But I think there is a deeper problem here than those ironies, and Ben alludes to it. When I was a freshman in the Washington State legislature in 1971, I passed a bill for an adoption subsidy for people who were adopting hard-to-place kids, which we defined as mentally handicapped, physically handicapped, or mixed racially. If you could demonstrate to the State that you had a cost above those costs of normal child rearing—because nobody gave me $5,000 when I had my two kids—so if you could justify costs above the normal cost of raising a child, the State would subsidize that. To me, that makes sense; that is the kind of specific program I could support.

The proposal here is just to fire up in the air a couple billion dollars and hope it comes down on the right people, and in my view, that is not a good way to use the taxpayers' money. I really—the question I have, and I keep asking myself is—if you are going to deny welfare to young women under the age of 18, what do you think the impact of that will be? Will that drive them to abortion or to put the children up for adoption? What do you think the impact of that particular part of the Contract With America is?

You are going to take welfare payments away from young women under 18 who have a child. Is the effect that they will give it up for adoption, or are they going to say, I can't pay for this so I am going to get an abortion? Which do you think will be the effect of that public policy? Because when you socially engineer from the Congress, you have to have some idea of what you are trying to create out there.

Mr. BUYER. I would say to the gentleman we are trying to create a stronger family base, stronger family unit. We know doing it your

way over 40 years of social engineering has created an atmosphere which has not been conducive to the American family.

When you say about doing a shot in the air, what we are trying to do is much narrower focus, whether it is taking nutritional programs in the welfare plan—we are not here on the welfare program. If you are throwing this up in this discussion, whether it is trying to take our 10 nutritional programs and send them back to the States, bringing—bringing government, whether it is to the States and to local communities, we want to not only empower local governments, but we also want to give—empower people and parents. So that is why I came here to testify on the $500 tax credit, and what it does to working families.

If you want to get into a discussion of, well, if—in fact, if we do this, will this mean there will be more abortions versus strengthening of the families, I don't want to get into quibbling with you. But that is a matter of discussion.

Mr. McDERMOTT of Washington. Thank you, Mr. Chairman.

Chairman ARCHER. The Chair recognizes Mr. Shaw for 30 seconds.

Mr. SHAW. Thank you. Thank you, Mr. Chairman. I only did ask for 30 seconds.

I just wanted to place in the record a problem that does exist and is an impediment toward adoption. It is State law that concentrates on reunification of the family, which is a noble goal. There are, however, literally thousands of kids in foster care that could be adopted if State law would try to measure the benefit to the child; that is, look primarily at the benefit of the child and the future of the child where adoption is the only logical alternative.

All of us want family reunification where it can work, but I think we need to encourage the States to expedite the procedures they go through to make the determination as to the future of these kids that could otherwise be adopted. People are going to Russia to adopt a child while knowing that there are kids here in foster care that are every bit as adoptable, and should be made available for adoption.

Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, both of you gentlemen, for coming and giving us your time, and for your excellent testimony and pointing out one of the very, very important provisions in the Contract With America, that is, a facilitator to create a support mechanism of love and help for children, which is probably the most important thing that we can do with our lives.

There is a true story that occurred in Houston about three little boys who were playing together, one of whom was adopted. Within a couple of hours, the other two were going home in tears. When they got home, they told their parents that they really were inferior because little Jimmy, who was adopted, had told them he was very special, that his parents picked him out voluntarily, and that the other two children's parents had no choice. I think that is a beautiful story that can occur when adoption is handled in the right way, and these children realize how very special they are because their parents chose them voluntarily. We should eliminate the monetary roadblocks that might exist to permit every parent,

every set of parents that wishes to adopt, the opportunity, economically, to adopt every child that is up for adoption.

Thank you very, very much.

Mr. DORNAN. Thank you, Mr. Chairman.

Chairman ARCHER. If our next panel would please take their seats. I want to announce a change in the committee, a change in the normal way that we proceed.

Two of the witnesses on our panel have asked that they not be filmed or photographed during their testimony in order to preserve their privacy and that of their child. I feel that it is essential that we accommodate them. So without objection, we will receive the testimony of the other members of the panel and go through their questioning period; and thereafter, we will take the testimony of Doug and Valerie, adoptive parents, separately so that the pool camera can be removed from facing them head on.

If the three witnesses will take their places, and our colleagues.

At this time, I would like to call on our colleagues, Dan Burton and Deborah Pryce, to introduce our first witness, who really is no stranger to any of us in this room, I am sure. But since he is from your area of the country, I recognize you to make that introduction to the committee.

STATEMENT OF HON. DAN BURTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. BURTON. Mr. Chairman, it is a great honor for me today, even though I don't represent Mr. Thomas' district, to introduce one of—I think, one of the finest people in this country. He is a great success story.

Dave Thomas started with nothing and has built one of the most successful businesses in the world. I think they have over 4,500 outlets now, maybe even 5,000. He started as an adopted child. He really didn't have anything to start from; he had a tough childhood, and he did it on his own. He is a real credit to the free enterprise system and himself.

He has become not only a great businessman, Mr. Chairman, but he is a great human being, as well. Many people, when they make a lot of money, become very successful, forget their roots, forget where they started. Dave Thomas has been very, very concerned about children who started like he did, children who don't have parents, children who need parents, who need adoption. As a result, he started the Dave Thomas Foundation for Adoption, and he has raised a tremendous amount of money to help in this regard.

He has several programs that he sponsors every year. One is the Three-Tour Challenge. I am a golfer, and I love that. He has the women's tour—the LPGA, the PGA, and the senior tour—play in competition. I think this year they raised over $465,000 to help in the area of the adoption of children.

He is just one of the finest Americans we have in this country. It is a real pleasure for me to be able to introduce him to you today.

Chairman ARCHER. Congresswoman Pryce.

STATEMENT OF HON. DEBORAH PRYCE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Ms. PRYCE. Thank you, Mr. Chairman and members of the committee.

I want to thank you for holding what I regard as a very, very important hearing today and it is my pleasure to cointroduce David Thomas, the founder of Wendy's International Food and international spokesman for adoption issues.

I am proud to have Wendy's corporate headquarters located in my Ohio congressional district and to be friends with many in the Thomas family. Mr. Thomas is a leader in promoting adoption. In 1990 he began an awareness program at Wendy's that included posters, tray liners, and commercials promoting the adoption of children. In addition, the corporation provides each employee a benefits package that may be used to defray the costs of adoption.

In 1992 the Dave Thomas Foundation was established to promote public awareness of adoption, and today I would like to commend Mr. Thomas for his leadership in this area and for raising the issue to this level of debate, because as many of you know, I am an adoptive mother of a 4-year-old and the issue has a very important place in my heart.

In the debate about policy and taxes, as they apply to adoptive parents, it is easy oftentimes to lose sight about whom we speak. After all, these are our Nation's children. Adoptive children come into our lives for many different reasons, but in the end, what an adopted child brings are all the joys and all the pains of parenthood. When we speak of adoption, we speak of commitment and hope and sharing. We speak of the values we, as Americans, hold most dear—the willingness to help others, birth parent and child alike at uncertain, frightening, and often difficult times; the commitment to build strong and enduring families, families that are filled with love and filled with laughter; and a choice to nurture a child and help it reach its dreams. They are, after all, our children, our Nation's children.

There are approximately 1.5 million adoptive families in the United States, equal to 2.2 percent of all U.S. families. Every year more than 60,000 adoptions take place in the United States, while another 8,000 Americans adopt an international child. By providing families a tax credit for adopting, more children will come into loving homes and loving families. There are tens of thousands of children waiting to be embraced into caring families, willing to raise them in an atmosphere of love, self-respect, and responsibility. Adoptive families are 100 percent functional, happy, and whole.

I look forward to my continuing work with Mr. Thomas on this issue so that permanence becomes the norm in all our Nation's families, and foster care and group settings should only be for transition.

As a member of the Congressional Coalition on Adoption, I look forward to working on promoting rational, caring adoption policies, and I applaud this committee for its work. At this time, I give you Mr. Thomas.

Chairman ARCHER. Mr. Thomas, you are a very popular person, because our member up here on the committee dais, Mr. Shaw, also wants to claim you as a resident of Fort Lauderdale.

Mr. THOMAS. Thank you very much.

Chairman ARCHER. I don't want him to lose out on the ability to claim you, too. We are most pleased to have you here with us.

STATEMENT OF R. DAVID THOMAS, WENDY'S FOUNDER; CHAIRMAN, DAVE THOMAS FOUNDATION FOR ADOPTION; AND CHAIRMAN, WENDY'S INTERNATIONAL, INC.

Mr. THOMAS. Thank you very much.

Thank you, Congresswoman Pryce and Congressman Burton—appreciate your being here.

Mr. Chairman, members of the committee, good morning. I am Dave Thomas and I'm here on behalf of the Dave Thomas Foundation for Adoption. I appreciate the chance to talk to you today about adoption, because it is a subject that is close to my heart. I know firsthand how important it is for every child to have a home and a loving family.

I was born out of wedlock and adopted when I was 6 weeks old. I never knew my birth parents. Life wasn't easy. My adoptive mother died when I was 5 years old, and my father remarried and moved from town to town, looking for work. But without a family, I would not be where I am today.

Right now, in America today, there are about ½ million boys and girls in the foster care system and 100,000 more are waiting to be adopted. Many of these youngsters are special needs children—they are older, they come from minority cultures, they have brothers and sisters who want to stay together, or they have physical or emotional challenges.

It takes an extra effort for families to find and adopt a special needs child. The Dave Thomas Foundation for Adoption works very hard to let people know about these boys and girls and share the success stories of those who have been adopted. We've developed special service announcements for radio and TV on adopting children with special needs. We put posters in all our Wendy's restaurants and feature special needs children who are available for adoption. You would be surprised how many calls we get from parents who want to adopt kids on these posters, and many of these potential parents don't know where to start. That is why we created a Beginner's Guide to Adoption, to help them understand the adoption process. We distributed nearly ½ million copies across America.

I really believe there is a family for every child who is waiting to be adopted in this country, but to reach this goal, potential parents need your help. We need to make adoption more affordable. The average adoption in this country costs about $9,000 or more. Most families have to pay for this alone and many simply can't afford it. That is why I support a $5,000 tax credit for parents who adopt. It is a great way for government to help build families without creating more programs. For parents who adopt a special needs child, I want to ask you to aim for even a bigger step of providing an additional $5,000 refundable tax credit.

Now, many of these kids come with special costs, like long-term counseling or extra doctor bills. I think $10,000 is a fair amount and a wise investment. I wouldn't be here today if it didn't make

sense and if it wasn't the right thing to do. We have to make adoption available to Americans who can't afford it right now.

There is another way you can help. As the largest employer in America, if a Federal Government employee has a baby, the costs of the child's birth are covered by medical insurance. Isn't it fair to cover legal or medical costs for an employee who adopts a child? For several years, I have been asking employers throughout the country, both public and private, to offer employees who adopt the same benefits and paid leave they provide for the employees who give birth. Now I am asking the same of the Federal Government.

Wendy's is one of hundreds of companies that offer adoption benefits, and the number grows every day.

Last year I spoke to the National Governors Conference and asked them to provide adoption benefits to State employees. Today, at least 30 States provide adoption benefits or plan to. These ideas are so simple and so fair, and it is so important for us to make them happen.

In closing, for all the young boys and girls waiting to be adopted, I ask you to remember this: It is not their fault. They can't change their situation; they can't solve their problem alone. But as partners—business, government, and local communities—we can make it easier for these children to become part of a loving family.

Adoption gave me a solid start in life. Let's help parents adopt special children. They grow up to be special people.

Thank you very much.

[The attachment to the prepared statement is being retained in committee files.]

Chairman ARCHER. Thank you, Mr. Thomas. We are very pleased to have you here today. I am glad you will be able to stay for some questions from the panel.

Mr. BURTON. Mr. Chairman, we can't hear you. Is your mike on?

Chairman ARCHER. Yes, it is. I have noticed that when your hair begins to turn a little gray, you also have a little trouble sometimes with the functions of your ear.

Mr. BURTON. I know, because I suffer from the same things.

Chairman ARCHER. Dr. Pierce, we would be pleased to have your testimony.

Dr. Pierce is the president of the National Council for Adoption, Inc., and we are delighted to have you with us today. You may proceed.

STATEMENT OF WILLIAM L. PIERCE, PH.D., PRESIDENT, NATIONAL COUNCIL FOR ADOPTION, INC.

Mr. PIERCE. Thank you, Chairman Archer, and thank you, distinguished members of the Committee on Ways and Means, several of whom we have had the opportunity to testify before about the need for tax equity for families who want to adopt.

I have a long prepared statement, Chairman Archer; and with your permission, could we have it put in the record?

Chairman ARCHER. Without objection, it will be inserted in the record; and we appreciate your keeping your verbal comments to the committee as succinct as possible.

Mr. PIERCE. Thank you, Mr. Chairman.

The issue of tax credits for adopted children is truly a bipartisan issue. It has been heartwarming to once again sit out in the audience and hear both from you, Mr. Chairman, and from Mr. Rangel, who has had a distinguished history in support of tax breaks for adoptive families.

It has been a bipartisan issue that has been endorsed by the Congressional Coalition on Adoption, several members of whom, including Congresswoman Payne here, is a member. I would invite all of you who are in the Congress to take part in that caucus. It is one of those caucuses that is not funded by any tax dollars, so it is, hopefully, not controversial. It is bipartisan and bicameral. Here in the House, since its founding, it has had distinguished Republican, Mr. Bliley of Virginia, distinguished Democrat, Mr. Oberstar of Minnesota, as the cochairs. Both of those people are adoptive dads. So adoption is something that is close to their hearts, and they have been very helpful.

We also like to claim Dave Thomas, as well, because Dave is one of the distinguished Americans who serves on our board of directors. In fact, Dave is in charge of the special needs committee work that we do in our organization.

This is really a very simple bill when you get down to it. It is very helpful. I hope that as the debate continues, consideration continues, that you will keep your eye on the main issue here, and that is, are kids waiting? Are there children who need to be helped? Are there children that are babies that we need to prevent ever getting into that foster care system?

When we hear people talk about, "Why do you want some kind of a tax break for babies?", the answer is because if we don't get babies adopted, then they will end up in the welfare system. They will end up in foster care. They will end up these expensive special needs adoptions that we are all familiar with. We are talking about the most basic humane kind of prevention here when we are talking about tax breaks for everybody who adopts any child.

Today's healthy white child that is born in Appalachia and ends up in the welfare system and rattles around that system for 5 years will be tomorrow's special needs kid. You are going to have all kinds of witnesses come up here and say, yeah, we need $10,000 or $15,000. We don't know how much it will cost to get a family for that child. Because he has been abused, he has been neglected, he has been ruined.

We say, spend $5,000 early on before the kids are ruined. Let them be adopted at 6 weeks, like Dave Thomas was. The battle here is not between two equally good choices for kids. It is really a battle between business as usual, which is to basically turn the kids over to a system that is funded by hidden tax dollars, dollars that are off the ledger.

When we had that tax change—and I heard Mr. Jacobs talk about it earlier; when we had that tax change in 1986, we had a piddling amount of money going for our little tax deduction. We tried to broaden it, and instead, we got creamed and the people took it off—off the front page and hid it as a multimillion dollar multiple in the public welfare system. It has been a tremendous disaster.

We have tried, in the Ways and Means Committee and technical markups, year after year after year to clean up that 1986 mistake. This is your opportunity to do it now. There are parents all across this country that need help.

I hope when Congressman Weller was testifying you heard about the Przybylskis, a family in Chicago who went over to Poland and adopted three kids. They ended up having $25,000 in costs. This family needs help, too.

I think, as you look through the testimony today, you are going to see that not only does Dave Thomas, not only does the National Council for Adoption, but Adoptive Families for America, the American Academy of Adoption Attorneys, Families for Private Adoption—they represent the vast majority of Americans that don't often agree on all these issues, who say this is an issue whose time has come.

If you want to add to this bill, and that is obviously your prerogative, that is fine. There may be things that you can add to make it even better. But I can tell you that, for us, after waiting for 15 years, we would be very glad to have this particular piece of legislation—which, thank goodness, was part of the Contract With America—become law just as is. You can come back in the second 100 days and improve it, if you want, add fine tunings. But we would be just happy if you do this piece of legislation.

Thank you, Mr. Chairman.

[The prepared statement and attachment follow:]

STATEMENT OF WILLIAM L. PIERCE, PH.D.
PRESIDENT, NATIONAL COUNCIL FOR ADOPTION, INC.

Mr. Chairman and members of the Committee on Ways and Means, my name is William Pierce and I am the President of the National Council For Adoption. Here today with me is Cassie Statuto Bevan, our Vice President for Public Policy. Thank you, Chairman Archer, for inviting us to testify today before the Committee.

The National Council For Adoption was formed in 1980. Today it represents 130 agency locations across the United States as well as several thousand individual members -- those who have been adopted, people who have placed children for adoption, adoptive parents, social workers, lawyers and people from all walks of life.

We are a non-sectarian and non-partisan organization, with our headquarters here in Washington, D.C. and formal affiliates in Texas, Pennsylvania and New Jersey and informal state affiliates in many other locations.

We strongly support the Family Reinforcement Act, which would provide tax benefits for those who adopt children, as many of the members of this Committee well know because we have been before the Committee on previous occasions. In fact, when we work with those who are members of the Congressional Coalition on Adoption, a bipartisan and bicameral caucus -- not supported by any tax funds, I might add -- the issue of tax fairness for adoptive families is always on the agenda.

This is the first time we have had a chance to testify on the kind of bill we have always preferred -- a refundable tax credit. This bill, preferably without any phase-out or "cap," is something we wholeheartedly endorse.

We endorse this bill for many reasons. It is needed by children. It is needed by parents. It is needed by the agencies and others who are not supported by tax dollars. It is needed by America.

It is needed by children because without a refundable tax credit, many children who would otherwise be adopted will be denied loving, permanent adoptive families. It is our estimate that there are 100,000 children who are waiting for adoptive families in this country -- stuck in the system, often because of financial reasons. These children are disproportionately of mixed ethnicity, or of African-American, Hispanic/Latino, Native American or Asian background.

These children are in the custody of or are placed by either the public or private sectors. A February, 1991, CRS report, Adoption: Federal Programs and Issues, says that about 15 percent of the children who are adopted in the U.S. come through the public child welfare system. Therefore, the tax credit could benefit about 85 percent of the children adopted each year.

It is needed by parents because without this financial help, many who could handle the day-to-day expenses of rearing a child who needs adoption can't handle the full fee for adopting. $5,000 would make all the difference in the world to them. And for others, like Valerie and Doug who are with us at this hearing today, a tax credit could mean the difference between adopting one child or two. This credit, in our view, should be available to every family who adopts, regardless of their income because it subsidizes an appropriate, family-building activity. It sends a clear signal that adoption is a legitimate way to reinforce the principle that children grow up best when they have a permanent, competent, loving family.

The tax credit is needed by the agencies and others who are not supported by tax dollars but who serve pregnant women and women in crisis and help find adoptive families for children. These agencies and people want to serve every woman and every child who comes to them, but without at least some minimum guaranteed level of fee that they can count on, they have to make a terrible choice. They can either continue serving everyone for a while, operating at an ever-deepening deficit and then bankrupt themselves leaving no one to help those women and children -- or they can operate on a sound fiscal basis, help those they can afford to with the contributions and money they can raise, and stay alive to serve some of those who come to them. If they know at least $5,000 per placement is available to reimburse part of the agency, legal and medical expenses that are incurred most of the agencies and people in the private arena will be able to drastically decrease the numbers they have to turn away. They turn away those who are likely to deliver children who will be difficult to place for adoption for a fee equal to cost outlays. Sometimes, they have to make placement decisions not on the basis of who would be the preferred parents but who has the $5,000 to partially reimburse costs.

It is needed by America, and doubtless is part of the "Contract With America" because it makes common sense. This kind of approach is something people with very differing philosophies and politics can agree on. Let me give you an example of what I mean. Two weeks ago, we convened a Conference at Hershey, Pennsylvania, and brought together about 30 experts from across the country to look at some of the issues that are in the Contract With America. These experts were from the fields of law, medicine, social work, psychology, and education. They were from the public and private sectors. They were ethnically diverse. By the end of the Conference, we had hammered out 20 recommendations. Recommendation number 16, which reads "To promote adoption, a refundable tax credit for adopting parents of $5,000 per adoption should be created," was accepted by a vote of 22 for, 1 no and 1 abstention. In a day when consensus is difficult to reach, it is highly significant that 90% of those voting endorsed the refundable tax credit. Such a plurality goes well beyond a landslide in public opinion.

The reason an adoption tax credit is good for America is that it translates common sense into public policy. Currently, the federal government is paying thousands of dollars per year per child, with tax dollars, and the results are miserable for the children. Most are not growing up to be healthy, productive citizens. Many go on to dependency status on welfare or in prisons. The price tag could easily average, even taking some of the absurdly low estimates we have seen from the Department of Health and Human Services, that welfare only costs $300 per month. Spending a maximum of $5,000 on a one-time tax credit to help kids get good families and to avoid the destruction of hundreds of thousands of young lives is far better. It is better for the children. It is better for a society that is increasingly fearful of the angry, violent children that are a feature of nearly every community. It is even better for some childless couples who would rather adopt than go through the painful, costly and often ethically-questionable process of infertility treatments.

There is a history of tax discrimination against adoptive parents, with only one true bright spot, that enacting this legislation would put aright.

There has been bipartisan interest in giving adopting parents a tax break for more than 15 years. Some of those who worked long and hard for such breaks have retired from the House -- like Bill Lehman of Florida. Others, and I include some on this Committee, like Charles Rangel, have long had an interest in getting some sort of tax break enacted. Among Republicans, Chris Smith of New Jersey certainly has been one of the leaders and was one of the first to speak about the need for a tax credit, going beyond the tax deduction approach.

So there is a history of bipartisan support for tax help for adopting parents.

Nearly 15 years ago, largely through the efforts of a Republican Senator from Iowa, Mr. Jepsen, a modest tax deduction for children with "special needs" made it through the Congress and was signed into law.

But it wasn't long until, under the guise of "simplification," those who were opposed to parents who adopt from non-government sources struck back. They convinced the Congress to wipe out the tax deduction for children with special needs and to give the public sector a blank check to help some families and some children. In the process, the intent of Congress was lost and we spent two sessions trying to get the problem fixed up through a technical amendment. The problem never was really fixed. We are in 1995 treating adoptive families who adopt from non-public sources more inequitably and unevenly than we did 10 years ago. So much for "improving Sen. Jepsen's simple, clear legislation"!

That is why we are so pleased to have the refundable tax credit as part of the "Contract With America". We certainly endorse this provision, and would ask that it be extended to all families, regardless of their income.

Why do this? How is this common sense, when people making over $200,000 a year would get a tax credit? Let me give you a real example, without using names or locations, to protect the privacy of the family involved.

I know a family that does have gross adjusted income in excess of $200,000. They have adopted several children, all from non-public sources. None of them are getting any subsidies or government help. Some have special needs. The last child has very challenging medical needs. Those needs are such that this family is putting out $3,000 per month for health care assistance so that the baby can be cared for at home by the stay-at-home Mom, with help, as the baby develops and its health status improves. Even with an income of $200,000, $36,000 in extra medical help for one child takes a big bite. Even at this income level, a $5,000 tax credit could make the difference between some child who needs a home getting one or not. Had this family not been financially able to pay the initial agency fee, the child would have had to have been referred to a public agency, where the baby would have likely languished for years at a great cost to taxpayers.

I think it is also important to keep in mind that the tax credit will help provide real options to families who would like to adopt, who have modest incomes, and who are members of racial and ethnic minorities. There are many families, working at low wages, often in rural areas who would be glad to adopt but they want nothing to do with the public welfare system, the child welfare system or the foster care system, which have too often been hostile and unresponsive to the option of adoption. They would adopt if there were a private agency they could go to, and they had some financial help to enable them to go with their heads high rather than their hats in their hands.

Let me give you an example from one of our member agencies in Houston, Texas, Los Ninos International Adoption Center. This agency used to provide services, as part of its program for American kids who need to be adopted, to a variety of children, including special needs children and healthy babies. Many were African-American or Latino/Hispanic. The combination of state regulations and a 100% tax-subsidized public sector which could offer "free" services to everyone drove them away from serving American kids. And this was true even though this agency had found a foundation that gave them a grant to help subsidize some of the costs of some of the adoptions. Many of the pregnant women that used to use this private agency's services now must go to the only other place they think will make adoption services available to them -- public agencies. They then are offered welfare and family preservations services and, generally, adoption services as a last and belated resort. Or they make choices other than adoption, choices they would rather not make, choices that are not in the best interest of children. One of those choices, when the young

woman is fearful enough, or has received no decent counseling, or sees no way to preserve her or her family's privacy, is literally throw the child away.

The refundable tax credit is at the top of our domestic "wish list" for this Congress. But this tax credit will also benefit families who are adopting children from other countries, children who are desperately in need of homes. These families often have very high costs because of the need to travel to those countries and complete the adoption, and they sometimes need to stay there for two to 12 weeks while their papers are being processed. These Americans are doing something tremendously heart-warming and humanitarian. They are Polish-Americans and Lithuanian-Americans and Russian-Americans and they have backgrounds from the Philippines or India or Korea or China and they have a special bond with the children who need families and who in those countries. That's why this makes so much sense. Why not help American families with a $5,000 tax credit so they can adopt children who are already born and in need of families rather than subsidize the infertility treatment industry, where in vitro fertilization and other exotic interventions provide a $50,000 price-tag for a 25% chance of having a healthy pregnancy? I would suggest that someone look at the tax consequences at the federal and state level of mandating broad insurance coverage for the infertility treatment industry and compare it with the social, ethical and fiscal alternative of a $5,000 tax credit.

I also hope that some of you who are concerned about the children languishing in foreign countries, and I know this is important to many ordinary Americans who are your constituents, will keep in mind one other issue that is not in the Contract With America but is at the top of our agenda for international programs. A new international treaty to smooth adoptions between countries has been drafted at The Hague and the U.S. needs to set up a system to fit into that treaty and then ratify that treaty. Ideally, both of those things should take place in the same 100 days that the Speaker has indicated will be spent focusing on the Contract With America. So, please consider slipping this priority in among the other work you are doing in those first 100 days and if that's not possible, please make it your first adoption priority for the second 100 days.

Thank you again for inviting us to testify. I would be glad to answer any questions you may have about our statement, about the recommendations that came out of our Conference two weeks ago at Hershey, or any other matter within the jurisdiction of this Committee.

THE FINANCES OF ADOPTION: A LOOK AT REVENUES AND EXPENSES

THE FINANCES OF ADOPTION: REVENUES

As consideration of a refundable tax credit for expenses incurred by those who adopt children begins in the Congress, it may be useful to review the sources of revenue which support adoption.

Public agencies

Commonly, the various public agencies providing adoption services are supported by tax revenues. It is our estimate that the mix is about 50% federal and the remainder of the tax revenues are a combination of state and local taxes, predominately state taxes in most instances.

Rarely, public agencies will seek fees for service from those they serve. This is most common in respect to fees for "home studies" -- usually a series of screening and orientation sessions for prospective adoptive parents conducted by a staff member of the public agency, usually a licensed social worker with a master's degree.

Private agencies

There are two broad types of private agencies: not-for-profit and for-profit, but the lines between the two types of agencies have been blurring in recent years as some for-profit providers of service, mostly attorneys, have created or formed alliances with not-for-profit agencies.

Most agencies, whether not-for-profit or for-profit, obtain the majority of their revenues from fees. Most of those fees are collected from adoptive parents. Generally speaking, adoptive parents are expected to put together, from a variety of sources, the funds needed to pay fees. The most common sources are: a) adoptive parents themselves, either from savings or from various forms of borrowing, including refinancing of their homes; b) loans or gifts from relatives, usually the parents of the adoptive parents; c) reimbursements from adoption benefit plans provided by employers.

Other major sources of assistance to those who adopt are: a) subsidies and other forms of support from the sponsoring organization of the adoption agency, often a sectarian organization; b) grants or loans from organizations that are set up to assist adopting parents.

Copyright 1995 by the National Council For Adoption, Inc. All Rights Reserved.

One of the major sources of support provided to adopting parents is in the form of donated services from the agency itself, or pro bono help. Depending on the agency, the child which is to be adopted, and a variety of other factors, this may range from as little as 5 percent of the fee to 100 percent of the fee. The agencies which subsidize adoptions for parents usually are enabled to do so because they have other revenue streams to draw from. Those alternative sources of revenue are: a) fund-raising activities of the agency; b) donated services and goods provided by staff and volunteers, especially board members; c) endowment income; d) sale or rental of assets, especially real estate.

Increasingly, for-profit agencies are attempting to model themselves, in respect to diversifying their sources of income, on the not-for-profit agencies. That is why increasing numbers of these agencies are engaging in fund-raising and other related activities.

At the present time, it is our estimate that at least 90 percent of agencies are not-for-profit.

Attorneys

Although there are several professions involved in adoptive placements, or helping people with adoptions, by a huge margin attorney predominate. In general, these attorneys may be divided into two groups: those who specialize in adoption and those who do adoption as part of their overall practice.

Attorneys who specialize in adoption often attempt to diversify their sources of income, much as for-profit agencies do. But their chief source of income remains the fees collected from their clients, the adoptive parents. Some of these attorneys provide substantial pro bono assistance to their clients.

Attorneys who do not specialize in adoption may be more likely than the other group of attorneys, because they have other sources of income to rely on, to reduce or waive entirely the fees they charge adoptive parents. This is particularly true of the attorneys who help with only a handful of adoptions each year.

Other facilitators

In rank order, we estimate that the others facilitating non-agency adoptions are: a) social workers; b) "counselors"; c) adoptive parent support groups; d) physicians; e) clergy.

Social workers, "counselors," and physicians largely depend on fees for their assistance. Of the three categories, it is our estimate that the fastest-growing are the "counselors," usually persons with baccalaureate degrees in fields other than social

work or law. Adoptive parent support groups operate generally like "cooperatives." Most clergy help out pro bono.

THE FINANCES OF ADOPTION: EXPENSES

As complex as the revenue streams that feed adoption is, expenses are even worse. The National Council For Adoption has received a first-hand report of a fee charged by a facilitator that is not an attorney or a social worker that is $40,000. At the other end of the scale, one of the member agencies of the National Council For Adoption charges no fee whatsoever, relying instead on the goodwill of the families it serves, along with its fundraising and its revenues from its endowment, to support its activities. In both instances, the child being adopted may be a healthy baby.

There are a dizzying array of variables as one considers what the expenses may be for an adoption. However, an attempt will be made here to provide some basic rules-of-thumb.

Adoptions of children with special needs

The term "special needs" is used by the adoption field to describe what formerly were called "hard-to-place" children. The definition of children with special needs is generally left to the states but generally includes children who have physical or emotional problems, children who are over age 10, children who are siblings and must be placed together and children who are members of racial or ethnic minorities, including children who are multiethnic. A child may be defined as having "special needs" by one state and not by another; no federal definition currently exists.

Public agencies not only place these children without charging a fee -- in most instances, "adoption subsidies," funded largely by federal tax revenues, are paid to the adoptive parents. These subsidies may range from as little as $1 per month, thereby qualifying the child to continue receiving needed Medicaid services, to several hundred dollars per month in the instance of children living with HIV/AIDS.

Private agencies which operate on a not-for-profit basis often place these children without a fee, relying on excess revenues generated from other sources -- including fund-raising or dipping into capital reserves.

Reportedly, some for-profit agencies and some adoption attorneys also place these children without a fee.

If there is a general rule-of-thumb about adoption of children with special needs, it is that the fees, if any, for the placement of these children are modest. A good-faith effort exists to find homes for them without charging parents fees. This rule-of-thumb also applies frequently to children adopted

from other countries, when the child or children have severe physical or emotional problems, when a sibling group is involved or when the child is over age 10.

It is our estimate that in calendar year 1994 about 15,000 children with special needs were adopted by U.S. citizens.

Adoptions of children without special needs

Certain costs, which we called "Core costs" in Adoption Factbook, are present in all adoptions and are seldom waived in these adoptions. Very few of the estimated 45,000 adoptions in this category are arranged by public agencies at the present time; therefore, the costs incurred to place these children are largely incurred by the private agencies, adoption attorneys, facilitators and adoptive parents themselves.

Residential maternity care

A percentage of the children who are placed for adoption as infants come from women who received residential maternity care. Some of this care is fairly informal, such as that provided by friends, relatives, etc., and may have been provided without charge. Such services are provided for women in other countries as well as here in the U.S. There are residential maternity care services in countries as diverse as Korea, Taiwan, Indian, the Philippines, Colombia, Romania and Russia. Care in the U.S. is provided by maternity service organizations ranging from The Nurturing Network, an organization founded by Mary Cunningham Agee which has served about 500 women who have placed their infants for adoption since its creation, to one of the 300 or so "maternity homes." The costs of providing such care vary dramatically, from country to country and within each country depending on the types of services provided to the women. Costs are much more modest if only shelter, food and basic maintenance is provided. But many residential maternity care programs offer education and job training, courses to help women learn how to care for their babies and counseling aimed at helping them arrive at an informed choice about whether they will try to parent their baby or plan adoption for the child.

In a low-wage, developing nation the cost may be $1 per day. In a major metropolitan area, the cost may be $120 per day. Since the time that a woman needs to spend in such a setting may vary from seven months to none, the corresponding cost factors vary tremendously.

If there is a rule-of-thumb for such programs, it probably is that women are admitted once they reach their third trimester and they are provided services 10 days after delivery.

Taking the least expensive level of reimbursement currently in place for Texas, $1,700 per month, three and one-third months' care would result in direct costs of $5,661.

Many of those who discuss adoption fees do not even include these costs in their computations.

Hospital and medical care for mother and child

As with residential maternity care, these costs vary dramatically from country to country and within countries. In some few countries, all costs are absorbed by the host country. In other countries, in order to maintain a minimal standard of care assistance is needed externally and that help comes from international donations and payments.

In the U.S., it is estimated that about 85 percent of women placing children for adoption have normal, uncomplicated pregnancies. We have no estimates for the international placements.

As recently as 10 years ago, one could generalize and say that most public agency clients were on Medicaid and most other women were not able to qualify for Medicaid to underwrite these health care expenses. Some shift has taken place, however, so that today we estimate that perhaps half of the children being placed for adoption and their mothers were receiving Medicaid assistance.

Not every locality has obstetricians available who wish to participate in the Medicaid program. Not every pregnant client wishes to be on Medicaid. Not every parent of a pregnant client wants a daughter planning adoption to be on Medicaid.

This means that an average bill for prenatal care, hospital care for mother and child and postnatal followup may be $5,000 for a normal delivery. In some instances, agencies can negotiate reduced rates for these services.

It is our estimate that the costs for Cesarean Section may add $2,000 to the average. And a major complication, especially for the newborn, can add $100,000 in a matter of days.

The result is that costs which the adoptive parent's representatives may have to pay -- whether an agency, an attorney or a facilitator -- may range from nothing to hundreds of thousands of dollars.

For purposes of our rule-of-thumb, a normal delivery in the U.S. may factor out at about $3,000 per adoption. In international adoptions, these costs are often absorbed and less easy to break out.

Preadoption foster care

Perhaps half of the children go immediately from the hospital to the adoptive parents, so that no costs are incurred for preadoption foster care. But in most adoptions across state

lines, many agency adoptions and nearly all international adoptions of infants, there are such costs.

In adoptions across state lines, delays resulting from the Interstate Compact on the Placement of Children may require a child to spend several days in foster care. With agencies, even when the Compact is not involved, a delay of 10 days is not uncommon. In intercountry adoptions, foster care of six months is common.

The result is that costs of providing preadoption foster care may be substantial. Rates vary substantially from country to country and within countries. In the U.S., some providers are able to recruit volunteers and they only have to pay for food and supplies for babies. But whether in the U.S. or abroad, the general rule is that the care must be paid for. In some instances, international adoption may result in foster care charges of several thousand dollars.

Given the fact that these costs may vary from $200 to $3,000, our estimate is that the average direct cost may factor out to $600.

"Home studies" or counseling for adoptive parents

In all international adoptions and in most adoptions in the U.S., a process is required to be completed prior to the child being placed for adoption that can be quite expensive. This is called by many names but usually involves a series of meetings with the prospective adoptive parents, the obtaining and review of a variety of documents and records, education and orientation about adoption and, less frequently, psychological testing. Once the pre-placement process is completed, a detailed, written report is provided. After the child is placed with the adoptive family, one or more post-placement visits are required. In some international adoptions, such visits and written reports to the country of origin are required for several years. Depending on the rigor of the process and the person or agency providing the service, a "home study" may cost as little as $250. The most expensive home study that the National Council For Adoption has knowledge of is nearly $6,000.

Consider that an orientation session, four pre-placement sessions, and three post-placement sessions are not unusual. It is not uncommon for the person doing the home study to need to spend two hours in preparation and report writing for each hour of direct contact with the clients. Therefore, if each of the eight sessions lasts two hours, there are 16 direct contact hours to be paid for and 32 indirect contact hours. Forty-eight hours of staff work must be paid for, at rates ranging from at least $30 per hour to well over $100 per hour in some unusual instances. At a rate averaging only $50 per hour, this would translate into direct costs of $2,400.

Indirect costs or "overhead"

A variety of indirect costs are incurred by any provider of services. These include such costs as administrative staff, telephones, travel, insurance (including, sometimes, malpractice, directors' and officers, and errors and omissions coverages) and all the attendant expenses of running any organization.

Most important, especially for the agencies that serve women who may not decide to place their children for adoption, are the costs incurred -- often as much as for those who plan adoption. For instance, one of our Texas member agencies reports that last year it provided extensive and expensive services for free to two women who went through its program and did not decide to place their children for adoption for every woman who chose adoption. Oversimplifying the calculations, that means that if the average cost of serving a pregnant client is $8,000 and if one of every three clients decides on adoption, the cost per adoption is $24,000. It is these very costs which account for the financial crisis being faced by many adoption agencies today, and why they must try to recover some portion of those costs through indirect costs added to the actual costs per client.

Most agencies today do not include attorney's charges as part of their "package." Those costs, which average $1,000 for an uncomplicated situation and add $1,000 for many cases involving the Interstate Compact, are usually paid directly by the adoptive family. However, to economize, some agencies are resorting to in-house legal staff and when this is the case, those direct but reduced costs are added to and factored into the fee.

Another cost that may not be immediately obvious is travel. An agency or attorney may have a pregnant woman travel from her home state to another state for the final months of her pregnancy. Her round-trip air fare, as well as the air fares of the adoptive couple (for the "home study" as well as placement, court hearings, etc.) would need to be added. These costs could easily range up to $4,000 if the delivery took place in California and the pregnant woman was from Minnesota and the adoptive parents were from New York City.

The number of variables are such that it is difficult to estimate what the indirect cost factor is that should be added to the computation. Our guess is that this should be not less than 15 percent and could be as much as 60 percent, and the range would be entirely appropriate given what the particular situation is of an agency. Perhaps 40 percent would factor out as average.

International costs

International adoptions add still another level of complexity. Certain basic costs, ranging from translations to authentication to passports, can be predicted and range from $300

to $3,000. Immigration and Naturalization Service has certain users' fees, as well. Other charges depend on whether the child was escorted to the U.S. to be adopted, as about half were last year, or whether the parents traveled abroad to adopt and bring the child home. In either instance, the costs are substantial. If both parents must fly, the air fare is roughly twice as expensive as if the child is escorted. If one or both parents are required to spend days (or weeks) in the country while the adoption process goes forward, several thousand dollars could be spent and the housing would not be extravagant. In addition, an increasing number of countries are levying varying kinds of fees or requesting consideration of donations which can run from $3,000 - $5,000.

In summary, an international adoption, when all factors are considered, may legitimately cost $7,000 - $10,000 more than an adoption from the U.S.

Attorney-arranged or facilitated adoptions and other options

In adoption, as in all services, there are fairly comparable costs for the same services no matter whether it is an agency or an attorney or a social worker or the adoptive parent who is coordinating the situation. Someone must pay for the expenses of the pregnant woman, especially costs related to the delivery of the child. Someone must pay for well-baby care and various pediatric examinations. Someone must pay for foster care. Someone must pay for travel, housing, etc.

It is claimed by some who represent not-for-profit agencies that the costs charged to parents are relatively similar between all providers, with the edge going to the non-agency providers. Those who represent these agencies point out that the basic laws of economics still apply and that usually the reason that such adoptions cost less is that the adoptive parents or someone receives less in the way of services, or in the quality of services.

In this paper, that particular debate is not appropriate. Rather, there is a need to arrive at some estimated costs of services. Given that need, it is our estimate that the costs are roughly similar, but that if there are differences, it would be fair to say that non-agency adoptions may be 10 percent less costly.

Summarizing the costs

It is difficult to summarize the costs of adoptions with so many variables, but given the need to illustrate the range of costs incurred by adoptive parents, we have laid out some numbers on the chart that follows. The chart is based on an earlier version which appeared in Adoption Factbook. It should be remembered that costs do not necessarily translate into collected fees. Indeed, NCFA agencies averaged under $10,000 in 1993.

Domestic Adoptions

Core Costs:

Maternity home care	$5,661
Normal prenatal and hospital care for mother and child	3,000
Preadoption foster care for infant	600
"Home study" or pre and post-adoptive counseling for the adoptive parents	2,400
Legal fees	1,000

Minimal Direct Core Costs:	$12,661
Indirect Costs (@ 40%):	5,064
Minimal Total Costs:	$17,725

Special Considerations:

Cesarean section	2,000
Interstate Adoption	1,000

With complications, an interstate adoption could result in costs (15,661 direct, 6,264 indirect) of: $21,925

International Adoptions:

"Home study" or pre and post-adoptive counseling for the adoptive parents, including reporting for country of origin	3,600
Legal fees (U.S. and abroad)	1,000-3,000
Travel and related costs	1,500-8,000
Translation, government fees, etc.	500-1,000
Fees to foreign agencies, governments	500-5,000
U.S. agency direct costs	2,000-5,000
Direct costs (range)	9,100-25,600
Indirect costs (range)	3,640-10,240
Total costs:	$12,740-$35,840

Chairman ARCHER. Thank you, Dr. Pierce.

The last witness on this panel is Mr. Totaro. Mr. Totaro is the Legislative Chairman of the American Academy of Adoption Attorneys from Pennsylvania.

We are pleased to have you with us and you may proceed.

STATEMENT OF SAMUEL C. TOTARO, JR., ESQ., LEGISLATIVE CHAIRMAN, AMERICAN ACADEMY OF ADOPTION ATTORNEYS

Mr. TOTARO. Thank you, Mr. Chairman. Good morning, Mr. Chairman, and ladies and gentlemen of the committee. My name is Sam Totaro. I am here today on behalf of the 275-member American Academy of Adoption Attorneys. The purpose of the academy, whose membership is by invitation only, is to study, encourage and improve the adoption laws and the practice of adoption law throughout the United States and abroad. The academy has members in all States of the country plus Canada. The academy is here today to strongly endorse H.R. 11. By enacting this piece of legislation, adoptive parents will take another step forward in establishing parity between themselves and biological parents. I would like to point out here that I also have a personal involvement in adoption. My wife, Andrea, and I are proud parents of two children who became members of our family through adoption—Juliana, who is now almost 12, and Christopher, who is 9; and they are both here with me today at this hearing.

Adoption can be a costly process. In almost every State in this country, it is legal for adoptive parents to pay agency fees that now average over $10,000, plus the actual cost for medical expenses for prenatal care of the birth mother and the birth of the child. These medical expenses can easily reach $8,500 or more. On many occasions, the adoptive parents' own health insurance will not cover these expenses. If this were a biological child, there would be no question at all that the family would be able to deduct these expenses on their own tax returns, but because their family is created by adoption, adoptive parents must bear the burden of these expenses without the benefit of any tax relief. By doing so, many young couples who are willing to adopt shy away from the process because they simply cannot afford it.

In all States, the courts that approve adoptions require all attorneys, agencies, as well as adoptive parents, to certify that only legally allowable expenses have been paid. These include those qualified adoption expenses as itemized in H.R. 11. There should be no fear, therefore, that those involved in the adoption process will raise fees to offset any tax credit given to adoptive parents. The courts would not allow any increase in fees or expenses without justification for doing so.

The Family Reinforcement Act would provide for lower taxes to young couples when they are most needed and, therefore, will strengthen the American family and encourage couples to create their families through adoption, thereby reducing the number of children in foster care awaiting permanent homes.

The American Academy of Adoption Attorneys stands strongly in favor of this very important piece of legislation. H.R. 11 should be enacted.

Thank you.

Chairman ARCHER. Thank you very much, all of you, for appearing and being with us today. We will proceed into our inquiry portion of this hearing.

Mr. Rangel.

Mr. RANGEL. I think we all agree, at least those testifying, that we should try to make it easier for people who want children to adopt them; and certainly, it is a beautiful experience for the child.

We have a major problem in inner cities where children are being born that are not wanted. Whether they have mental or physical defects, they are still at risk, and we provide stipends to encourage people to place these at-risk kids. I believe, and I am asking some professionals to challenge me, because it is only a belief, that most of these unwanted children—and there is very little consideration statistically for abortion—that most of these kids come from teenage parents, unmarried mothers. They come from communities of high unemployment, high dropouts, and produce unemployable people that get involved in antisocial behavior.

Is there anyone that has any statistics or reason to believe that this is untrue?

Mr. PIERCE. No.

Mr. RANGEL. So if it is true, as we try to facilitate the adoption, would we not all agree we should also facilitate the birth of children who are unwanted by their parents? Then, if you agree that young people and others who are employable and are working are not having these kids, should we not invest in them to make them responsible and to have a life that they would not want to destroy by having a child prematurely, before marriage? Of course, if you agree with me on that, then tie me in with the Contract With America, because we probably all are looking for the same type of family values, but we have to work closer together.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Shaw will inquire. Let me alert the committee that at the conclusion of Mr. Shaw's inquiry, we will break to vote, because with the new rigid restrictions on voting time, I think we should not wait any longer. So Mr. Shaw is now recognized to inquire, and at the conclusion of that inquiry, we will break temporarily and go to the floor and vote and then return.

Mr. SHAW. Thank you, Mr. Chairman. I was particularly struck by Mr. Thomas' testimony with regard to the kids with special needs. We have in Fort Lauderdale, Mr. Thomas, a nonprofit group called Kids in Distress, which has done just a remarkable job. I was over there going through the facility about 2 or 3 weeks ago, and I saw a situation which was incredible, and it is just unbelievable that this kid has survived.

This youngster, as an infant, lived in the streets with her 3-year-old older sister caring for her for—we think for in excess of 1 week. The child was very, very small. They find that the older sister was putting diapers made of grocery bags on the child before somebody finally called the police and the children were picked up. Since then, the older sister has been adopted. Both the parents have died with AIDS. The kids are clean; they don't have the AIDS problem. But the younger sister is still there at Kids in Distress because she is afflicted; I think it is multiple sclerosis. It is a mild case, but she is afflicted.

Darling little African-American girl. She—when I came in, she just threw herself to hug me and other people who came into the facility. A wonderful, loving child, but that child will always be in a group home setting or a foster care setting, because it is just human nature to try to get as perfect a child as you can get when you are trying to adopt.

I think perhaps she would be a perfect applicant for a picture at one of the Wendy's, because she certainly is a very special child with very, very special needs. If you would like, I would get further information to you and see if maybe we can follow up and something good can happen to this child whose life has been absolutely nothing but tragedy. They call it a "little miracle child." It was an infant taking care of an infant in the streets for a substantial period of time, anywhere from 1 week to several weeks, and they survived. It is absolutely—absolutely an incredible story, and it is hard to believe, but that is exactly what happened.

Mr. THOMAS. If you give me the information, we would like to.

Mr. SHAW. Yes, sir.

Mr. THOMAS. We also built a home there, the Eilareen Thomas Home, Children's Home Society.

Mr. SHAW. Yes.

Mr. THOMAS. Have you been there? We just opened. We have got to get you there.

Mr. SHAW. No. I hope that is an invitation.

Mr. THOMAS. It is an invitation.

Mr. SHAW. I will look forward to that.

Thank you, Mr. Chairman. I yield back my time.

Chairman ARCHER. Since we still have some time before the second bell, if Mr. Bunning would like to inquire briefly.

Mr. BUNNING. Briefly.

I am familiar with this situation. I have two daughters who have adopted. One daughter has adopted a foreign-born, severely handicapped child with cerebral palsy. I also have a daughter who has adopted biracial babies. So it is a problem that we should address in the Tax Code and give those that need it the help. Both of my daughters were able to afford it, thanks to their ability to pay. But as has been stated by Dr. Pierce, the ability to pay up front for the cost of in-home care and hospitals and things can amount to a severe penalty for those trying to adopt if we don't address it in the Tax Code.

Mr. Thomas, I am amazed at the things that you have been able to do in such a short period of time with this high-profile position you have taken on adoption, and I encourage you to continue because it is a severe problem in our society. I only hope that the rest of our Members are as aware of this problem as this committee is, and—because we hear constantly about it; and I thank you for your testimony and yield back the balance of my time.

Chairman ARCHER. I am told that this vote will be a single vote, so we will recess to vote, and I encourage every Member to come back as quickly as possible so we don't keep the witnesses waiting. We will stand in recess until we return. It is 11:28; recess until 11:43.

[Recess.]

Mr. HOUGHTON [presiding]. Could we begin questioning?

Mr. BUNNING. Mr. Chairman, we have another vote coming up.

Mr. HOUGHTON. OK. Well, we will proceed until we get the second buzzer. Mr. Jacobs will inquire.

Mr. JACOBS. Actually, I won't, Mr. Chairman, but I do have an observation to make. That is—we all know in Indiana; people who have read certain national publications know it also, but I think the record ought to show that Mr. Burton himself is a product of some experience in an orphanage, and he is among the very few Members of Congress who are in a position to testify with a great deal of authority. Consequently, he is an invaluable asset to the Congress, as I see it, in terms of raising the consciousness of the other Members of Congress on this issue.

I happen to be Operation Late Start myself. I was never a father until 5 years ago. My wife and I have a 5- and a 3-year-old son; and what I say about that is, the reason our children are special is that they are children, no other reason. God put that in nature; God put that in universally, and all of us that listen to ourselves, our inner selves, that is the No. 1 responsibility. That is the No. 1 morality; that is the No. 1 religious obligation that we all have. I don't care whether you know the child or not. If you see a child on the street and your head's screwed on right, if you think that child is disoriented, you drop everything.

I was driving out in Indianapolis the other day either at Kmart or WalMart; let's not play favorites. Suddenly, in that parking lot, a woman turned around and dashed right in front of the car I was driving, and I was barely able to stop without hitting her. Why did she do it? Because she saw somebody else's little child headed my way toward the path. That is what God put us on Earth to do before anything else, is to look after children. Danny Burton is another example of enormous success over an enormous handicap. So you have something besides the fact that is he a carnivore, and I am a vegetarian.

Mr. BURTON. Thank you, Andy.

Mr. HOUGHTON. Thank you, Mr. Jacobs.

Mr. Ford.

Mr. FORD. Thank you, Mr. Chairman.

Mr. Thomas, I want to follow up on your comments a little bit. In your opening remarks, you talked a little bit about the special needs child; and you mentioned this committee should report out a $5,000 tax credit for adopted kids and also a refundable tax credit for parents adopting special needs children.

Is it either/or, or should we—what happens if we are working under tight budget restraints and can only pass the $5,000 tax credit for——

Mr. THOMAS. We should do both.

Mr. FORD. We should definitely do both?

Mr. THOMAS. Definitely do both.

Mr. FORD. If not, what happens to the special needs child?

Mr. THOMAS. Special needs children, because of age, come with a lot of problems, sometimes doctor bills and counseling, and it is a higher risk—I mean, as far as medical bills. To have the incentive for people to adopt them affordablely, I think they need the $5,000.

Mr. FORD. You think there are families ready to adopt the special needs children?

Mr. THOMAS. I know there are. There are people there if they could afford it. I think that is one way to give incentives for people to afford it.

Put a price on a family, I just don't think you can do that. I mean, families are so important and incentive to adopt is so important.

Mr. FORD. Mr. Chairman, I would like to follow through on it, and I know time is of the essence right now. We have a vote, about 8 minutes now.

Mr. HOUGHTON. I am going to ask a question myself of the panel, and then I think we will recess.

Dr. Pierce, you talked about the Tax Act of 1986, and I guess there was some sort of disagreement that you had with it. The concept, if I remember correctly and in reading the act itself, which I have in front of me, was that they took help for the adoption process away from the Tax Code and put it into a direct subsidy. The language here was that the deduction for adoption expenses gave relatively more benefit to higher income-track taxpayers and no benefit to nonitemizers. So now, what we are doing is, we are going to go back.

Why is it better to go back to the Tax Code as it was, rather than giving the direct subsidy through HHS?

Mr. PIERCE. We had a number of problems, Mr. Houghton. When that particular change in the Tax Code took place—and I was then, as now, with this organization—we attempted to broaden it from a tax deduction to a tax credit at that time, because obviously a tax credit benefits people regardless of their income. We were opposed by, basically, the public welfare lobby; and you will hear from some people here today who get their money from public welfare organizations and from tax dollars. They basically said, give the job to the public welfare departments. Give us money under administrative costs to pay for the lawyers, for all of the costs that these parents have. Any of the unusual expenses, we will just pick up as part of our administrative costs.

They have refused in the years since 1986 to recognize either the adoptions done by private attorneys that are helping to find homes for kids, including special needs kids, or most of the voluntary agencies, the charitable organizations—Jewish Child and Family Services, Catholic Charities, Lutheran Social Services, et cetera. There is basically a monopolistic approach there for just a few of the children in a few of the States.

If you have a tax credit, it takes it out of the control of the public welfare department and puts it in basically the private sector where there can be all of the people trying to help kids find families, get some help for those families. Now, Dave Thomas as an example is one of the corporations.

Mr. HOUGHTON. Doctor, I have got to go because we have got a vote.

Mr. PIERCE. OK.

Mr. HOUGHTON. We will recess and we will come back.

Just one other thought here—and I know you have got some other things you would like to share with us—that as it stands

now, we will have a two-tiered system. We will have part of the process going through the Tax Code and then we will still have, in special cases, the direct subsidies going out through HHS. I am wondering whether that is a good idea. We will be right back.

[Recess.]

Mr. HOUGHTON. Ladies and gentlemen, can we continue the hearing? I am sorry for the witnesses that more people aren't here. There is a bit of a controversy going on over in the House, and I just thought it might be better to complete our questions and answers.

I had asked a question. Dr. Pierce, you were answering it. Maybe you can complete that, and if Mr. Thomas or Mr. Totaro would like to add anything to that or anything else, fine; and then after that we will dismiss the panel.

Mr. PIERCE. In our testimony, Mr. Houghton, we are not addressing the issue of whether the committee should do away with the current benefits for special needs kids and subsidies and all the rest of that. As a nonlawyer and as a nonlegislator, as I read what is in the Contract With America, it seems to say that this $5,000 tax credit would be available. But if some adoptive folks have gotten some other benefits through tax dollars, then they couldn't—they couldn't be a doubledipper.

So as I read it, it seems to mean, yeah, we are going to continue to have some subsidies and accounts available through the public welfare system, but we want to empower the private side. We want to give benefits to the voluntary agencies and those who adopt privately so that we can get homes for every kid that needs them.

Mr. HOUGHTON. Yes. I guess, Doctor, my feeling was, who can argue with the general thrust of the argument? It is absolutely right on target. People want it; it is the humane thing to do. I think the question is in the mechanics, how we do this. I know there is an antidoubledipping concept that applies here.

But I guess my feeling is that there was a body of opinion, of which I was not part, in 1986, that decided that going through the Tax Code was not either the most efficient or the fairest way of doing it. Now we are throwing it back. I mean, the major benefit going through the Tax Code. I just want to know what your feelings are on that.

Mr. PIERCE. That body of opinion was reflected by very distinguished Members of the other body, like Senator Bentsen and many others who just said, philosophically, we don't want to use the Tax Code to encourage or discourage behavior.

Well, we use the Tax Code all the time to encourage or discourage behavior, and all we are saying is, we have been hearing that excuse for 10 years. Let's use the Tax Code to do something that makes sense for kids and taxpayers, because right now, for want of $5,000, there are lots and lots of kids that are stuck in the system. We are spending lots of money we don't need to spend for them.

Mr. HOUGHTON. Right. All right. Well, thank you very much. That helps.

Mr. Thomas, would you like to add anything about this or any other issue?

Mr. THOMAS. Yes. What we have done at Wendy's, we have put adoption benefits right in with our maternity benefits, so people either can have their biological child or they can adopt; and they can adopt special needs children, which we pay additional. So I would like to see that in the Federal Government, as well; anybody that has maternity benefits, just add adoption benefits, give people a choice.

Mr. HOUGHTON. So you would urge that in any legislation that we come out with, when we are tackling the health bill that we would put adoption procedures in that?

Mr. THOMAS. Right. It is——

Mr. HOUGHTON. Thank you very much.

Mr. Totaro, have you got anything to add?

Mr. TOTARO. We would also urge that any legislation consider the Tax Code—go through the Tax Code, and that any doubledipping that may occur would be taken care of as it normally is taken care of. You won't find that happening.

We think that it would be best to provide it the way the legislation is drafted now.

Mr. HOUGHTON. All right. Thank you very much.

Mr. Burton, would you like to add anything?

Mr. BURTON. Thank you, Mr. Chairman.

I am not officially a part of this panel, but I have had some personal experience in my life with people who were in welfare homes, in welfare centers. I was in a children's guardian home in Marion County when I was a boy for some time because of a family incident that took place, and I recall vividly the expression on young people's faces, particularly those in my dormitory. My brother was in one dormitory, my sister was in another, and I was in the older children's dormitory; I was about 12 years old. We had kids in there from the ages of about 9 until maybe 13.

Prospective adoptive parents would come through and everybody would have their beds made, and we would all be standing up, and the ones who were up for adoption would be really looking with eager anticipation at the prospective parents. All I recall is the terrible look of disappointment when the people would come through and look at each child and then leave, and there was never any response and nobody was adopted.

The look of despair on those kids' faces remains with me to this day, and if we can do anything in this Congress to help kids find a home, I think it would be a giant step forward. It would be a feather in the cap of every Member of this body, and I think it would help go a long way toward helping solve some of the delinquency problems that we have in our society. If kids have a loving home, I don't think they are likely to get in trouble, but if they don't have a loving home, you are going to have a real problem in society.

Mr. HOUGHTON. OK. Well, thank you very much.

The chairman chided you, I think, in terms of when your hair gets white, many times your hearing is impaired. When your hair gets white, maybe your eyesight is impaired. But I don't see anybody here who wants to ask another question. So I thank the panel very much for their contribution.

Mr. HOUGHTON. OK, a 5-minute recess.

[Recess.]

Chairman ARCHER [presiding]. The committee will come to order.

My apologies to you, Doug and Valerie, and to the previous witness, Dr. Pierce. This was unavoidable. We thought we were going to go to the floor for one vote. When we got over there, we saw that parliamentary procedure had begun to get into disarray, and the result was that we really couldn't come back here and still do our duty over there. But we do appreciate your coming today to be with us, and as I specified earlier, we are going to ask the cooperation of video and still photographers to respect your privacy and not photograph your faces or that of your child.

VALERIE. Thank you.

Chairman ARCHER. We welcome you to the committee. We are pleased to hear your testimony, and you may proceed. We normally ask witnesses to try to limit their testimony to 5 minutes or less, and if there is anything in addition that they would like to insert into the record, in writing, then that would be permitted. We hope that you will be able to hold your testimony to 5 minutes.

DOUG. I think we can.

Chairman ARCHER. You may proceed.

STATEMENTS OF DOUG AND VALERIE, ADOPTIVE PARENTS

DOUG. OK. Mr. Chairman and members of the committee, my name is Doug and with me is my wife, Valerie. We recently watched your committee on C–SPAN. Let me tell you we live outside the Washington Beltway in a typical suburban community on the eastern seaboard. Valerie is a full-time, stay-at-home mom. I work full time, as I have for the last 15 years, for a publishing company.

We are here today as fairly ordinary American citizens who have adopted a child and who support the provision in the Contract With America that would provide a refundable tax credit for people like us. My wife and I have never testified before Congress or any other legislative body, so we hope you will bear with us.

Valerie and I were married 9 years ago. At that time, like many couples, we hoped and prayed for children. When we were unable to conceive, we went to infertility specialists. Those treatments, a portion of which were covered under our health insurance, proved to be fruitless for us. We then thought about adoption, got advice from friends and professionals about the pros and cons of adoption, tried to discern what was best, and eventually decided we wanted to build our family through adoption.

VALERIE. Working through a wonderful, licensed, nonprofit agency, we learned of a waiting child, a child of mixed ethnic background. This was a child the agency could not place because their pool of waiting African-American parents either wanted a female or were unwilling to adopt a racially mixed child. So we adopted that child, and he is with us today. His name is Michael and he is nearly 2 years old, and he is here because of the brave and self-sacrificing young woman who gave him the gift of life.

DOUG. Thank God for Michael and what he has meant to us. Adopting Michael was one of the most wonderful things that ever happened to us, but the financial side of it was very difficult. Even with Valerie working full-time last year, until we brought Michael

home, what with the cost of living, money was tight. We did not have the cash to pay the $7,000 fee that our agency needed to collect for the placement. The only way we could get the money was to refinance our modest home. Given the help we got before this adoption happened, we did not feel right about going to relatives to ask for a gift or a loan to do this adoption. Besides, it was personal, just as personal as our infertility treatments. As Valerie and I told the agency, we have the income to raise a child, good insurance and so on, but not a lump sum of $7,000.

What frightens us is that there are so many children like Michael, babies that are male and of mixed ethnic background, who never get adopted here, stuck in the public welfare system simply because there is no way many of the people who are willing to adopt can afford the fees.

VALERIE. People kept telling us and encouraging us to adopt through the State because that would be free. We are not expert on taxes like you folks are, but we know nothing is free. Tax dollars pay the salaries and pick up the costs of the supposedly free adoptions from the welfare department and social services people, plus we are the wrong color. In the opinion of many of those in the public welfare system, at least in our State, to adopt a child like Michael in a world that is celebrating the end of apartheid in South Africa, racism still exists in adoption. Whites are not supposed to adopt black children. African Americans are not supposed to adopt white children. As we read in the paper, that is one of the reasons thousands upon thousands of children who could be growing up in good, adoptive homes are stuck in the welfare and foster care system instead. Too many social workers insist on same-race adoption, even at the cost of making children wait and wait.

DOUG. I guess Mike wants his voice heard, too. Valerie and I would like to have at least two children. But with Valerie caring for Michael, our family income is certainly going to be less than last year. We certainly will gross less than $60,000. We live in a high-cost area of the country. If you pass this refundable tax credit, we would have $5,000 to help pay the fees when we adopt Michael's brother or sister. Otherwise, that child might have to grow up in foster care, costing the taxpayers at least $5,000 per year.

Worse than the money loss, that child would not have the love, support, and supervision of two parents, the most wonderful difference between children who are productive citizens and those who end up in jail or on welfare. I don't need to tell you welfare or prisons are expensive.

Finally, let us explain why we are not giving our last names and where we live at this time and why we have only provided that information to your staff. Privacy and confidentiality in adoption is important to us and to the birth mother of our child.

Our time is up, and we thank you for asking us to testify today. Valerie and I would be glad to answer any questions you may have.

Chairman ARCHER. Thank you for coming to us with your real-life story. Often we in this committee room hear from experts who speak with authority from ivory towers, but the real world lies in your hearts and in your home, and you clearly represent what should be a goal for every child that does not have a supportable home in this country.

There is a clear message there—not just the economic part, which is very, very important and which this committee must deal with; but there is another message, because there are other roadblocks out there that would attempt to prevent, in some way or another, no matter how well-meaning, children from being adopted by parents that are of a different cultural or ethnic background. That, in itself, can be a denial of opportunity to a young person.

So I am very, very pleased that you have come to this committee today, and I will at this time recognize Mrs. Kennelly from Connecticut.

Ms. KENNELLY. I don't have any questions, but I thank you very much; and I also thank you for bringing Michael, so we could see him also and share in your joy.

VALERIE. Thank you.

DOUG. Thank you.

Chairman ARCHER. Ms. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman.

It was delightful to hear your story. I am curious, as we talk about the goals that would be achieved through this tax credit for parents who are adopting, do you think it would break down that wall that exists right now between adoptive parents and a child of a different race?

DOUG. I know from experience. We know many couples who have adopted. What they have indicated to us over the last couple of years is that they would have liked to have adopted more children. It is just quite cost prohibitive. I know, for us, scraping together the money to adopt Michael is like trying to scrape together the money for a downpayment on a house. I think that is one of the biggest obstacles to any kind of adoption, that it is just so difficult to come up with the funds for the adoption.

In terms of helping to break down that wall, I really hope it would. I really do.

VALERIE. Can I add something to that?

Chairman ARCHER. Surely.

VALERIE. Along with that, we really surprised ourselves with Michael. We simplified the process here but had pursued adoption a number of years ago, which proved fruitless. At the time that my husband first told me about Michael, it was one of those rare moments in time where we were given the opportunity to abandon our reason and our preference. All the notions and dreams and aspirations that we have—and found something that flows from deep inside of us—the deepest part of our humanity from where our own heart cries out. I surprised myself and was just so happy that what cried out in the bottom of my heart was love.

That love was colorblind. That wasn't an issue. In fact, that wasn't even raised until much later in the process until which time it just perhaps wasn't an issue. Perhaps if I thought about it logically, maybe a few years before, maybe I would have made it an issue. I don't know.

DOUG. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman.

Let me add my thanks for your being here. We hear the statistics; you put a face on the issue. You make us understand the is-

sues. I know it is a sacrifice for you to be here. We want you to know how much we appreciate your testimony today.

You have indicated in your testimony the problems that you went through in adoption, the financial cost, as well as the bias of local agencies on a mixed-race child. Were there other problems that you confronted in the adoption process and how long did it take?

VALERIE. This particular adoption went very well. Again, I think that is a credit to the agency that we worked with. It was a wonderful process. The folks there were very supportive and things moved along quickly. But again, remember, Michael was "hard to place" for the agency because no one—none of their candidates at the time wanted him for the reasons that I outlined previously in my testimony. They were racial reasons.

DOUG. One thing I would like to add is that a few years back, we had attempted to work with another agency. After we began working with that agency, their policy seemed to change. They were encouraging us toward an adoption where the birth parents would play a role in the upbringing of any child that we might adopt. We found that to be an obstacle because in adopting a child, we are taking sole responsibility for him. We need to be the sole authority in his life. So that was one obstacle we ran into previously that was really a deterrent to us adopting.

Mr. CARDIN. Mr. Thomas, in his testimony, pointed out the recommendation that there should be a differential in the credit for children with special needs. In your experience of dealing with other adoptive parents, would it be a good policy to provide a larger credit for adopting parents who are willing to take children in special needs, such as Michael, because of the mixed-race background.

VALERIE. Well, I would think about that three ways. Again, we are not expert testifiers here; we are just ordinary folks. This is my opinion and my impression.

But remember that Michael would have become a special needs child within a couple of years down the road because he would be older. Last night as I was holding him, the thought that Michael would have been to this day shifting around from foster home to foster home is unimaginable to me.

Mr. CARDIN. Let me just stop you one moment.

VALERIE. Sure.

Mr. CARDIN. We can define special needs as we see fit, so it does not necessarily require an age requirement to meet special needs. Adopting parents of a different race of the child can be special needs; a handicap, a disability, or age can be a special need. So we could refine that.

In order that we don't get Michael locked out of an adoptive circumstance sooner, would it make sense to offer certain incentives to try to deal with children who otherwise may go without being adopted?

VALERIE. Again, my experience with other families is special needs frequently develop. I don't know what the statistics are. I would defer to Dr. Pierce on that. But because of limited information on medical backgrounds of the child or the biological parents, oftentimes very significant special needs are not known but do de-

velop. Although a child doesn't start out as special needs, he is a special needs child.

All children need to be adopted. Age is part of the special needs criteria. Personally, I would feel that would be a mistake.

Mr. CARDIN. Mr. Chairman, thank you again for the time and thank you for your presence here.

Chairman ARCHER. Again, thank you for representing what I believe is the great strength in America. I think there are an awful lot of people in this country that share the same feelings that you do.

I am curious, beyond the economic impediment of the cost of adoption, when you began the process to adopt Michael, did you sense that there was any reluctance on the part of the adopting agency to consider you because of the color of your skin?

DOUG. No. Our experience was entirely opposite of that. We were totally supported every step of the way in this adoption. It is to the credit of the agency.

Chairman ARCHER. Well, that, to me, is the way all of the agencies should operate around this country. We should do everything that we can to assure that that will be the case. Because I believe, as you believe, that our society should be colorblind in determining where they should go, what they should do, or anything in their life based on the color of their skin.

My compliments go out to you. Michael is a very lucky young man.

DOUG. Well, actually we keep telling people. They keep saying that, too, but we are the ones who have been blessed by his presence in our lives.

Chairman ARCHER. There is no question that that is true, because there is no greater pleasure than seeing young people grow up, develop, and know that you have had a hand in that. I know because I have watched seven of them in my own house. It is the greatest treasure that I have today for anything that I could have done in life.

We are very grateful to you for coming and bringing your story to us, and God bless you.

DOUG. Thank you for inviting us, and God bless you.

Chairman ARCHER. The committee will recess for 5 minutes while the cameras are rearranged.

[Recess.]

Chairman ARCHER. We welcome our next panel, and we would ask our guests and witnesses to take their seats so that we may continue with today's hearings. We have some excellent witnesses before us today in the field of adoption, and we are pleased to hear your testimony. To begin, Ms. Freivalds. Did I pronounce that correctly?

Ms. FREIVALDS. Freivalds.

Chairman ARCHER. Ms. Freivalds, I apologize, is the executive director of Adoptive Families of America from Minneapolis, Minn., and we are pleased to have you with us and you may proceed with your testimony.

STATEMENT OF SUSAN A. FREIVALDS, EXECUTIVE DIRECTOR, ADOPTIVE FAMILIES OF AMERICA

Ms. FREIVALDS. Thank you, Mr. Chairman and committee members. Thank you for the opportunity to be here to represent adoptive and prospective adoptive families. I am executive director of Adoptive Families of America. We are a national support organization for adoptive and prospective adoptive families.

We provide education, information, and support. We have a membership of about 17,000 families and are the umbrella for about 300 local adoptive parent support groups. I, myself, am the mother of a 20-year-old daughter we adopted as an infant.

I am asking your support today for H.R. 11, title I, concerning a refundable tax credit for adoption expenses. This issue is one that concerns adoptive families deeply, and I want to thank the committee for giving it high priority, because the current inequity in tax treatment of family building methods not only serves as a hardship on adoptive and prospective adoptive families, but it also serves as a significant barrier to the adoption of America's children.

As you have heard today, the expense of adopting a child is significant. We are currently advising families that they need to plan on costs of $10,000 to $12,000 for the adoption of a healthy newborn. The adoption of a child from overseas will typically cost about $10,000 to $18,000. The adoption of a child with special needs can vary from having no unreimbursed expense to a cost of perhaps $10,000, depending on the circumstances of the child.

These expenses include agency and attorney fees, legal expenses, medical costs, foster care, support for the birth mother, and more. All these expenses, of course, are necessary and legal, but they serve to shut out from adoption many families, particularly some families that we think would be the best possible parents. For example, moderate income helping professionals, such as teachers, nurses, social workers, and the clergy.

Families cope and borrow as best they can to afford to adopt. There is no insurance you can buy to cover this cost and there are no extended payment plans. Adoptive parents deplete their savings, borrow from relatives, take out second mortgages, apply for additional credit cards. All these strategies serve to place the young parents in a precarious financial position as they start out their life as a family.

These high adoption costs and other inequities that adoptive parents face, including the inability to obtain paid or even unpaid leave when they adopt, remain a significant barrier to the adoption of America's waiting children.

We have in place currently several important programs to facilitate the adoption of children with special needs, including title IV–E adoption assistance, and these programs should not be disturbed by other changes we might enact. However, we must not lose sight of the fact that these current programs have limitations, typically applied by the States, that restrict the children with special needs to whom they apply.

In other words, all children with special needs who would benefit from adoption are not eligible for these special programs. H.R. 11 correctly applies to all adoptions, ensuring that some of America's

most vulnerable children are not disadvantaged in their search for an adoptive family.

I also want to address the fact that employers in the private sector can be encouraged to participate in providing aid to adoptive families and awaiting children.

I urge the committee to consider providing tax exemption for payments and reimbursements for adoption expenses made by employers to their employees who adopt. These plans represent a praiseworthy way the private sector is stepping forward in aid of America's children and should be rewarded with beneficial tax treatment.

However, these adoption expense reimbursement payments are typically taxable as regular income to the employee and are not deductible as a business expense to the employer. H.R. 11 could be improved by incorporating provisions to make these benefit payments tax exempt both to the employer and to the employee.

A Wendy's International survey of Fortune 1,000 corporations found that for corporations not offering employee adoption assistance benefits, concern about their cost was the single most important reason cited. Tax deductibility of adoption benefits would be a powerful means of removing this barrier to private sector participation.

As you consider these issues, please keep in mind the families and the children that you will be helping. Adoptive parents take children who are not our own and we make them our own. We raise them to be productive citizens of this country. We do this at tremendous initial expense and then give our children everything we can thereafter. We ask that our government recognize this by working toward the tax equity we deserve. Thank you.

[The prepared statement follows:]

Statement of
Susan A. Freivalds

Adoptive Families of America
3333 Highway 100 North
Minneapolis, Minnesota 55422
612-535-4829

Thank you for the opportunity to speak to you on behalf of adoptive and prospective families throughout the United States. It is a pleasure to be here.

I am Executive Director of Adoptive Families of America, a national support organization for adoptive and prospective adoptive families. We are not a child-placing agency, rather we provide education, information, and support to families built through adoption. We have a membership of 17,000 families and individuals, and are the umbrella organization for 300 local adoptive parent support groups, representing thousands more families. Our membership makes us the largest adoption organization in the nation. Personally, I am the mother of a 20-year-old daughter adopted as an infant. Ours is one of many adoption successes. This is a matter dear to my heart.

I am asking your support today for H.R. 11, Title I, concerning a refundable tax credit for adoption expenses. This issue is one that concerns adoptive families deeply—tax equity for family-building methods. I want to thank the committee for giving this issue high priority, because the current inequity in tax treatment of family-building expenses not only serves as a hardship to adoptive and prospective adoptive families, it also serves as a significant, substantial barrier to the adoption of America's waiting children.

1. Adoption expenses are a significant barrier for families hoping to adopt. A tax credit would address this concern, and help move adoptive families toward tax equity for their family-building expenses.

The expense of adopting a child is significant. We are currently advising prospective adoptive families to plan on costs of $10,000 to $12,000 for the adoption of a healthy newborn, whether through an agency or in an independent adoption. The adoption of a child from overseas will typically cost between $10,000 and $18,000. The adoption of a child with special needs can vary from having no unreimbursed expense to a cost of perhaps $10,000, depending on the circumstances of the child.

No one will disagree that these costs represent a lot of money. These expenses may include agency and attorney fees, legal expenses, medical costs of the child's birth and subsequent care, foster care for the child before placement with the adoptive family, support for the birthmother (as permitted by state law), travel of the adoptive parents and/or the child, and more. All these expenses are necessary and, of course, perfectly legal.

For many American families, these expenses are astronomical. The dream of a family for many American couples and singles has become a nightmare of rising expense. These costs can work to shut out from adoption many of those whom we might consider the best possible parents: moderate-income helping professionals, such as teachers, nurses, social workers, the clergy.

Families cope and borrow as best they can to afford to adopt. There is no insurance to cover this cost; there are no extended payment plans. Adoptive parents deplete their savings, borrow from relatives, take out second mortgages, apply for additional credit cards. All these strategies serve to place the young parents in a precarious financial position as they start out their life as a family.

Provisions in H.R. 11, the "Family Reinforcement Act," allowing a tax credit of up to $5,000 for qualified adoption expenses, would go a long way to addressing these concerns and to providing a measure of equity to adopting families. We receive calls daily from parents who wish to add to their family through adoption. Typically they tell us that they have the resources to raise a child or another child, but do not have the $10,000 or so they need to complete the adoption. I believe this tax credit would greatly aid these families and prove a powerful incentive to the adoption of children.

2. An adoption tax credit should be available for *all* legal adoptions, not only as a matter of equity, but also because some children with special needs are not eligible for other incentive programs.

High adoption costs, and other associated inequities adopting families face, including but not limited to the inability to obtain paid or even unpaid parental leave when they adopt, remain a significant barrier to the adoption of America's waiting children. We have in place today several important, necessary programs to facilitate the adoption of children with special needs, including Title IV-e adoption assistance, and these significant programs should not be disturbed by other changes we might enact.

However, we must not lose sight of the fact that these current programs have limitations, typically applied by the states, that restrict the children with special needs to whom they apply. In other words, *all* children with special needs who would benefit from adoption are not eligible for these special programs. H.R. 11 correctly applies to all adoptions, insuring that some of America's most vulnerable children are not disadvantaged in their search for an adoptive family.

Adoptive Families of America member Debra McElroy of New Mexico illustrates the need for tax equity to apply to all adoptions. She writes:

> It is always assumed that children with special needs, once a family who wants them is identified, come into that family without adoption expenses and with government subsidies that cover all their needs. But this is not always the case.
>
> My own son, Nathaniel, is in every way a child with special needs, but because he was in the custody of a private agency—instead of the State of Florida—there was no help for us in the cost of his adoption or with his medical needs. Nathaniel was born 1-1/2 months prematurely—his first two weeks were spent in a pediatric ICU—with "failure to thrive" and developmental delays. Because the State of Florida did not have control, there was little cooperation in processing the paperwork. There was also no purchase of services available, no medicaid or state coverage of the child's medical bills at any time, and no travel expense reimbursement to see our child or to bring him home. But we loved him from the moment we saw him.
>
> It took all of our savings and some borrowing from relatives, but we finally were able to bring him home and finalize his adoption. Our total cost for his adoption, not including medical exams required prior to finalization, was $16,000.
>
> But we were lucky. We have a beautiful son to love. Friends of ours were not so fortunate. They tried to adopt a 5-month-old girl classified as special needs from Washington State. This child was born two months prematurely, with a club foot requiring some amputation, cataracts needing surgery, and dwarfism. The State of Washington offered no travel expense, no subsidy, and no purchase of services. Because she was special-needs classified, however, they would have reimbursed some of the medical co-payments, but only up to $1,000.
>
> My friends wanted this little girl. Her physical situation was not a difficulty for them, since they had previous experience with most of her defects. But the estimated cost of almost $8,000 for the adoption, plus the expense of all the child's medical needs, were severe hardships, particularly when they considered the financial risks that could arise from the medical needs of their two other adopted children with special needs. In the end, they had to make the painful decision not to adopt this little girl.

These cases illustrate how imperative it is that a tax credit for adoption expenses not be restricted to only certain children. Too many children with special needs fall through the cracks of our system. Any tax credit put into place to help children should not have the unintended result of disadvantaging any special needs child.

3. A tax credit is a fiscally responsible way to provide incentives for the adoption of children.

Can we afford to support adoption this way? Where will the dollars come from to support the proposed adoption tax credit?

Study after study shows that adoption is not only the preferred solution for children who cannot be cared for by their birth families in terms of their emotional and mental health, but adoption is also the least-cost solution. Figures from Iowa comparing out-of-home care costs in 1994 find that, on a per-child, per-year basis, family foster care costs $10,000; independent living, $21,455; shelter care, $30,111; and group care, $40,414. A $5,000 maximum one-time benefit to support a child's adoption pales in comparison to these yearly expenditures to support non-familial care of children.

4. Employers in the private sector can be encouraged to participate in providing aid to adoptive families and waiting children. Congress should exempt from taxation employee adoption assistance benefits provided by employers.

In examining ways that equity can be achieved for family-building methods, I encourage the committee to consider providing tax exemption for payments and reimbursements for adoption expenses made by employers to their employees who adopt. A 1993 study by employee benefits consultant Hewitt Associates, cited in "The State of Corporate Adoption Benefits" published by Wendy's International, Inc., found that approximately 18 percent of 1,000 large U.S. corporations now offer adoption-related benefits, up 6 percent from 1991. The average benefits plan provides an estimated $2,000 maximum reimbursement per adoption.

These plans represent a praiseworthy way the private sector is stepping forward in aid of America's children and should be rewarded with beneficial tax treatment. However, these adoption expense reimbursement payments are typically taxable as regular income to the employee, and are not deductible as a business expense to the employer. H.R. 11 could be improved by incorporating provisions to make these benefit payments tax exempt both to the employer and the employee. A Wendy's International survey of Fortune 1,000 corporations found that, for corporations not offering employee adoption assistance benefits, concern about their cost was the single most important reason cited. Tax deductibility of an adoption benefit, on a par with other employee benefits, would be a powerful means of removing this barrier to private sector participation.

As you consider the fiscal and equity issues presented by the proposals you are hearing today for beneficial tax treatment of adoption expenses, please keep in mind the children and the families you will be helping. It is indisputable that in current law and regulation the standing of families formed through adoption is unequal to that of families formed through birth. In spite of this, we take children who are not our own and make them our own. We raise them to become productive citizens of this country. We do this at tremendous initial expense and then give our children all that we can thereafter, just as any real parent would do, because we are real parents. Just ask our children. We ask that our government recognize this as well by working toward the equity we deserve.

Mr. HOUGHTON [presiding]. Thank you very much. Thank you very much, Mrs. Freivalds.

I wonder if Mr. Molock could talk and then Mrs. Molock. Is it Mrs. Molock? Women first.

STATEMENT OF SHERRY DAVIS MOLOCK AND GUIZELOUS O. MOLOCK, JR., FORT WASHINGTON, MD.

Mrs. MOLOCK. My name is Sherry Davis Molock and I am accompanied here today by my husband, Guy Molock, Jr., to urge that Congress support the tax credit for adoption expenses that is included in the Family Reinforcement Act. I am a clinical psychologist by training, currently employed at Howard University in the department of psychology, and I also have a small part-time practice in Fort Washington, Md.

But perhaps the most important experience that I bring here today is that I am also the proud adoptive parent of a 4-year-old and a 2-year-old: Amber, who is 4; Jelani, who is 2 years old, and we also have a biological child who is 3 months old.

In my professional work, I constantly run into families who are interested in pursuing adoption, but who simply cannot afford the considerable fees that often accompany adoption. Adoption is perceived by many families as a way upper middle income and rich people can build a family.

The cost of adoption, which can be as high as $15,000 at some nonprofit agencies, is simply out of reach for most American families. It seems inherently unfair that only a few privileged people can build families via adoption when there are so many needy children who are currently languishing in the child welfare system. There are many people who would love to provide a nurturing environment for a child if given the opportunity.

Many of the families who would like to build a family through adoption are couples who experience infertility. That is certainly true of my husband and myself. They have often spent their life savings on expensive diagnostic tests and/or infertility treatment, which is not covered by health insurance. Other families decide not to pursue treatment at all because they cannot afford it. Many of these families are devastated because they cannot build a family they would love to have.

When these same families decide to build families in an alternative way, namely through adoption, they are then confronted with another set of astronomical fees that are simply out of their reach. It seems no matter what they do they are confronted with insurmountable odds.

One family I have worked with professionally has been attempting to get pregnant off and on for 5 years. The husband is a custodian and his wife is a teacher. After enduring four surgeries, his wife still has not become pregnant.

After deciding that it was more important to them to be parents and not necessarily to be biologically related to their children, they began to pursue adoption only to find that they could not afford the fees at most nonprofit agencies, which range from $5,000 to $16,000. The wife tearfully told me 2 months ago that by the time we save up the money to pay for the adoption we will be too old to meet the age criteria for most agencies.

The income tax credit may be particularly helpful to African-American families who have considered pursuing adoption because African-American families on average earn less and have less income available to them to afford adoption and the adoption fees associated with this.

The income tax credit for adoptive families would also send a message that adoption is considered to be a viable and legitimate way to build a family. Adoption continues to be stigmatized in the mass media as something that is either second best or a process that is frayed with illegalities and problems.

The income tax credit provides a means of acknowledging that Americans can build their families in many different ways, and one viable way is through adoption. We cannot stress enough the important impact we think the tax credit will have on prospective and current adoptive families. It will mean more families will be able to build a family through adoption and many couples will now be able to consider adopting a second child.

One of the greatest joys in our lives has been the honor and privilege we have had from parenting our three children. We hope you will pass the income tax credit so that other families can also share the joy that we experience each day. Thank you.

[The prepared statement follows:]

STATEMENT OF SHERRY DAVIS MOLOCK AND GUIZELOUS O. MOLOCK, JR., FORT WASHINGTON, MD.

My name is Sherry Davis Molock and I am accompanied here today by my husband, Guizelous O. Molock, Jr. to urge that Congress support the tax credit for adoption expenses that is included in the Family Reinforcement Act. I am a clinical psychologist and am currently employed as an Associate Professor of Psychology at Howard University in Washington, D.C. I also have a small, part-time practice in Ft. Washington, Maryland where one of my specialties entails issues in infertility and adoption in African American clients. In addition to my clinical work, I am a professional member of RESOLVE of the Washington Metropolitan Area, Inc., have written the "Ask the Expert" column for the RESOLVE national newsletter for the last two years, am a member of the Board of Trustees of The Barker Foundation, a local adoption agency servicing the Washington, D.C. metropolitan area, and am a member of the Board of Directors of Adoptive Families of American (AFA). In a professional capacity, I have had numerous opportunities to work with African Americans individuals and families who may be interested in adoption. However, perhaps the most important experience I have had with adoption is that I am the proud parent of three children, two of whom are adopted. Amber Najee, age four, came to join our family at the age of seven weeks in February, 1991 and Jelani LeAndrew, age 2 joined our family at five months old in March, 1993. We most recently gave birth to our youngest child, Diarra Marie Imani, age three months in October, 1994.

In my professional work, I constantly run into families who are interested in pursuing adoption but who simply cannot afford the considerable fees that are often accompany the adoption process. Adoption is perceived by many families as a way that upper middle income and "rich" people can build a family; the cost of adoption, which can be as high as $15,000 at some non-profit agencies, is simply out of reach for most American families. It seems inherently unfair that only a privileged few can build families via adoption, when there are many needy children who currently languish in the child welfare system. There are many families who would love to provide a child with a loving and nurturing environment. Allowing families to claim an income tax credit for qualified adoption expenses would be an important step in helping to alleviate the financial burden that adoption often entails.

Many of the families who would like to build a family through adoption are couples who have experienced infertility. They have often spent all of their savings on expensive diagnostic tests and/or infertility treatment that are not covered by health insurance. Others decide to not pursue treatment because they simply cannot afford it. Many of these families feel devastated because they have been unable to have children biologically. When these same families decide that there is an alternative way to become parents, namely via adoption, they are confronted with another set of astronomical fees that often accompany the adoption process. It seems that no matter what they do, there are

insurmountable obstacles to building a family.

One family that I have worked with has been attempting to become pregnant off and on for five years. The husband is a custodian and the wife works as a teacher's aide. They already provide a loving home to three foster children who are between the ages of six and fourteen; these children are not eligible for adoption. While they enjoy parenting their foster children, they want to experience the joys of parenting an infant. After enduring four surgeries, the wife still has not become pregnant and the couple has exhausted all of their savings. After deciding that it was more important to them to be parents and not necessarily biologically related to their children, they began to pursue adoption only to find that they could not afford the fees at most of the non-profit agencies, which ranged from $5,000 - $16,000. The wife tearfully told me, "by the time we save up the money to pay for the adoption, we will be too old to meet the age criteria at most of the agencies!"

This income tax credit may be particularly helpful to African American families who have considered pursuing adoption because African Americans, on average, earn less than White Americans, even when one controls for educational levels and occupational experience, and they are less likely to be able to afford some of the fees associated with adoption. The initial reaction that I get from many African American families when I ask them to consider adoption is "it costs too much" or "adoption is for rich white folks". As one client put it: "when you see movies or TV, you only see rich white people involved with adoption; it always involves large sums of money or the kidnapping of someone's child. The media doesn't portray black families as having any money or as being stable; we just have babies and get on welfare".

The income tax credit for adoptive families would also send a message that adoption is considered to be a viable and legitimate way to building a family. Adoption continues to be stigmatized in the mass media as something that is "second best" or as a process that is plagued with problems and illegalities. The income tax credit provides a means of acknowledging that Americans can build families in many different ways, and one important alternative in family building is through adoption.

We can not stress the important impact that we think the tax credit will have on prospective and current adoptive families. It will mean that many more families will be able to build a family through the adoption process. Many families who have only been able to adopt one child can now consider adopting a second child. One of the greatest joys in our lives has been the honor and privilege that we have had in parenting each of our three children. We hope that you will pass the income tax credit so that other families can also share the joy that we experience each day.

Mr. HOUGHTON. Thank you very much, Mrs. Molock. Mr. Molock, would you like to add.

Mr. MOLOCK. No, Mr. Chairman, I will not give any independent testimony. Mine was a part of my wife's testimony.

Mr. HOUGHTON. All right. She is a good spokesman for you; is that right?

Mr. MOLOCK. Very good.

Mr. HOUGHTON. All right. Good. How about Mr. McDermott.

STATEMENT OF MARK T. MCDERMOTT, ESQ., COUNSEL, FAMILIES FOR PRIVATE ADOPTION

Mr. MARK MCDERMOTT. Thank you. I want to thank the members of the committee for allowing me to address you today. I speak from a number of different perspectives, as an adoptive parent and also as an attorney who handles adoption cases, also as the past president of the American Academy of Adoption Attorneys and as a board member of a group known as FPA (Families for Private Adoption).

You heard earlier this morning from my good friend and my colleague, Mr. Totaro, who spoke to you on behalf of the American Academy of Adoption Attorneys. I am here today to speak to you on behalf of Families for Private Adoption.

Families for Private Adoption is a support group consisting of parents which comprises about 400 families. FPA supports the income tax credit for adoption expenses contained in the Family Reinforcement Act. It will enable persons with lower incomes to form families through adoption and, thus, provide nurturing environments to children in need of homes. The size of one's income is not a reliable measure of one's aptitude as a parent.

Our society will benefit if we encourage the formation of stable, loving families through adoption. At the same time, our Nation's economy will benefit because the alternative for many of these children, who would be adopted, would be to grow up in a welfare system supported by public funding.

The sponsors of this measure are to be applauded. FPA sincerely encourages you and all of your congressional colleagues to work as hard as you can for the passage of this measure. I thank you and I would be glad to entertain any questions if you have any.

Mr. HOUGHTON. Thank you, Mr. McDermott. I think we will wait until the panel has testified.

Ms. Veney.

STATEMENT OF RHODA L. VENEY, EXECUTIVE DIRECTOR, FAMILY AND CHILD SERVICES OF WASHINGTON, D.C.

Ms. VENEY. Thank you. Family and Child Services of Washington, D.C., the agency that I represent, is a private, not-for-profit organization that has been around for 113 years. The agency now serves over 20,000 children, families, and older adults in programs that include child adoption.

I am going to skip around on this testimony.

The modern child welfare system is largely concerned with the care of an increasing number of children, ages birth to 21, who are in need of alternative placements because of parental neglect, abuse, and abandonment.

Professional, custodial, and other services needed to care for these children present a complexity of problems not only because of the sheer number of children in out-of-home care, recently estimated by the Child Welfare League of America to be 450,000, but escalating costs for their care at a time when public dollars are scarce.

Child welfare administrators, as well as the managers of tax dollars, have been severely criticized over the years for not adequately addressing issues involving children who need placement outside of their birth families. One type of permanent placement for children who cannot return to the birth family is adoption.

Children between the ages of birth and 18 are placed with adoptive families through three primary sources: public child welfare agencies (39 percent); voluntary agencies, like Family and Child Services of Washington, D.C. (29 percent); and independent practitioners (31 percent). While child adoptions have increased by about 1 percent in the United States between 1987 and 1990, the studies for 1992 estimate that approximately 91 percent of all adoptions that year were domestic and 8 percent were foreign.

Among domestic adoptions, 50 percent involved relatives of the birth parent and 49 percent were unrelated adoptions. Of the unrelated adoptions, 48 percent were children under age 2, 25 percent were healthy children over age 2, and 26 percent were children with special needs.

While the majority of adoptive placements involved infants, most of the children waiting for permanent families are older, racial minority, and have medical and physical conditions. Last year in the District of Columbia, for example, 99 percent of the adoptions completed by the city's legal child care representative, the Department of Human Services, and 93 percent of those handled by Family and Child Services, our agency, were special needs.

The 1993 profile on children in the District of Columbia revealed 1,918 children in foster care due to parental neglect, abuse, and abandonment. Ninety-five percent of them were African-American, and 11 percent had adoption as a permanent goal.

If what is happening in the District of Columbia is typical, families adopting special needs children may neither need nor should they be eligible for a refundable tax credit since they can either request reimbursement or receive no cost legal services and qualify for monthly stipends.

In conclusion—I think that bell means my time is up, doesn't it?

Mr. HOUGHTON. No.

Ms. VENEY. In conclusion, the credit as currently drafted may be very expensive to finance. Therefore, if there are limited resources, it would seem that they should be used for children who are, in fact, in need of permanent families. Children with special needs and children who are the racial minority.

Thank you.

[The prepared statement follows:]

FAMILY & CHILD

FAMILY and CHILD SERVICES of WASHINGTON, D.C.

929 L STREET, N.W., WASHINGTON, D.C. 20001-4394
(202) 289-1510 • FAX (202) 371-0863 • (202) 289-1828 TDD

OFFICERS

Mrs. Monty Burnham
President

William H. Herrington
First Vice President

Mrs. Charles W. Bailey
Second Vice President

Mrs. Annabelle T. Lockhart
Treasurer

Alan L. Skvirsky
Assistant Treasurer

Ellen L. Goldstein
Secretary

Deborah M. Smith, M.D.
Assistant Secretary

BOARD OF TRUSTEES

Mrs. Ana Anders
Mrs. Charles W. Bailey
Jerome A. Barron
Mrs. Eileen Blumenthal
Mrs. Monty Burnham
Bruce A. Cohen
Ellen L. Goldstein
Bernardo J. Gonsalves
Mrs. Nathaniel H. Goodrich
Shelley D. Hayes
Corbin C. Harwood, M.D.
Mrs. Shirley S. Henderson
William H. Herrington
Alyce P. Hill, Ph.D.
Mrs. LaSalle D. Leffall, Jr.
Mrs. Annabelle T. Lockhart
Mrs. Jeanette Miller
Elizabeth L. Newhouse
John E. Oxendine
Thornell K. Page
Elizabeth A. Patterson
Mrs. Panida Puccinelli
Ms. Donna R. Richardson
Steven S. Rosenthal
Alan L. Skvirsky
Deborah M. Smith, M.D.
Mrs. Katharine Sreedhar
Mrs. Potter Stewart
Mrs. Paul C. Warnke
Maurice E. White
Joan M. Wilbon
Wesley S. Williams, Jr.
Ellis Wisner
Dr. Muriel D. Wolf
Robert C. Wood
Patricia Yates, ACSW, LICSW

Rhoda L. Veney
Executive Director

Ms. Charlotte L. McConnell
Deputy Director

John G. Theban, ACSW
Emeritus

January 17, 1995

The Honorable Bill Archer
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to the request for comments regarding the Family Reinforcement Act's inclusion of a refundable tax credit for adoption expenses.

INTRODUCTORY STATEMENT

Family & Child Services of Washington, D.C., Inc., (the Agency) is a private, not-for-profit organization that has been in existence for over 113-years. The Agency is now serving over 20,000 children, families and older adults in programs that include child adoption, day care, family preservation, mental health counseling, residential camping, and foster care. We also provide a broad-range of services enabling frail, elderly adults to remain in their own homes. The operating budget of $7.3 million is derived from three major funding sources: government grants and contracts (73%); the United Way of the National Capital Area (22%); and private donations (5%).

BACKGROUND STATEMENT

The modern child welfare system is largely concerned with the care of an increasing number of children, ages birth to 21, in need of alternative placements because of parental neglect, abuse and abandonment. Professional, custodial and other services needed to care for these children present a complexity of problems not just because of the sheer number of children in out-of-home care, recently estimated to be 450,000, but escalating costs for their care at a time when public dollars are scare.

"EQUAL OPPORTUNITY EMPLOYER"

Child welfare administrators as well as the managers of tax dollars have been severely criticized over the years for not adequately addressing issues involving children who need placements outside of their birth families; e.g., the long period of time that children must wait before permanent homes can be recruited and investigated and the children placed.

One type of permanency placement for children who cannot return to their birth families is adoption.

Family & Child Services of Washington, D.C., Inc., has long offered formal legalized adoption as a favored resource for children deprived for whatever reason of life with their birth parents. Traditionally, children adopted have been infants relinquished in the early years of life. Now agency responsibilities in child adoption have expanded to include older children, sibling groups and wards of the District of Columbia.

During the past 48-years, the Agency has initiated a number of projects to improve adoption programming in the District of Columbia:

- the 1st cash subsidy to a low-income family adopting a "special needs" child, in 1960;
- the 1st major recruitment project for African American families to adopt children in public custody, in 1980; and,
- the 1st organized pool of attorneys willing to give pro bono legal services to low-income families seeking to adopt children.

Children between the ages of birth and 18 years are placed with adoptive families through public child welfare agencies (39%), voluntary agencies like Family & Child Services of Washington , D.C, (29%) and independent practitioners (31%). And while child adoptions have increased by 1% in the United States, between 1987 (117,585) and 1990 (118,779), studies for 1992, estimate that approximately 91% of all adoptions that year were domestic and 8% were foreign. Among the domestic adoptions 50% involved relatives of the birth parent and 49% were unrelated adoptions. Of the unrelated adoptions, 48% were children under age 2, 25% were healthy children over age two and 26% were children with "special needs".

While the majority of adoptive placements involve infants most of the children waiting for permanent families are older, racial minority and have medical and physical conditions. (Last year in the District of Columbia, for example, 99% of the adoptions completed by the Department of Human Services and 93% of those handled by Family and Child Services were children with "special needs.")

A 1993 a profile on children in the District of Columbia, revealed 1918 children in foster care due to parental neglect, abuse and abandonment. Among those in public custody over 95% were African America and 11% had adoption as the permanency plan.

STATEMENT ON THE TAX CREDIT

If what is happening in the District of Columbia is typical, families adopting "special needs," children may neither need nor should they be eligible for a refundable tax credit since they can either request reimbursement (of between $1000-$2000) or receive no-cost legal services and qualify for monthly stipends of between $437-$874 for children classified as hard-to-place due to age, race, physical or mental handicap or combination of circumstances making an adoption placement difficult.

IN SUMMARY

Many child welfare advocates and practitioners in human services programming have said that minority and "special needs" children have not been well served by the child welfare system. An examination of the history of children in public funded out-of-home care "...reflects a perpetual march down a road of good intentions with the failure to check the quality of the road, and, indeed, whether the interim goals to be accomplished coincide with those of the final destination". Given the fiscal realities of today some question the rationale for a tax credit that may benefit so few of the 50,000 children in America who were awaiting families in 1993.

If the goal is in fact to encourage American Families to adopt American children it would seem that any refundable tax credit should benefit the greatest number of those awaiting for permanent families.

In conclusion it is unclear given the fiscal demands on our tax dollars how a refundable tax credit for adoption expenses will facilitate efforts to find permanent homes for the most needy among children awaiting adoption; i.e., children who are public wards, members of sibling groups, African Americans and physical or mentally challenged.

Sincerely,

Rhoda L. Veney
Executive Director

RLV:jmr

Mr. HOUGHTON. Thank you, very much, Ms. Veney.
Now, Mr. Kroll.

STATEMENT OF JOE KROLL, EXECUTIVE DIRECTOR, NORTH AMERICAN COUNCIL ON ADOPTABLE CHILDREN

Mr. KROLL. Mr. Chairman and members of the committee, I want to thank you for the opportunity to speak today. I represent the NACAC (North American Council on Adoptable Children), which is an organization of adoptive parent groups, adoption agencies, and individuals who are committed to improving opportunities for permanent homes for special needs children who wait for adoptive families.

I am glad that Congressman Ramstad could be here because the two organizations that represent the largest number of adoptive parents in the country are based in Minnesota, in Golden Valley, which I believe is in your district, and I am in St. Paul, and I think we have a lot to say on this issue and I am glad you are here to hear that.

I am here today because I am an adoptive parent. In 1974, after the death of our second child, we began the adoption process. That ended about 2 years later with the adoption of a 5-month-old infant from Korea, named Mei Lin. Mei Lin is now a freshman in college and is one of those real success stories, I think, in adoption.

We have a birth child and an adoptive child and if someone said what is the difference, I would say their looks. Other than that, they are both our children and treated the same. Some would say that as somewhat of a doting father I am closer to my daughter than I am to my 24-year-old son.

NACAC supports this legislation. We have on the books supported a tax deduction or tax credit since 1989 because it is fair to adopted families. It is fair to adopted families because families with medical coverage get maternity benefits that are by and large unavailable to adopted families. Without the leadership of Dave Thomas, I don't think that that issue would be in the forefront that it is today.

I would like to comment on who I think will benefit most by this piece of legislation. We did a study in 1991 examining barriers that families of color face in accessing the adoption system. We discovered that within the arena of infant adoption by private agencies, that 50 percent of the black infants and 66 percent of the Latino infants were being placed transracially, which led us to believe that somehow there were no families of color out there.

So we began to examine the barriers that families of color faced and discovered that the No. 1 barrier that families of color faced in adopting healthy infants of their race were fees. So it is my belief that this piece of legislation will be a great advantage to families of color in adopting children within their own communities. I would like to again highlight the fact that many children are placed transracially by private agencies in this country.

I don't think transracial adoption is so much an exception as it is fairly normal in this country, as I adopted transracially, as Susan adopted transracially, as many families in our organization have adopted transracially.

I would also like the committee to take a look at two amendments. I am giving committee staff rough drafts of the language. The first one dealt with the availability of this tax credit to special needs adoptive families who do not necessarily have the requirement to pay the $5,000. I would like to see this as an incentive to families who adopt special needs children, regardless of the cost to them, so that they would have a tax credit that would not be refundable, but would be a tax credit available to them because they adopted a special needs child.

Second, and this is very complicated, so I will try to read it from my testimony, there is a small group of people in this country who receive adoption assistance payments who are ineligible—or who have trouble claiming their child as a dependent. The reason they have trouble is because they cannot meet the 50-percent support requirement of IRS rules.

IRS requires that a family receiving adoption assistance payments be able to document that they provide 50 percent of the financial support. Some families get a large subsidy, have children with severe medical problems, and cannot get that tax dependent status. I think we should consider treating the adoption assistance payment as nontaxable income as a possible amendment.

Finally, and I want to make it real clear, that we are very concerned of the possibility of tightening of the title IV–E program; the possibility, as the Governors suggested 10 days ago, of block granting that program. We believe the adoption assistance program for special needs kids is the best program to get kids out of foster care that exists.

Families who adopt these children have limited means. The children have many requirements. If the IV–E program were cut in any way, as a possible offset against this program, I think it would be disastrous to the kids who we have got to care for within the foster care system in this country.

Thank you.

[The prepared statement follows:]

STATEMENT OF JOE KROLL, EXECUTIVE DIRECTOR NORTH AMERICAN COUNCIL ON ADOPTABLE CHILDREN

Mr. Chairman and Members of the Committee, I thank you for this opportunity to appear before you today to discuss the needs of adopted children and their families. My name is Joe Kroll and I am the Executive Director of the North American Council on Adoptable Children (NACAC). NACAC is an organization of adoptive parent groups, adoption agencies, and individuals who are committed to improving opportunities for permanent homes for "special needs children" who wait for adoptive families. For over twenty years NACAC has been involved at the local, state, and national level providing advocacy for children who wait.

I am here today to ask you to support H.R. 11, the refundable credit for adoption expenses and suggest amendments as a way to encourage adoption of special needs children. By passing expanded legislation, you will serve three groups: parents seeking children; families adopting waiting children; and older and handicapped children who now wait in foster care. I firmly believe that by helping to build families through adoption, you will be passing the most positive and cost effective legislation of 1995. Please let me explain further:

SUPPORT FOR REFUNDABLE TAX CREDIT FOR ADOPTIONS

NACAC supports the H.R. 11 refundable adoption credit section because it helps middle income families contend with the increasing cost of adoption.

Perhaps my most relevant qualification for appearing today is that I am the parent of two children, one of whom is adopted. Adoption provided a way for my wife and I to have the family we dreamed about at a very difficult time in our lives. In 1974, following our second child's death soon after birth, my wife and I began the adoption process. We needed to raise nearly $2,500 to adopt our infant daughter from Korea. Today Mei Lin, as we named her, is a freshman in college and one of those real adoption success stories. Anyone who knows me is tired of my countless "Mei Lin" stories.

Since 1989, NACAC has supported a tax deduction or credit for adoption expenses, therefore it is easy to support the proposed tax credit for adoptive families. One welcome outcome of H.R. 11 is that it would expand opportunities to adopt for many working families who would otherwise find it very difficult to raise the necessary funds to adopt a healthy infant through an agency or intermediary.

Adopting an infant from Korea today would cost up to $15,000, six times the fees my wife and I paid twenty years ago. Fees for American infant adoption now range from $7,000 to over $20,000. Not many families' incomes have increased six-fold in twenty years, making adoption increasingly difficult. Most families with health coverage have maternity coverage for biological children but no way to offset the costs incurred in adopting an infant. This tax credit provides such support.

BENEFITS

HR 11 will eliminate fees as a barrier to adoption for African American, Native American, and Latino families.

The tax credit would be helpful by easing access to adoption for African American, Native American, and Latino families who because of prohibitive fees have been unable to adopt infants in their own communities. In 1991, NACAC researched the issue of adoption in communities of color to better understand why there were inordinate numbers of minority children available for adoption. As a result of the research, we wrote *Barriers to Same Race Placements*. In that research brief we documented that minority communities utilized informal or extended family care at a much greater rate than the majority community. However, 50% of African American infants and 66% of Latino infants were placed transracially because large fees form a significant barrier to formal minority family adoptions. This credit will help eliminate that barrier for African American and Latino parents and level the playing field for adoptive families.

We support the sliding schedule which phases out the credit at higher incomes. The program should primarily benefit families for whom cost disallows access to adoption.

AMENDMENTS

1. Tax credit for families adopting waiting special needs children.

At any given time there are approximately 452,000 children in foster care in the United States. Over 35,000 of them are legally free for adoption and waiting for permanent families of their own. More than half of these waiting children have special needs that require additional services and support in order to overcome past traumas and abuse, physical, mental or emotional handicapping conditions, or other characteristics historically marking them as "hard to place." Approximately half the children waiting for families are over the age of twelve. Some of them need to be placed with their siblings. Almost half of waiting children are of minority heritage.

NACAC, as well as other organizations in the adoption community, is actively involved in helping to create innovative methods of recruiting families to adopt these needy or "interesting" children. In the twenty years of our existence, we have learned that there are many special families in this country who are willing and eager to take on the responsibility of loving and raising a special needs child. Many more could be recruited but they need your help.

I suggest that to encourage adoption of hard-to-place children, you should extend the tax credit to families that adopt special needs children, but in a way that would provide for a tax return even if the family had not incurred $5,000 worth of expenses. Families would be eligible if their child fit the state special needs definition. The credit would be a fully refundable credit, much the same as the existing earned income tax credit.

In South Carolina Governor Campbell has also proposed a state employee adoption recruitment program. If passed, each employee who adopts a special needs child will receive $10,000 and an employee who adopts a non-special needs child will receive $5,000. The federal government should consider following Governor Campbell's leadership.

Adoption of special needs children will generate a substantial cost saving. A child in out-of-home care costs the government approximately $5,000 to $10,000 if placed in family foster care or $36,000 if housed in an orphanage. Even if an adoptive family is granted adoption assistance payments which typically are less than family foster care, the cost saving for each special needs child adopted will very quickly return the lost revenue.

2. Treat adoption assistance payments as non-taxable income.

Although adoption assistance payments are not directly taxable, adoptive parents who receive adoption assistance must prove 50% support to claim adopted children as dependents. Or, if they do claim a child as dependent an cannot meet the 50% support test, the income must be reported under the miscellaneous section. The problem is further complicated by the fact that if a child is not claimed as a dependent, insurance companies can deny coverage to that child. The matter could be simply solved by including adoption assistance payments as excludable income for all purposes such as is currently done for Foster Care, AFDC and SSI payments.

CURRENT FEDERAL ADOPTION PROGRAMS

I want to encourage you to continue support for adoption through the Adoption Opportunities Act and through Title IV-E Adoption Assistance.

When considering income offsets to finance H.R. 11 we ask you not to cut these invaluable federal adoption programs that support the placement of special needs children. You should not cut or eliminate programs serving children caught in the foster care system to fund a tax credit that would primarily serve healthy infants for whom there are many families interested in adopting them. It would be inappropriate for this middle class tax entitlement to replace an entitlement program for dependent and neglected children (Title IV-E.)

Since 1978, the Adoption Opportunities Program sponsored by the late Senator Heinz has provided demonstration projects, research, training, and national resource centers for families and professionals who serve America's waiting children. This project is currently funded at $13.1 million dollars. It serves public and private agencies, adoptive parent groups, researchers, and state adoption units.

Since 1980 the federal government has supported adoption assistance agreements with families who adopt special needs children. The Title IV-E Adoption Assistance Program currently serves over 100,000 children and is funded at $399 million in FY' 95. The government contracts with adoptive families to care for children who would otherwise be in foster care. These adoption subsidies can provide families the wherewithal to meet the often severe and costly physical or emotional needs of their adopted children. Thus, many families who would otherwise have been unable to consider adoption are now providing loving homes for some very special children. Elimination or reduction of this program would violate the contract with these valuable families. They have stepped forward to meet the needs of America's most vulnerable children and have made lifelong commitments. Block granting of this program endangers its continuation.

EMPLOYER SUPPORT FOR ADOPTION

Employee adoption assistance benefits are presently taxable as regular income. I would urge you to also classify this benefit as excludable income. NACAC endorses the efforts of Dave Thomas, founder of Wendy's and the most visible promoter of adoption in this country as he works to convince corporate America to offer adoption benefits. I ask Congress to join corporations in their efforts.

CONCLUSION

Adoption legislation always needs to be viewed in individual terms. Right now, a 9 year old girl named Angel is waiting for a family. She has cerebral palsy and a seizure disorder and is fed through a G tube. Angel likes to have people pat and talk to her. There is also a little boy waiting. His name is Jarod. He is a mixed race black and white child - four years of age. His mom had some problems with substance abuse which resulted in developmental delays. He plays well by himself and loves cars and musical toys. Jarod wants a home.

If your work today facilitates finding either child, Angel or Jarod, a forever family - they and their families will owe you a debt forever.

Mr. HOUGHTON. Thank you very much, Mr. Kroll. Thank you very much, members of the panel. Now we will start the questions. Mr. Herger will inquire.

Mr. HERGER. Thank you very much, Mr. Chairman. If I could ask whoever would want to answer this, we hear about these astronomical costs for adoption. I believe some of the numbers that were used, and we heard varying numbers here, but in the vicinity of $10,000 to $12,000 to adopt here in this country, and I think we even mentioned up to $18,000 for overseas. Would one of you maybe go into what we are talking about?

What is it that costs so much and could you break that down; someone?

Ms. FREIVALDS. I would be glad to do that. The adoption of an infant in the United States typically happens either through a private agency or as an independent adoption. The agency has a certain fee that can be as much as $8,000 to $10,000, because they are covering all the expenses of the birth parent, the expense of giving birth to the child, the expense of counseling the birth parent. They have the legal expense involved as well as the expense of maintaining a child or children in foster care. These moneys also can go toward their programs to place children with special needs where they would want to keep the expenses down. So those are the kinds of costs that are involved.

With an independent adoption, a family will typically be paying the medical expenses of a particular birth mother. Of course, there is no insurance in most States that covers this.

Some States do require the adopting parents' health insurance policy to cover the expenses of the baby's birth, but that is very rare. So, typically, they are paying this medical expense dollar for dollar out of their pocket.

Typically, they have to put up quite a large deposit at the hospital before the baby is born, and then there is the legal expense of completing the adoption, the expense of the home study, by which you are studied and educated and approved to be an adoptive parent. So those are the expenses that go into it.

For an overseas adoption, they have all that expense plus, typically, the expense of traveling to the child's country of origin and completing the adoption there. Typically, they will need to stay a few weeks, so that is why that adoption costs typically more.

Mr. HERGER. Now, overseas, a lot of that is travel and staying expenses. Are there other expenses that are somewhat the same as here?

Ms. FREIVALDS. The other expenses are the same. The expense of the home study, the fees by the agencies. Typically, there will be a fee to the agency or orphanage overseas that cares for the child. You will not be typically paying just for the care of your child. It will be a lump sum that the orphanage will use for the care of all the children, including those who cannot be adopted.

Mr. HERGER. Well, I thank you, and when we are thinking about what the American taxpayer is paying if these children are not adopted, the cost over a period of years, which is really the least of the cost, most of the cost is really to that individual child who is going without a loving parent or parents who can care for them,

and not that those where they are do not care for them, but it is obviously never the same.

It would certainly seem that a $5,000 tax credit, even that only goes—it is not even 50 percent, or barely of what the real costs are—it would seem to be a minimum—it would seem to be a very good investment to make early on for many thousands of dollars saved, I would think, over the long run.

So I thank you for what you are doing. I thank each of you. I certainly support you very much and, again, thank you for being here.

Ms. FREIVALDS. Thank you.

Mr. HOUGHTON. Thank you. Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman. Ms. Veney, let me thank you for informing me of special problems that your agency faces in the District of Columbia. Is it your understanding that, by law or by definition of the rules and regulations, that an African-American child, because he or she is African-American, is at risk or hard to place automatically?

Ms. VENEY. Yes.

Mr. RANGEL. So, therefore, this child, all of the fees and all of the funds that are available that would be paid automatically just because of the child's status.

Ms. VENEY. No, it is not automatic. But any child who reaches age 2 and is not placed can be classified as a special needs child and, therefore, the family is eligible for the benefits that I have described.

Mr. RANGEL. But you would not encourage the expense of a tax credit, refundable tax credit, because you think the special needs child, that most of these services and fees are waived so that there is no expense?

Ms. VENEY. My position, Congressman, is that in this time of very scarce resources, you need to direct the resources where you will get the greatest bang for the buck, I guess that is the expression that I would like to use. If you look at the 50,000 children, the Child Welfare League of America is saying were waiting in 1993——

Mr. RANGEL. I understand that. I have to get to my point, though. If I had no income problems and I wanted to adopt a black kid, are you just saying that I can rest assured I will have no fees to pay, that these fees will be picked up just because of the background of the child.

Ms. VENEY. No, I am not saying that. You may incur some expense. I am saying that at Family and Child Services, and in Washington, D.C., the likelihood is quite slim. In fact, at our agency, while the city allows a charge, $5,000, $2,500 would be the maximum fee.

Mr. RANGEL. I understand that. But you don't have a problem with families that want to, but they cannot afford these fees that they would get tax credits for the fees.

Ms. VENEY. Absolutely not.

Mr. RANGEL. Your problem is it expands beyond that of the child with special needs.

Ms. VENEY. Yes.

Mr. RANGEL. Now, Mrs. Molock, did you have the same understanding as Ms. Veney as relates to the child of color; that seldom if ever would you have any expenses? If you have no expenses, of course, you cannot take advantage of the credit?

Mrs. MOLOCK. My experience has been it depends on the agency and the jurisdiction. We live in Prince George's County, and in Prince George's County we adopted both of our children through social services there. There were no fees involved with the agency, but even those families have attorneys' fees they have to pay plus the expense of just raising their child.

Mr. RANGEL. Well, I would rather be on the side that says that no matter what the status of the child is that if we can facilitate the adoption of that child, that it helps society, it helps the child, it helps the parents. So I am for it.

But let me ask this, Ms. Veney. Isn't one of the problems we have with these at-risk children that many of them are born unwanted?

Ms. VENEY. No, that is not our experience. We have had a waiting list of 60 to 70 single people and couples waiting for African-American children for the last 5 or 6 years. The problem is getting the children for placement, freeing the children for placement, and that is a whole separate hearing.

Mr. RANGEL. Let me try——

Ms. VENEY. The African-American family is out there.

Mr. RANGEL. Let me interrupt, because I did not frame my question correctly. What you are saying is that you can do your job if you have the tools to do it. My question should have been and in my opinion and I hope yours, that there should not be the need to have so many children seeking parents out there. Would you agree to that?

Ms. VENEY. Yes.

Mr. RANGEL. OK. Would you agree that most of the children that end up without parents come from communities that have the highest unemployment, the highest dropout, the highest crime, the highest homelessness?

Ms. VENEY. Yes.

Mr. RANGEL. So one way to alleviate the problem of even placement would be to create conditions where those having the children would avoid it—having children—because they feel that they have a stake in life and opportunity and could not afford for their own sake to have a child that they could not take care of?

Ms. VENEY. I fully support that.

Mr. RANGEL. So we would not even have to think about the expenses involved in making this transition with the expenses of even the at-risk child if we made an up-front investment so that every child that finds themselves in this case would not be at risk, and it would be less expensive and easier for people to take these children into their home and their hearts.

Ms. VENEY. Yes.

Mr. RANGEL. Does anyone disagree with this exchange we have had?

Thank you, Mr. Chairman.

Mr. HOUGHTON. Thank you.

Mr. Ramstad.

Mr. RAMSTAD. Well, thank you, Mr. Chairman, and I want to thank all of you on this wonderful panel for your very important testimony here today. I particularly want to welcome my two fellow Minnesotans, Susan and, you, Joe, and thank you for being here today. I have long been an admirer of your two organizations, Adoptive Families of America and the North American Council on Adoptable Children.

I particularly appreciate, Susan, the line in your testimony and your statement that this is a matter dear to my heart. I know it is dear to the heart of everyone on this panel and it is also dear to my heart in that the three children closest to me are all adopted. My sister, my only sibling, and her husband, adopted the two Korean-born nieces that I have, and one nephew. So this is a very, very important matter to all of us here today.

I noted also, Susan, in your statement, that you say every day you receive calls from parents who wish to add to their family through adoption and typically they do not have the resources because they do not have the $10,000 to meet adoption expenses.

Let me ask you or any of the other witnesses, hopefully, we will in a bipartisan way, enact the $5,000 tax credit for adoption expenses and assuming we do that, do you have any studies, anything, any research or have you kept any numbers, do you have any estimates as to how many children could be adopted who are not currently being adopted if we enact this tax credit?

Ms. FREIVALDS. I am not aware of any studies that would give us hard numbers.

Mr. RAMSTAD. In other words, how many people do you think are actually not adopting now because they just cannot afford it?

Ms. FREIVALDS. Well, there is some evidence that there are maybe a million couples who are thinking of adopting. I think there also are many adoptive parents who would adopt more children than there are.

Adoption agencies have told me that they are not seeing the number of adoptive parents fall off for children as much as they are seeing the size of adoptive families shrink because of the expense of adoption as well as the cost of raising children, obviously. I wish I could give you a hard number, but we do not have that.

Mr. RAMSTAD. Well, that corroborates what I have been led to believe, certainly in talking with people from your respective organizations in Minnesota, as well as Roger Toogood and others from Children's Home Society and other organizations like this.

Well, I just, again, want to thank all of you for your very important testimony, for what you are doing in terms of education, information, and support to adoptive families and certainly we appreciate your testimony in support of the tax credit for adoption expenses. Thank you very much.

Ms. FREIVALDS. Thank you.

Mr. HOUGHTON. Mr. Payne will inquire.

Mr. PAYNE. Thank you very much, Mr. Chairman. I, too, want to thank all the panelists for being here and for the testimony today.

I would just like to go back and try to understand, Mr. Kroll, you mentioned that you felt that the title IV–E program was one that is very important and that we should continue to fund it. I think in your testimony you mention the funding for fiscal year 1995 is

$399 million. You mention that that should be level funded or funding should be increased in that particular program.

Mr. KROLL. Yes. Right now that program is an entitlement program uncapped, and it is really meeting the needs of children who are in the foster care system with special needs who are coming out of the foster care system and are adopted by families, and that program serves the kids who are most in need.

One of the things we have not talked about today very much is the fact that there is competition to adopt children in this country when they are healthy infants; that there are more adoptive families than there are adoptive children who are in the healthy infant category. When it comes to special needs kids, that is not the case. We need to recruit, we need to prepare, and we have to make sure we have the right family and then we need to provide them support. The title IV–E program does that very well.

Mr. PAYNE. Mrs. Veney mentioned in her testimony that we are looking at scarce resources; that one of the things we have to be cognizant of here is that as we have tax credits for various purposes, unless we are increasing the budget deficit, which we do not want to do, we have to find ways to decrease expenses correspondingly. Programs such as title IV–E and others all will, I am sure, be reviewed.

The question then becomes if there is a tradeoff, if a decision is being made about do we do more to fund the title IV–E program or should we have tax credits, I would be interested in anyone's comments about the tradeoff between those two. Where you think we would best spend the money: on tax credits or on title IV–E programs?

Ms. VENEY. Title IV–E.

Mr. KROLL. As an adoptive parent, I think the fairness issue is critical. I want it all, but I think the special needs kids really have got to be a focus, as they have been by the Federal Government for the last 15 years.

Ms. FREIVALDS. We all want to be fiscally responsible, and we certainly do not want to do anything with title IV–E, but I believe that a tax credit will prove to be a fiscally responsible way to move children into adoptive homes sooner so that they can be adopted as babies and do not grow up to become special needs children merely because of their age.

The cost of maintaining a child in out-of-home care is so great and is incurred on a per-year basis, that a one-time $5,000 tax credit, at a maximum, is, I think, really going to pale in comparison to $30,000 a year for group care or $10,000 for foster care per year per child. I would hate to see it come down to a competition between these two programs, as if either one of them is expendable, because I do not believe they are.

Mr. PAYNE. I do not think we want it to come down to competition between these two programs. But given the fact we now borrow more money than we should and we are looking at a balanced budget amendment and we need to reduce that deficit, as we look at the provision of tax credits, then we also have to look at corresponding ways we can reduce the costs. Whether it is in this program or another, there will have to be tradeoffs that are being made.

Ms. FREIVALDS. Well, let us try to look elsewhere than to our kids, if we can.

Mr. PAYNE. I think you are right, and I think you make a good point that this could be considered an investment, because as you invest the $5,000 today, it actually says to the Federal Government or State or local governments that there are less moneys perhaps that will be spent in the future.

Ms. FREIVALDS. Right.

Mr. PAYNE. I think your cause is one that is certainly one I support and it is a very good one. But we always need to think about how it is we are going to be able to be as fiscally responsible as we need to be. I thank you again very much.

Mr. COLLINS [presiding]. We thank the gentleman.

Ms. Veney, in your statement you refer to the fact that when special needs children are adopted, there are stipends that assist those families.

Ms. VENEY. Yes.

Mr. COLLINS. What stipends are those?

Ms. VENEY. Adoption subsidy payments that the family can receive up until the child reaches age 18. They are monthly. They are received monthly. In Washington, D.C., the lowest amount that a family would receive is $437 a month and the maximum would be $874.

Mr. COLLINS. Do those stipends come through SSI or some other agency?

Ms. VENEY. It is IV-E, yes. IV-E money, Social Security. But, in addition, Washington, D.C., has pulled together a pool of attorneys to provide free legal services, also, to cut down on that exorbitant expense that relates to adoption placements.

Mr. COLLINS. My interest is in the stipend. Does that stipend come regardless of the income level of the family?

Ms. VENEY. Yes.

Mr. COLLINS. Thank you.

Mr. Christensen, you are next.

Mr. CHRISTENSEN. Thank you, Mr. Chairman. I have a question concerning something Ms.—is it Veney?

Ms. VENEY. Veney.

Mr. CHRISTENSEN. Veney said earlier, but I do not know who can address it best. It is dealing with interracial adoptions and I do not know if there are other problems related to interracial adoptions.

I have heard of things where it is hard sometimes to, through regulatory things that we have done here, to make it harder to have interracial adoptions. Is there any truth to that? What can this body do to help in that area, if there is a problem?

I support everything you have said here today. I believe we need to have this kind of legislation put through, but I am also wanting to see if we can help—we hear about the terrible stories in Michigan and Iowa and some of the heart-wrenching things that have gone on, and I, for one, would sure like to see adoption be an alternative to what has been going on and to make it an easier alternative. I am open for ideas. Anybody.

Mr. KROLL. I think Senator Metzenbaum, last year, had legislation called the Multiethnic Placement Act that addressed two sides of that issue and it is probably the most gut-wrenching issue in the

adoption field today. One side that was addressed was the fact that in some agencies there are delays of children who are legally free for adoption in being placed on the basis of policies that would try to match a child with a family of the same race, and really trying to limit that as much as possible.

At the same time, we are well aware that families of color have a harder time accessing the system. All families of color do not have an agency like Family Services in Washington, D.C., to go to. They may have agencies that they are not comfortable with that have a number of children of their own race.

So it dealt with trying to get access for those minority families, at the same time making sure that children would not wait too long. I think that is where the policy in the country should be, do not delay placements, but make sure that the adoption system is open to everybody.

Mr. CHRISTENSEN. Any other thoughts?

Ms. FREIVALDS. That is Adoptive Families of America's position as well; that we need to put some efforts into working on the barriers to adoption by families of color. Because that is a significant problem, especially when the issue comes up where there are waiting families, such as at this agency, and waiting children in another jurisdiction and they cannot seem to get together.

As we said, this is probably a whole other set of hearings, but it is a significant problem.

Mr. CHRISTENSEN. OK.

Mr. MCDERMOTT. Families of Private Adoption would like to concur in that also. We would like to promote transracial adoption, but, at the same time, promote same race adoption. I think this would—Mr. Kroll made the point well in his earlier testimony that giving this tax credit to families of color will bring more of them into the system and promote adoption.

On your point about the tragic contested cases that have occurred in places like Iowa, the problem with trying to address that on the Federal level is that adoption is largely a product of State law. Each State has its own separate set of laws on how one goes about doing an adoption or freeing a child up for adoption, and there is some progress being made on that at this time.

There is a Uniform Adoption Act that has been proposed by the National Conference of Commissioners on Uniform State Laws, and that is up for consideration by each of the States to see if they wish to enact that into their own legislation. If that happens, there will be more uniformity across the country, and, I feel, fewer problems like we saw in some of these media attention cases.

Ms. VENEY. If I might add just one point, let me dispel the myth that African-American families are not available. There are African-American families available waiting to adopt. One of the tragedies is what you heard this morning with the biracial youngster who was placed not too far from Washington, D.C., in a white family while there are families here in Washington, black families waiting to adopt.

The problem with the transferring of these children is that if we have, for example, a black family waiting to adopt and there is a biracial or a black child in a private agency, we will have to pay

the cost that that agency incurred in taking care of that child before that agency will transfer the child to us for placement.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

Mr. COLLINS. Thank you, Mr. Christensen.

Mr. McDermott.

Mr. MCDERMOTT of Washington. Thank you, Mr. Chairman. I spoke earlier about the whole question of subsidized adoption for hard-to-place kids, and I have a fundamental problem with this proposal in that it is not specific enough. If you take a family, let's say an aerospace mechanic and his wife, who are 35 years old, and he makes $55,000 a year working at the Boeing Co., and he and his wife want to adopt a child, and you have another family making, between the husband and wife, $15,000 or $20,000 apiece, why should you spend what little bit of money we have on subsidizing somebody, the first couple, who, obviously, are capable of taking a child into their home and subsidizing them?

Why should you have this across-the-board kind of program rather than one that relates to the needs of the child beyond those of normal child rearing?

I referenced earlier the program in the State of Washington for subsidized adoption for mentally handicapped, physically handicapped, and mixed racial kids. Seems to me that a targeted program is the only kind of thing that really makes sense. I would like to hear anybody give a justification for this across-the-board thing.

How do you know who that helps? Isn't it really a windfall for some people?

Ms. FREIVALDS. Well, I think the cap on income, on the adjusted gross income that is part of the bill, addresses your issue. Perhaps you feel it is too high at $60,000 phasing out at $100,000, and perhaps it is, but I think that is why the bill includes that provision so that it is not a windfall to people who can obviously afford this expense.

The other issue for adoptive families, though, is an equity issue; that our family building expenses are not seen as legitimate expenses that should receive beneficial tax treatment like the family building expenses of people who give birth to their child.

Mr. MCDERMOTT of Washington. But give me the example of what—besides attorneys' fees, what other family building expenses——

Ms. FREIVALDS. That is what I am talking about.

Mr. MCDERMOTT of Washington. You are saying it is attorneys' fees; you want to limit attorneys fees' in this country?

Ms. FREIVALDS. I am sorry, I thought you said maternity fees.

Mr. MCDERMOTT of Washington. Attorneys' fees.

Ms. FREIVALDS. I am talking about the fact that it does not seem fair to adoptive families that all of the expenses that they have, that we have gone through here today, the fees of the adoption agency, the fees of having their home study done so that they are approved to adopt, even the medical expense. They pay for the birth of their child. Because the child is not a dependent at that time, it is not deductible to that family. However, for the family that gave birth to the child, all of that would be deductible as a medical expense.

That is the equity issue that really does not seem fair to us; that we have these very significant expenses that if we had given birth to the child would be deductible, but because we have not, they are not.

Mr. McDERMOTT of Washington. Then you would be open to the idea of us limiting the amount that any adoption agency could charge, would you?

Ms. FREIVALDS. Oh, I think that is problematic. I would have to see a specific proposal, I guess, on that. Most adoption agencies are nonprofit to start with. I know that they do, some of them, use the fees that they get for adoption to do other good work.

For example, they will charge more for the adoption of a healthy child than they will for the adoption of a child with special needs as a way of subsidizing the adoption of the child with special needs. Absolutely, a laudatory kind of thing to do, but it does result in these high fees that we have for the adoption of some children.

Mr. McDERMOTT of Washington. So you are saying that the reason kids do not get adopted in this country is because they cannot pay the up-front $5,000?

Ms. FREIVALDS. I think that is part of the reason, absolutely. I think that we have seen that, for example, in the study that Joe Kroll referred to with African-American families. They name that as their No. 1 reason they were unable to adopt.

Mrs. KENNELLY. Would the gentleman yield?

Mr. McDERMOTT of Washington. Yes, surely.

Mrs. KENNELLY. May I ask a question? What about white infants. Do you think the $5,000 makes any difference? It is my understanding there is a waiting line for——

Ms. FREIVALDS. No, I think white infants will be adopted.

Mrs. KENNELLY. I understand that there is still a waiting list to adopt white infants in this country.

Ms. FREIVALDS. I think that is true. They will be adopted by the higher income people, though. That is just I think a given; that we are shutting out some of the lower and moderate income folks to adoption of babies because they just cannot afford it.

Mr. KROLL. I was at a training session for adoptive parents and we got into the discussion of race, which is a very controversial issue, and as we were describing the situation that African-American families face trying to adopt infants, the lower income white families said that is us, too; that we do not have the same resources to adopt a healthy white infant that other people might have. So there are large numbers of couples who are, and singles, who would be very good parents, but who do have a fiscal barrier and I was saying in my testimony there are a lot of families of color who fit that description.

Mr. McDERMOTT of Washington. I think——

Mr. COLLINS. The gentleman's time has expired.

Mr. McDERMOTT of Washington. If I may say one thing, that is my point. If this were a more targeted thing so the fact that people who actually cannot pay for it—at a $60,000 income, you can pay for having a kid come into your home, or you should not be considering it. You are living too high. But at $25,000, then those maternity fees—and I think there has to be some recognition it is not a

black and white question here, it is a poor versus rich question. That is what the question is.

Thank you, Mr. Chairman.

Mr. COLLINS. Thank the gentleman.

Ms. Kennelly.

Mrs. KENNELLY. Yes, thank you. Let me just take a moment. One of our earliest witnesses more or less insinuated that was a question about party or choice, and I want to say for the record I think any Democrat here is very much in favor of adoption, and those of us who are pro-choice certainly encourage adoption.

Having said that, I am sure all of you have been following in the press and everywhere, I guess, the Contract With America, and one of the pieces of it is the suggestion that anybody 18 and under who has a child, an illegitimate child, not married, will return to live with their families and will not receive cash assistance. They can continue to receive food stamps and Medicaid, but not the AFDC check. We all agree this is not a situation for a child to set up their own household.

However, what impact do you think this will have? Will there be more children being put up for adoption? Have you thought about this as you have read about the Contract, and know what a fast track this is on? If you would help us with that, I would appreciate it.

Ms. VENEY. The impact will be many more sickly babies than there are now because the mothers who will be having these children will not have the wherewithal for prenatal care and nutrition and those things are of concern.

If you look at the medical records of the mothers who are now leaving their children for adoption, you will see children who did not receive prenatal care prior to delivery of the child. So while I will not speculate on the number of children who will hit the market as a result of that, I will speculate the children that we will see will be much sicker.

Mr. KROLL. I would have a fear that more children will come into the foster care system for neglect primarily but also abuse, and those children won't necessarily be relinquished for adoption. They will come into the foster care system and then be processed forever and ever and may become a special needs kid when they are 8, and that isn't a goal that anyone should have. I think we need to provide support to a child from birth through whatever program that is appropriate.

But getting the child—getting more children into the public foster care system is not a goal that anyone should have.

Mrs. KENNELLY. Have you got any suggestions for us? Is there any other alternative solution? Because I am really struggling with this. It is fine to say go back to the home, live with the family. But if the family is dysfunctional, what is the alternative?

Mr. KROLL. There was a program highlighted in the Minneapolis Tribune just Monday, and in that paper they highlighted a program where young mothers with children were taken in as a group with positive parenting models. It was like foster care, but it was—the young mother, the teen mother and the child, so that they had a support system and that that family then, maybe after the young woman graduated from high school, could then go out on her own.

But it was working—it wasn't separating that mom and kid. It was keeping them together with an older couple who was providing support and guidance.

Mrs. KENNELLY. Mr. Kroll, would that older couple be subsidized?

Mr. KROLL. That was a foster care placement, yes. They received State and I assume Federal support for that.

Mrs. KENNELLY. It is hard to see how you do this without any backup or any support.

Mr. KROLL. Oh, you absolutely have to have backup, yes.

Mrs. KENNELLY. Thank you. I thank some of you for mentioning the fact that 72 percent of the children waiting for adoption have special needs. When the gentleman in the chair was talking about subsidies, I think I am right. Subsidies are the reason people do adopt, are able to adopt. They take a special needs child who is desperate for affection and a family. With the special needs comes the subsidy that is necessary so that the adoption does in fact occur.

Mr. KROLL. I think if you look at the description of the children at the end of my testimony you are talking about kids with severe problems, physical problems, children who have been abused so they have serious emotional problems. We have to support the families who step forward to take those kids in.

Mrs. KENNELLY. So the program we have now is working.

Mr. KROLL. Yes, it does work.

Mrs. KENNELLY. Thank you.

Mr. COLLINS. Mrs. Dunn.

Ms. DUNN. Thank you very much, Mr. Chairman, and thank you, panel, for coming. I am sorry there aren't more of us. But, as you have heard before, there has been debate on the floor, and we have had to be present for that.

I am coming at the young unwed mother issue from a different direction from Mrs. Kennelly, and I have a great fear of a young teenage unwed mother who chooses to keep her child and moves on to welfare. I believe that that creates a cycle, exactly the cycle we want to tear ourselves away from.

I would like your help in understanding this situation. I want to make a connection mentally in my own mind. If we move ahead with the Contract welfare plan, which would restrict any kind of welfare payments, not all but most kinds, from an unwed mother, do you think the effect of that would be that fewer unwed mothers would keep their children in their home if, for example, they did not have a home, a family to move back into? Do you think that they would give that child up for adoption?

If you think that would be the effect, how would that affect the business that you are in of helping loving parents find a child to adopt? It is an effect—what I am looking for is a connection that is different from what we have been discussing, the effect of the high costs on parents.

Mr. MARK MCDERMOTT. I don't think that eliminating welfare payments to mothers will necessarily increase the incidence of adoption. I think that concept sells the birth parents short who are involved in these cases.

I think most of the professionals that are with me will agree with this. There are many dynamics that go into the decision of a birth parent to make an adoption plan for a child. While economics is certainly a part of it, perhaps an important part, I don't think the birth parents that I have had the good fortune to come in contact with over the years in my profession would make a decision solely on that basis. They do not say I am going to relinquish my child for adoption because I can't get welfare benefits. I think they do—they do it because they love that child, and they want what is best for that child. They make a loving, sacrificing decision that is not going to be made just because they can't get a welfare payment.

Ms. FREIVALDS. I agree with that as well. When you ask birth mothers why they choose to place their child for adoption, the fact that they couldn't support the child is not typically at the top of the list. It is a choice for other reasons. I agree that this is likely to increase the number of children in foster care rather than the number of children in adoption.

Mr. KROLL. My father's father died when he was very young, and my father spent 6 years in orphanages in the twenties. My father died when I was 9, and my mother raised four children between the ages of 3 and 14. Fortunately, at that time she had a welfare program available to her, Social Security, widow's benefits. That was a change over 50 years in the way government has looked at families, and I have to say that that support that my mother had was invaluable.

I think that we have to look at the value of some of the welfare programs as well as the problems. I think that we have to support families, and if they are poor families, we have to look at what we can do to help those mothers raise their children because, typically, they are single moms. Employment opportunity is very important.

In my children's school, young mothers were brought back into school to finish their high school education, and day care was provided on the campus. I am not sure if it glamorized that situation or if it said to some of the other young women I don't want to get into this situation. But there was a support system there set up for those young mothers so they could maintain their families, graduate from high school, and move on.

Ms. MOLOCK. In my professional work as a psychologist, most teenage mothers that I work with don't get pregnant and keep their children because of welfare checks. Usually, the money is the last thing they are concerned about. That is something that is presented in the media a lot. I don't think that will have an impact on adoption.

Most of these mothers are chronically unemployed. They are living in hopeless situations. Oftentimes, although it is unrealistic, they look a lot to their role as a mother as the only meaningful role that they are going to have in their life. Getting a welfare check is not something that they are considering.

Ms. DUNN. Thank you. Thank you, Mr. Chairman.

Mr. COLLINS. Thank you, gentlelady.

Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman.

Just a quick question for Mr. Kroll. I do appreciate the time that the panel spent. We have sufficiently explained that there has been

work on the floor that has kept most of the Members away. I intended to ask this question or at least make a suggestion, but I will in the followup.

I know what that Social Security program is about because that kept our family together. My sisters and I lived with an elderly aunt rather than go to alternative forms of living, and it was very, very important to us. I would like to think in some measure that I have become one of the chief defenders and protectors of Social Security in the House.

You did raise a question before I would like you just to elaborate on. You talked about special needs children. You talked about parental preparation. Would you just elaborate on that for a couple moments?

Mr. KROLL. Yes. Families who are adopting children from the foster care system (who have been in care for a number of years, who have got the problems, as I illustrated) need to be prepared for those children. They need to be aware of the conditions of the kids. They need to make an active decision that they can care for that child. They need support, both in training as well as medical services, counseling services, et cetera.

But there are excellent programs now that prepare families, because, in the last 20 years, kids who used to be in institutions are now adopted. We have those programs all over the country, in every State that serves families who adopt these special needs kids.

Mr. NEAL. Thank you very much.

I will just close on this note that before the Reagan administration cut those Social Security benefits, one of my sisters and I, we were able to go to college while we received those benefits as well. Terribly, terribly important.

I know that the press would like to have the public believe that everybody that came to the House was born to come to the House. That is not the way this institution works. The House is a very careful reflection of American life. The truth of the matter is that, in some measure today, I give great thanks to Mr. Roosevelt who the new Speaker of the House has proclaimed as the great President of this century. I give great credit to Mr. Roosevelt for going to college, having stood against the forces that would have denied those kind of basic benefits to the American people.

Thank you.

Mr. COLLINS. Thank you, Mr. Neal.

Mr. McDermott has requested to ask another question.

Mr. MCDERMOTT of Washington. Ms. Molock raised the question which prompted me to think of something I watched on television. I watched Phil Donahue one day talk to a woman who had put as many as six kids into the adoptive system. The program was about how they had made deals with people to kind of carry them along on an income basis during that process.

One has to be very careful to draw one's conclusions from what one sees on Phil Donahue. So I would like to hear from you how much of a problem you think that really is in the whole adoptive scene. Because if you are going to put $5,000 out there and some people know that adoptive parent is going to get a $5,000 tax credit, you have set up a situation where there is a pot of money. I would like to hear your comments because you are all experts in

this field and are actually working in the field today. I would like to hear what you think.

Mr. MARK MCDERMOTT. I can start off, I guess, and address that.

I don't think it is a legitimate problem. It is one of these things that we see in the media. It is sensationalized. It makes for good copy on the Donahue show.

In my experience as an adoptive parent and an adoption attorney and my broader experience as the past president of the American Academy of Adoption Attorneys, I see a lot of what goes on around the country. If you are talking about illegal payments being made by adopting parents to birth parents, while of course there are some cases—isolated cases—where that happens, that is certainly not commonplace. It is not the norm.

Mr. Totaro in his earlier testimony made the point that all of the courts that review these cases and finalize these adoptions require financial accountings under oath that are reviewed by the judge and approved by the judge before an adoption can be finalized. So there are controls on this.

The people that do adoptions are not, except in some exceptional situations, doing anything other than following the letter of the law. They would be crazy to do otherwise because the aspect of taking a child into your home, making that child a part of your family and having some serious legal cloud like that hanging over your head. That would create a risk of your adoption being disrupted which is the sort of risk that only a fool would take.

Ms. MOLOCK. Plus I think one of the things adoptive families have to deal with is when you are home studied you go through an FBI check. So I think that those cases that are on the Donahue show are aberrations. It is not the norm.

Mr. MCDERMOTT of Washington. That was my opinion, but I wanted to get it into the record, because some might think that that was a common practice, and I really think that that is not what generally goes on. I think it is a difficult job making an adoption work in the first place. But that is really a very, very rare kind of case. Thank you.

Thank you, Mr. Chairman.

Mr. COLLINS. We thank the gentleman. We would also like to take this time to thank the panel for taking time to come and express your views and opinions about the legislation. We appreciate you very much and, at this time, you are dismissed.

Mr. COLLINS. We will call the next panel: Nancy Summerfield, Val Halamandaris, and Suzanne G. Mintz. We want to thank each of you for being here today.

Nancy Summerfield from Reno, Nev. We will start with you, Ms. Summerfield.

STATEMENT OF NANCY SUMMERFIELD, RENO, NEV.

Ms. SUMMERFIELD. Thank you. Mr. Chairman and members of the committee, I would like to thank you for giving me this opportunity to be here. I would especially like to thank my Representative, Barbara Vucanovich, who has taken the lead in putting the issue of long-term care into the Contract With America.

I am here because I cared for my mother in my home for 8 years. Mom recently died during the holidays from Alzheimer's disease.

As a matter of fact, if she were still living I wouldn't be able to attend this hearing. I am speaking to you on behalf of not only Alzheimer's but other millions of Americans caring for loved ones with other disabilities. My experience is not unique.

I would like to say that the $500 tax credit is an indication that our country and representatives are becoming aware of the financial burden of care giving. It will help some Americans. However, there is a greater need than a tax credit. What is needed is financial help on a regular basis. The $500 is a start in the right direction.

My mother was a strong, independent woman. She raised four daughters by herself, and she worked full time as a civilian for the Armed Forces. As a matter of fact, this is kind of ironic because she dedicated her life working for government, and when she finally needed help. the government wasn't there.

During her illness with Alzheimer's disease, she qualified for Medicaid, but because it was my choice to keep her at home, she received no financial assistance. Her income was used for her care. Other expenses such as utilities, food, clothing, housing, and many other expenses were provided by my husband and myself. If my mother had been admitted into a long-term care facility, Medicaid would have paid the expenses.

It always baffled me that the laws provide assistance for care in a licensed facility, yet to keep a person in their own home or with family members the law provides little or no assistance. It stands to reason that an ailing person will do much better and be much happier if they are with friends and family rather than strangers.

I am using Alzheimer's disease as an example because that is what my mother was afflicted with. However, there are many other diseases and disabilities where individuals require care giving and the expenses are not in many cases recognized as medical or are not tax deductible. As an example, my mother could not even qualify for the definition as disabled for income tax purposes yet she could not eat by herself, speak, bathe, or even walk.

The expenses of care giving are not necessarily for medicine or physician costs. Often, as in my case, the largest expense was the cost of paying someone else to care and stay with my mother so I could continue to work, make a living, and stay productive in society.

In order for many families to keep their loved ones at home, a family member must often sacrifice their living standard. I myself gave up a 26-year career with the government in order to continue to care for my mother.

During the 8 years my mother lived in our home, my mother-in-law also lived with us—with my husband and I—for more than 1 year. She was bedridden due to complications from diabetes and cancer. It was necessary for both of us to provide care for each of them, continue to work, and manage to provide care giving in our absence. It became very costly.

I realize that in order to provide more benefits there is additional cost to the government. However, if some of the existing laws were modified, the government could save money. If Medicaid benefits were changed to assist home-bound patients rather than just li-

censed facilities, it would be less expensive. Costs in the home for the same care or better would be much less.

The first 3½ years I cared for my mother, she was able to attend an adult day care facility during the hours I worked. This was a lifesaver for me. The program was funded through county and Federal grants. These programs need to continue to receive government funding and be expanded.

There is a proposal in the Contract With America that could have made an important difference to us, to make long-term care tax deductible. I paid the bills willingly, but it made me angry I could not deduct these expenses from my mother's nor my income tax. The costs were a result of my mother's illness and should have been considered medical expenses. Mother needed care because she was ill.

Long-term care is a huge problem in this country for millions of families facing Alzheimer's and other diseases and disabilities. Not all of them are elderly. What we need to do in this country is develop community services that people need and give them real financial help to pay for them, whatever their age, whatever the reason for their disability.

I cannot sit here and say that a $500 tax credit would have made a big difference to us. It is a gesture, a step toward recognizing that families are taking on a big job, and they need help. It would be better if it were more money and if it was not just for people caring for parents and grandparents.

There are just as many people providing this kind of care for spouses, adult children, siblings, and other family members. They face the same kind of financial burdens we did.

Once again, I would like to thank Representative Vucanovich for taking the lead in recognizing the long-term care issue. The $500 tax credit is a good start.

Thank you for giving me this opportunity to tell my story.

[The prepared statement follows:]

STATEMENT OF NANCY SUMMERFIELD
of Reno, Nevada

House Ways and Means Committee
January 18, 1995

Mr. Chairman and Members of the Committee. Thank you for giving me this opportunity to be here. I would especially like to thank my representative, Barbara Vucanovich, who has taken the lead in putting the issue of long term care into the Contract with America.

I am not an expert on tax law. I am here because, for the past 8 years, I took care of my mother who came to live with my husband and me when she got Alzheimer's disease. My mother died last Thanksgiving. I am speaking to you on behalf of the families who are out there today taking care of the 4 million Americans living with Alzheimer's disease. I am also here to speak for the millions of families caring for loved ones with other disabilities. I am President of the Alzheimer's Association for Northern Nevada and my experience of caring for my mother is not unique. I'm sure that many of you have constituents who could tell you a similar story.

I would like to say that the $500 tax credit is an indication that our country and representatives are becoming aware of the financial burden of caregiving. It will help some Americans. However, there is a greater need than a tax credit. What is needed is financial help on a regular basis. This $500 is a start in the right direction. It will probably mean the most to low income families, but it is the middle class American that really needs assistance.

My mother was a strong independent woman. She raised 4 daughters by herself and she worked full time as a civilian for the armed forces. In a way, that is the most frustrating part of the story. After a lifetime of working for the government, when she finally needed help, the government wasn't there for her.

During her illness with Alzheimer's disease, she qualified for Medicaid. But because it was my choice to keep her at home with loved ones where she received love and individual care, she received no financial assistance. Her income was used for care. Other expenses such as utilities, food, clothing, housing and many other expenses were provided by my husband and me.

Alzheimer's disease is a medical disease. It is a deterioration of the brain, yet many costs related to caring for victims of the disease are not recognized as medical deductions.

If my mother had been admitted into a long term care facility, Medicaid would have paid the expenses. It always baffled me that the laws provide assistance for care in a licensed facility, yet to keep a person in their own home or with family members, the law provides little or no assistance. It stands to reason that an ailing person will do much better and be much happier if they are with friends and family rather than strangers.

I am using Alzheimer's disease as an example because that is what my mother was afflicted with. However, there are many other diseases and disabilities where individuals require care giving and the expenses are not in many cases recognized as medical or are not tax deductible. As an example, my mother could not even qualify for the definition of <u>disabled</u> for tax purposes and claim the disability deduction. Yet, she could not eat by herself, speak, bathe, or even walk.

The expenses of caregiving are not necessarily for medicine or physician costs. Often, as in my case, the largest expense was the cost of paying someone else to care and stay with my mother so I could continue to work, make a living, and stay productive in society. In order for many families to keep their loved one at home, a family member must sacrifice their living standard. I, myself, finally gave up a 26-year career with the government in order to continue to care for my mother.

During the eight years my mother lived in our home, my mother-in-law also lived with my husband and me for more than a year. She was bedridden due to complications from diabetes and cancer. It was necessary for both of us to provide care for each of them, continue to work, and manage to provide a caregiver in our absence. It became very costly.

I realize that in order to provide more benefits there is additional cost to the government. However, if some of the existing laws were modified, the government could probably save money. If Medicaid benefits were changed to assist home bound patients and not just licensed facilities, it would be less expensive. Costs of long term facilities can be $3000-$4000 monthly. Costs at home for the same care, or better care, would be much less.

The first three and a half years I cared for my mother, she was able to attend an Adult Day Care facility during the hours I worked. The program was funded through county and federal grants. This was a life saver for me. These programs need to be expanded. My mother was released from the program because she became incontinent and advanced into another stage of Alzheimer's disease. If these programs continue to receive government funding and are expanded to accommodate more advanced individuals, this would also save money because it would allow families to keep their loved ones home for a longer time.

There is a proposal in the Contract with America that would have made an important difference to us. That is the proposal to make long term care expenses tax deductible. I paid the bills for my mother's care willingly. But it made me angry that I could not deduct those expenses from either my mother's or my income tax. The costs were a result of my mother's illness and should have been considered medical expenses. Mother needed care because she was ill.

Long term care is a huge problem in this country for millions of families facing Alzheimer's and a lot of other diseases and disabilities. Not all of them are elderly. What we need to do in this country is develop community services that people need and give them real financial help to pay for them – whatever their age, whatever the reason for their disability. That is a much bigger discussion than the one we are having here today.

I cannot sit here and say that a $500 tax credit would have made a big difference to us. It is a gesture, a step toward recognizing that families are taking on a big job and they need help. It would be better if it was more money, and if it was not just for people caring for parents and grandparents. There are just as many people providing this kind of care for spouses, adult children, siblings, and other family members. They face the same kind of financial burdens we did.

Once again, I would like to thank Representative Vucanovich for taking the lead in recognizing the long term care issue. The $500 tax credit is a start, especially when it is combined with the provision to make long term care expenses deductible.

Thank you for giving me a chance to tell my story. I would be happy to answer your questions.

Mr. COLLINS. Thank you, Ms. Summerfield.
Mr. Halamandaris.

STATEMENT OF VAL J. HALAMANDARIS, PRESIDENT, NATIONAL ASSOCIATION FOR HOME CARE

Mr. HALAMANDARIS. Thank you, Mr. Chairman. It is a pleasure to be here with you this morning.

I would like to begin by commending you and the members of this committee for holding a hearing and focusing on the most crucial problem that we have in America, which is keeping families together. Families are the bedrock of American society. You are here to be commended for looking and seeing what we can do to help support them.

We also want to commend you for recognizing the changes in the tax law and the Tax Code inevitably affect and influence social policy in this country. So we think that you are on the right track. We thank you for that, and we support what you are doing here and your suggestion to offer a tax credit for people that need help and assistance in caring for parents and grandparents.

My long history as chief counsel with the House Aging Committee and before that with the Senate Aging Committee, some 20 years of experience in that field—I wrote a similar bill back in 1974, which went nowhere, and I am glad to see the concept resurrected for your consideration.

It has been said by other witnesses this morning, and I would like to reiterate, that—things that I am sure you already know—long-term care is a massive problem that we face in this country. We are presently spending about $58 billion in long-term care, most of that in nursing home care and most of that in the Medicaid program.

If you ask the Governors, Republicans and Democrats alike, what the biggest problem they have in their State budget is, they will say the Medicaid program. It is difficult to keep up with that. Most of it goes to provide nursing home care.

The Governors in 1992 and again in 1993 passed a resolution asking the Congress for more flexibility and for the ability to use some of those Medicaid dollars in home and community-based care. They figured out they could spend similar dollars and cover more people.

With specific reference to the program in Mr. Rangel's State, New York State has a program called the Nursing Home Without Walls. You probably know very well, sir. This was something that was created by the legislature. Individuals who are about to gain admittance to a nursing home, if their care can be met for 75 percent or less of what the State deems it would pay to put them in a nursing home and there are qualified home care agencies who can provide comparable care, they are allowed to do so.

There have been numerous studies by the legislatures and indeed by the auditors of New York State that have documented that they saved over 50 percent what they normally would have spent in community-based care as opposed to what they would have spent by putting people in institutions. I commend that program for your interest. I would just like to have us look at the system in general terms and what it encourages.

The Medicare program, as we all know, valuable as it is, does not pay for long-term care at all. Private insurance only pays for about 5 percent of the cost of long-term care—it is growing, thank goodness, but it still is inadequate. It is difficult to protect yourself for dealing with the cost of a long-term illness.

I heard Senator Rockefeller talk about Alzheimer's with his mother in saying we have resources. Everybody knows we have resources, but it stretched those resources to the limit to care for our mother who needed long-term care. If he and his family have trouble, I suggest most of America is going to be beyond troubled with the problem.

So there is basically nothing you can do to protect yourself right now against the costs of long-term care. You can't save enough money to deal with it. You can't buy private insurance to protect you. Medicare doesn't cover it. The only way you get help or assistance is by going on the dole, going on the welfare program, and then what is offered is the Medicaid program.

Well, I just want to suggest to you that we can do better than this. If you think about it, what is the cost of placing somebody in a nursing home in this country? The average person who goes into a nursing home is in there 30 months, and the cost is about $2,100, on average, nationwide. Some States a lot more. Every individual we place on the Medicaid program costs us $100,000.

Now, when you compare that with the tax credit that could be given to people, and if they share the costs of caring for their mother or their father or if they don't pay taxes, there is some sort of a negative tax credit, it would be indeed very, very helpful to keep some of those people at home where they prefer to be, as opposed to placing them in an institution and having them go through this elaborate gaming of the system.

There are books and there are lawyers that teach you how to make your parents eligible, your grandparents eligible for the Medicaid program, basically to divest themselves of all their assets. Wouldn't it be much better to give families a tax credit to care for their parents and indeed to be able to share it among several children, which is beyond the scope of the bill that has been introduced?

I would suggest to you if it costs $100,000 on average to put somebody into a nursing home, then the $500 tax credit is small by comparison, and that amount needs to be adjusted.

But I again would like to reiterate and commend this committee for looking at this problem. We do think that the system we have in place is flawed and needs to be changed and needs to be adjusted.

I am not here advocating that Medicare be retrenched or that the Medicaid program be cut dramatically. I am suggesting some reallocation of the dollars that we are currently spending along the lines that have been suggested by the Governors and others.

One final comment that I have suggested, the Tax Code already allows a one-time $120,000 tax credit if you sell a home, your principal residence, in your retirement years. You can have that escape capital gains tax, at least up to $120,000. I see nothing wrong with allowing families to take that credit incrementally year by year in the form of an annuity.

There are a series of programs now called reverse annuity mortgages where people slowly draw down the proceeds of their home, provided that it is used—and I emphasize this again—provided that it is used to provide for your long-term care. In that instance and only in that instance do I believe that it should be possible.

Again, the Tax Code currently allows it one time. I am suggesting that we ought to be able to allow people to do that incrementally over a period of time provided the care goes to meet their long-term care needs.

Again, I commend this committee and the Members for looking at what are some very important problems and looking beyond that at the value to society, because that is what unites us as a society.

Thank you, Mr. Chairman, members of the committee.

[The prepared statement follows:]

Testimony of Val J. Halamandaris, President

National Association for Home Care
Washington, D.C.

My name is Val Halamandaris. I am President of the National Association for Home Care (NAHC), which represents our nation's home care providers -- including home health agencies, home care aide organizations and hospices -- and the people they serve. NAHC is committed to assuring the availability of humane, cost effective, high-quality home health services to all individuals who require them. In short, NAHC's principal mission is keeping families together.

I would like to take this opportunity to commend the Chairman and the Committee for examining ways to assist families. We are delighted to work with this Committee on ways to help families care for parents and other loved ones at home. We believe in individual responsibility and family responsibility to care for the aged, infirm and disabled to the extent it is possible to do so. We believe the problem of long-term care is so great that private insurance as well as state and federal governments must share their resources now and in the future in order to deal with it.

As one who served as counsel to both the House and Senate Aging Committees, I have a long history with family caregiver issues and understand both the financial and physical toll that providing for a dependent loved one has on American families. In fact, in 1974, I helped write a bill that would have provided tax credits to families for health care costs, much along the lines of H.R. 11.

Long-Term Home Care: The Growing Need

I want to stress our views that long-term care is one of the most devastating problems America faces today. Estimates indicate that between 9 and 11 million Americans of all ages require long-term care because of chronic illnesses or disabilities that render them unable to perform basic tasks of daily living without assistance. This number could double by the year 2030 to more than 19 million.

Today we are spending some $57.8 billion on long-term care, mostly for nursing home care. Medicare does not provide for long-term at all and Medicaid limits its reach largely to institutional care for individuals whose income places them below the poverty line. Private insurance does not begin to provide adequate protection for the cost of long-term care. As a consequence, many families exhaust their physical, emotional and financial resources providing and purchasing long-term care. A million Americans a year are impoverished trying to meet the cost of long-term care. Only the most wealthy Americans are insulated from potential financial devastation caused by the need for long-term care which can happen to anyone. The sad truth is that there is nothing most Americans can do to prevent their lifetime savings from being wiped out in a matter of months paying for long-term care.

After more than 32 years of experience, I am a strong advocate of long-term home care because it improves the quality of life, is cost effective and most of all, keeps families together. It reinforces and supplements the care provided by family members and friends and maintains the recipient's dignity and independence, qualities that are all too often lost in even the best institutions.

I would like to call to the Committee's attention the positive experience of the states with long-term home care and their judgment that it is highly cost effective allowing the same or fewer dollars to be used to provide higher quality of care for more people.

Long-term home care is also often much less costly than institutional care. New York State's experience with its Nursing Home Without Walls program has been a great success. It takes individuals who are eligible for Medicaid and allows them to be cared for at home if the costs so incurred are 75% or less than the cost of comparable nursing home care. Well-documented studies by the New York State Senate have proven that the program has allowed the state to save them 50% of the cost for these patients which would have been incurred had they been placed in a nursing home.

I would also like to call to the Committee's attention other models that work. Medicaid waiver programs have increasingly made use of home care services as a way to reduce their Medicaid costs. For example, New Mexico's waiver program for people with AIDS estimates a savings of $1100 a month for patients who use home care rather than skilled nursing facility care. The average patient plan of care costs $1000 a month for home care compared to $2100 a month for skilled nursing facility care. Moreover, New Mexico reports that only about 47% of patients receiving waiver services are hospitalized in a given year, compared to 70% of those not under waiver.

The National Governors' Association (NGA), after years of study, recognized this and adopted a resolution in 1992 stressing the importance of home- and community-based services as a key component of health care reform. NGA recommended elimination of the current institutional bias in public programs such as Medicaid. The Governors, both Republican and Democratic alike, are asking for more flexibility to make greater use of home care as the more preferred and cost effective method of meeting the growing need for long-term care.

In many ways, the problem we face with long-term care is the direct result of the success this Nation has had in promoting longer, healthier lives through medical advancements, which have been supported by programs such as Social Security and Medicare. Any efforts to meet the Nation's long term-care needs should build upon these national success stories.

The tax credit for family caregivers as envisioned in H.R. 11, The Family Reinforcement Act, is a good first step toward providing the proper incentives to encourage family members to care for loved ones in the home. It appropriately uses tax policy to help shape social policy. For example, the deductibility of Individual Retirement Accounts (IRAs) is specifically geared towards encouraging Americans to save money. We would go even further than the Committee in saying that when an individual in retirement years draws on his or her IRA for purposes of paying for their long-term care bills, these funds should be exempt from taxation. Whereas current laws encourage individuals to resort to unethical behavior of hiding assets or spending-down their income in order to become eligible for Medicaid, a program largely limited to coverage for institutional care, a tax credit for individuals who take on the burdens providing care for a parent or grandparent is an excellent idea which would keep families together by caring for loved ones at home.

The very nature of home care and hospice is to help keep families together; to help care for individuals in the least costly, most effective setting; and to help individuals retain their dignity and independence. This Act, therefore, will work towards a goal upon which all Americans can agree: keeping families together.

Expanding H.R. 11

It should also be stated that long-term care is an intergenerational problem which is defined not by age or family relation but by disability. All family members are vulnerable -- children born with disabilities, parents paralyzed in an accident, grandparents stricken with Alzheimer's Disease. Approximately one-third of those who need long-term care services are under 65 years of age. Rather than limiting the tax credit to parents, grandparents and spouses, the Committee should extend these incentives to families who care for a disabled child, brother or sister. Through the tax code, we should encourage families to care for their own at home.

The tax credit should also be available to adult children who shoulder their parents' health care costs, even if the parents are able to continue to live in their own homes. And the credit should be available in cases where adult children share the costs of their parent's long-term home care needs. Under current tax law, even in cases where children share the costs, only one child can claim the costs on his or her income tax return. Changing this policy will make it easier for families to work together to meet these needs, without asking any one family member to bear the full weight of these costs. According to sociological studies, one sibling often becomes the burden bearer, whereas we believe all children in a family should be encouraged, through the tax code to participate.

By limiting the credit only to some family members, and only in cases where parents live with their adult children half the year, whole segments of society will be denied an incentive for providing care in the home. Expanding the credit as we have suggested here will help fulfill the commitment to American families as promised in the "Contract with America."

Tax Credits Can Complement Other Federal Programs

The tax credit proposal in H.R. 11 will help families care for their loved ones at home. While a good and worthwhile first step, it will not fill the need millions of Americans face every day in their struggle to care for family members -- young and old -- who need long-term home care. A $500 tax credit, while certainly worthwhile, will not significantly offset the tremendous costs involved in caring for a loved one in need of long-term care. Only a national long-term home care program can ensure that all individuals in need of care have access to high quality, affordable home care. Tax credits should be viewed as an addition to, and not a substitute for, further action.

Neither should it be viewed as a substitute for any part of the Medicare or Medicaid programs. The tax credits should not be paid for through any reductions in these programs. Any incentives provided through a tax credit could easily be wiped away if the credit is financed through cuts in the Medicare program. For example, a 20% payment on Medicare home health services would require the average home health beneficiary to pay $965 in increased out-of-pocket costs. The $500 tax credit provided to the taxpayer, therefore, will be dwarfed by the increased cost to the beneficiary.

I would like to stress that the primary option currently available for families who need long-term care is to require a spend down and impoverish themselves so Medicaid will step in and pay for the cost of nursing home care. There are even numerous handbooks on the market which do a lively business teaching people how to establish eligibility. Once a patient enters a nursing home, their average length of stay is about 30 months at an average cost of $2100 a month. That means the taxpayer will pay an average of $100,000 for every person so placed. We believe it makes a great deal more sense as a matter of social policy to increase the amount of tax credit available to families so they will be encouraged to combine their resources and provide the care needed by their relatives. To be meaningful, the amount of the tax credit should be a great deal higher than $500.

The tax code presently allows a one-time exemption from capital gains coming from a sale of a primary residence of a senior citizen. I see no reason not to allow the same exemption from taxation for reverse annuity contracts in which seniors slowly draw down the equity in their homes provided this money is used to pay for the cost of medical care and especially long-term care.

Conclusion

I want to again thank the Chairman and the Committee for inviting the National Association for Home Care's views on this important matter and for your leadership and interest in helping meet the very real and compelling needs of American families. A great many improvements can be made today, and in keeping with the Contract with America, ones that can bring real and immediate improvements to families struggling to keep their families together and shoulder the emotional and financial burdens of long-term care.

I look forward to working closely with you in this Congress on H.R. 11 and other issues the Committee will consider.

Mr. COLLINS. Thank you. We would like to inform each panelist that your full statement will be entered into the record.

Ms. Mintz.

STATEMENT OF SUZANNE G. MINTZ, PRESIDENT, NATIONAL FAMILY CAREGIVERS ASSOCIATION, ON BEHALF OF THE HOME CARE COALITION

Ms. MINTZ. Thank you, Mr. Chairman, for this opportunity to testify today.

My name is Suzanne Mintz, and I am president of the National Family Caregivers Association, an organization dedicated to improving the lives of the Nation's approximately 18 million family care givers. In case you are unfamiliar with that term, family care givers are those individuals who care for a loved one who is chronically ill or disabled.

When I was 28 years old, I became a family care giver. It was then that my husband, Stephen, age 31, was diagnosed with multiple sclerosis, a debilitating and incurable neurological disease. In the ensuing 20 years, we have struggled to redefine normalcy while living with the increasing disability. Stephen uses a wheelchair and needs assistance with the basic activities of life, such as dressing and transferring.

I am pleased to testify here today on behalf of the Home Care Coalition and its more than 100 national organizations. The Coalition is a diverse group, dedicated to enhancing consumer access to quality home services, supplies and equipment. The Home Care Coalition is delighted that the Contract With America includes a $500 refundable tax credit for individuals caring for a parent in their home since help for care givers is one of our legislative priorities.

I have to question, however, why the Contract considers those care givers who assist an elderly parent to be more deserving than those care givers such as myself who care for a spouse or those who care for a chronically ill or disabled child. We, too, are in need of equal help and support.

Care giving cuts across all generations and family relationships. To dissect us into groups makes neither good economic sense nor good policy.

I know a couple here in Washington, both of whom are in their seventies. They are not being cared for by anyone. Rather, they are caring for their own adult child who is bedridden with multiple sclerosis. In this case, the elderly are caring for the middle aged. Are not these people entitled to a tax credit?

I implore the committee to examine carefully the complete spectrum of family care giving. It is a mistake and poor policymaking to single out one group of care givers for support.

Collectively, family care givers provide two-thirds of all the home care services in this country. We provide it for free with love and based on a sense of duty.

The National Family Caregivers Association estimates that the market value of care giver services is over $190 billion a year. The number is so staggering let me repeat it—over $190 billion of free service every year.

Let me make clear this is not our replacement value. That amount would be a great deal higher. It is only an estimate of what

we would be paid at market rates for providing basic, nonmedical care giving services 4 hours a day, 7 days a week.

Family care givers provide a wide range of services, such as dressing, feeding, bathing and toileting, activities that most people take for granted. We provide other services as well: transportation, shopping and management of financial affairs. We dress wounds, give injections and, with the increasing sophistication of medical technology, we can now even give people IV therapy at home.

In addition to care giving, many family care givers are employed full time. Those who work part time or not at all face significant financial burdens which are compounded in their own old age because care giving does not accrue Social Security benefits. These care givers, in effect, are being doubly penalized.

There are many debilitating aspects of care giving, financial drain just being one of them. Others include depression, isolation, negative changes in family dynamics and complex decisionmaking for another person's life.

The proposed $500 tax credit is a gesture toward lessening these conditions. It is a first step. Some people will use it to get much needed respite care, a few hours away on a regular basis.

Getting a break from care giving is what many surveys show care givers want most and find most beneficial. In fact, protecting care givers from burnout is the most cost-effective thing that you can do.

Some people will use the $500 tax credit to pay for basic medical expenses. Many care giving families do not have any insurance and those that do are often confronted with significant out-of-pocket expenditures for the patient's therapies or medications. Because of this, many care givers forego their own medical care.

Some people will use the $500 tax credit to pay for equipment and other items that promote independence and enhance the quality of life. My husband has hand controls in his car. These have enabled him to continue to go to work, earn a living, and pay taxes. The cost was $500. We have just spent $5,000 to make our home more accessible so that he can shower and use the toilet without my help. Neither of these costs are covered by insurance.

Because of all these reasons, Mr. Chairman, the proposed elderly care tax credit is a critically needed first step in recognizing the contribution of America's family care givers and our need for help in caring for our loved ones. But recognize it is only a first step and a small one at that.

The Home Care Coalition has again defined other significant measures that it believes will strengthen the family and improve home care, and we hope you will consider these additional proposals which are in our written testimony.

In conclusion, I would like to read a quote from a family care giver, a woman who should be in the prime of her life who is caring for her spouse.

> I feel that my life has become a day-to-day existence with no hope of a happily ever after. I feel like a very old 46-year-old. I am needed but get no strokes or warm fuzzies. I care for him, but who cares for me?

Please help us find an answer to that question.

[The prepared statement follows:]

STATEMENT OF SUZANNE G. MINTZ
PRESIDENT
NATIONAL FAMILY CAREGIVERS ASSOCIATION
ON BEHALF OF THE
HOME CARE COALITION
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
January 18, 1995

INTRODUCTION

Good morning, Mr. Chairman, and thank you for giving me the opportunity to testify today. My name is Suzanne Mintz, and I am President of the National Family Caregivers Association, an organization dedicated to improving the lives of the nation's approximately 18 million family caregivers. Family caregivers, sometimes referred to as informal caregivers, are those individuals who care for a loved one who is chronically ill or disabled.

I am pleased to testify here today on behalf of the Home Care Coalition. NFCA is an active participant in the Coalition which is comprised of more than one hundred national organizations. I am here to express the Coalition's strong support for the proposed Elder Care Tax Credit in the House Contract with America.

I would like to begin my testimony by sharing with you some background on my life and why the issue of family caregiving is so important to me. When I was 28 years old, my husband Steven, then 31, was diagnosed with multiple sclerosis, a debilitating and incurable neurological disease. In the ensuing 20 years, we have struggled to redefine normalcy while living with his increasing disability. Today Steven uses a wheelchair and needs assistance with some of the basic activities of life, such as dressing and transferring. During the past twenty years I have suffered from two bouts of clinical depression and our marriage was disrupted by two periods of separation. It is because of my own experiences that I co-founded the National Family Caregivers Association with my long time friend, Cindy Fowler, who cares for her 82 year old mother who is afflicted with Parkinson's disease.

Cindy and I both know the personal and financial toll that caregiving takes on American families, regardless of whether they are caring for a loved one who is elderly, middle aged or still a minor. We know full well why a tax credit for family caregivers would be so beneficial. Proposals such as the Elder Care Tax Credit enhance the quality of life for both the caregiver and their loved one, and thereby reinforce the family unit.

THE HOME CARE COALITION

The National Family Caregivers Association is an official member of the Home Care Coalition, which was founded in January of 1991. The Coalition is a diverse group of organizations representing consumers and patients, family caregivers, health care professionals, providers, and manufacturers dedicated to serving people in their homes. The mission of the Coalition is to enhance consumer access to quality home care services, supplies, and equipment, and it focuses attention on providing education and communications advocating the benefits of home care to policymakers and the public.

HOME CARE COALITION'S SUPPORT OF THE ELDER CARE TAX CREDIT

The Home Care Coalition has identified specific ways to improve access to home care. The Elder Care Tax Credit provides an excellent first step towards achieving our goals. There are other critically needed approaches as well, and we look forward to presenting to Congress this year legislative initiatives which recognize and support home care as a cost-effective and patient-preferred alternative to institutional care. Legislative initiatives to encourage home care that the Coalition supports include patient choice of provider, caregiver issues, coverage of home IV and respiratory therapy serivces, reimbursement issues, and quality assurance controls for the patient receiving home care services, supplies and equipment.

Specifically, the Home Care Coalition supports the following legislative initiatives:

I. Caregiver Issues

Caregiver Tax Credit - Provide $500 refundable tax credit for individuals caring for a chronically disabled grandparent, parent, spouse or child in their home.

Personal Assistant Services/Attendant Care Demonstration - On a demonstration or pilot project basis, require all payors (Medicare, Medicaid and private payors) to provide defined period of personal assistant services/attendant care services to persons with disabilities requiring assistance with activities of daily living.

Caregiver Safety and Well-Being - Require all payors to take into consideration the safety, health and well-being of the primary caregiver when determining the medical necessity of, and prescribing, appropriate home health services and home medical equipment (HME). Authorize payors, including Medicare, to pay for specific items and upgrades of otherwise medically necessary HME when, in the clear and documented clinical judgment of the prescribing health care professional, the HME recommended will significantly reduce the risk of injury to the unpaid primary caregiver.

II. Patient Choice

Patient Choice of Provider - Require health plans to allow a patient to go to a provider of their choice outside of their health plan's network at no more than a reasonable charge to the patient.

Patient Choice/Upgrade - Amend the Medicare law to authorize beneficiaries to pay suppliers who agree to take assignment on their claims the balance above the Medicare allowable for the equipment which has functional or other features exceeding those of the item determined by Medicare to be covered. Further amend the Medicare statute to clearly continue to allow a supplier to submit any claim for payment under assignment for an item the beneficiary chooses to upgrade.

III. Coverage and Reimbursement Issues

Home Care Benefit Package - Include legislatively defined comprehensive home care services, supplies and equipment in any standard health benefit package.

Medicare Coverage for respiratory therapy services - Cover respiratory therapy services under Medicare.

Medicare Coverage for home intravenous (IV) therapy - Cover home IV therapy services under Medicare.

Medicare Coverage for occupational therapy - Cover occupational therapy under Medicare.

Non-Discrimination against home care - Provision would eliminate any financial or other disincentives for utilization of home care under Medicare or private payor systems. (Requiring home care beneficiaries to pay a co-payment for care is a disincentive to use home care when there is no co-payment required for institutional care.)

Reimbursement for physician home care visits - Medicare and other payors should reimburse the physician at a reasonable fee for medically necessary home care visits to a patient in the home.

IV. Quality Assurance

Certification of Suppliers; Quality Standards - Establish Medicare supplier standards based on the complexity of the services provided for suppliers to be able to bill Medicare for durable medical equipment, prosthetics and orthotics (DMEPOS). For example, suppliers providing respiratory equipment and related services would have to meet more rigorous standards than suppliers providing only "traditional" HME such as hospital beds and canes. Further, suppliers providing

certain "life-supporting" equipment and related services would be required to meet even higher standards.

V. Miscellaneous

Home Care Data System - Provide for a series of data management improvements, including administrative simplification, standard claims processing forms (paper and electronic) for all public and private payors, and standardized home care data management to facilitate communications among providers, payors, *etc.*

Home Care Council - Establish a national council on home care to make recommendations to Congress, and to develop proposed changes in regulations and policy related to the provision of home care. The national council would make recommendations on simplifying consumer understanding of home care benefits and payments. The Council would include consumers, providers and fiscal intermediaries. The Council would make recommendations to the Secretary on streamlining procedures for approving coverage criteria and appropriate reimbursement for new technology products.

The Home Care Coalition is delighted that the Contract With America includes a $500 refundable tax credit for individuals caring for a dependent parent or grandparent in their home, since this provision is one of our legislative priorities. This very family-friendly proposal will provide some needed support for our nation's family caregivers.

I have to question, however, why the Contract considers those caregivers who assist an elderly person to be more deserving than those caregivers, such as myself, who care for a middle aged spouse, or those who care for chronically ill or disabled children. We, too, are in need of equal help and support. Caregiving cuts across all generations. To dissect us into groups makes neither good economic sense, nor good policy.

I know a couple here in Washington, both of whom are in their 70's. They are not being cared for by anyone; rather they are caring for their own adult child who is bedridden with Multiple Sclerosis. In this case, the elderly are caring for the young. Are not these people entitled to a tax credit?

I implore the Committee to examine carefully the complete spectrum of family caregiving. It is a mistake and poor policymaking to single out just one group of caregivers for support.

WHY THE TAX CREDIT IS NEEDED

Family caregivers provide two thirds of all the home care services in this country. We provide this service out of love and duty, and we provide it for free. The National Family Caregivers Association estimates that the market value of caregiver services is over $190 billion a year. The

number is so staggering, let me repeat it - over $190 billion dollars of free service every year. Let me make clear - this is not our replacement value. That amount would be a great deal higher. It is only an estimate of what we would be paid at market rates for providing basic non-medical caregiving services, four hours a day, seven days a week.

Family caregivers provide a wide range of services. These include helping people with activities of daily living, such as: dressing, feeding, bathing, toileting and transferring - things that most people take for granted. These 'ADL's'- as they are called - often become major aspects of our lives, and take hours of time, and become major topics of conversation. We provide other services as well, such as: transportation, shopping, housekeeping, help with financial affairs and filing insurance claims. We dress wounds, give injections and, with the increasing sophistication of medical technology, we can now do procedures that previously could only be done in the hospital. A good example of this is intravenous or IV therapies.

For many caregivers, caregiving is a part-time job. Many caregivers, such as myself, are employed. Many are the principal or significant breadwinner in a family. Many others have dependent children at home. Those caregivers who are not employed, or who are underemployed, face significant financial burdens, burdens which are compounded in their own old age. Their caregiving prevents them from accruing social security benefits so they are, in effect, being doubly penalized.

Family caregivers are the invisible link in the health care chain. We are not only helping our loved ones, we are also assisting the health care industry, both public and private. Studies show that those patients who have family caregivers follow their medical regimens more completely and return to the hospital and emergency rooms much less often than those individuals who lack a family caregiver.

Caregivers receive no recognition for their service and virtually no help. This tax credit is a significant first step in rectifying this inequity. What you have to ask yourselves is what is the cost to the country if caregivers fall apart? What is the cost to the country if we too become ill in the process of caregiving? It is staggering compared to the cost of a $500 tax credit.

This is not an idle question. In a recent survey conducted by the National Family Caregivers Association, 49% - virtually half - of all respondents said they had experienced prolonged depression because of their caregiving experiences. It is very difficult to care for another when you are in the throes of depression. I know; I was there, and I dread the thought of ever being that sick again.

Depression can be just one of the debilitating aspects of caregiving. Others include isolation, changes in family dynamics, loss of friends, loss of personal time, complex decision making for another person's life, and financial drain. The $500 tax credit will not change all of that, but it certainly will help. It will give people the opportunity to get assistance.

THE ELDER CARE TAX CREDIT PROVIDES ASSISTANCE IN MANY FORMS

Respite Care

Some people will use the tax credit to get much needed respite care, a few hours on a regular basis, or an actual mini-vacation. Getting a break from caregiving is what our survey showed caregivers want most.

Listen to what one caregiver says on the need for respite:

> "The hardest thing is to make family understand you need time away on a regular basis. You talk; they agree; but after several times it becomes a chore to them and you feel guilty for asking. I wish there was a movie, tape or book I could give them to make them understand the importance of time away."

Hiring a home care aide to provide much needed respite, that's one of the things the $500 tax credit will be used for.

The Cost of Care

Even for those of us who have health insurance, many therapies and pharmaceutical needs are not covered. Insurance most often pays far less than actual medical costs. Out-of-pocket expenses in reality can be significant, and in some cases, catastrophic. Many people who are ill or disabled don't have any insurance, and neither do many of their caregivers. The $500 tax credit will be used to pay for medication, at home therapies, and other aspects of medical care that caregiving families use in abundance. Many people in fact forego therapies just because they cannot afford them.

As one caregiver eloquently told us:

> "I have been caring for my husband for five years. He is a double amputee and paralyzed. I need health insurance for myself because I cannot afford to pay for it with a part time job."

Paying for basic medical care, for both themselves and their loved one -- that is what some caregivers will do with the $500 tax credit.

The Cost of Equipment and Enhancing the Quality of Their Lives

I am convinced that the people who draft the rules about what health insurance covers - whether private insurance or Medicare - are not caregivers. My husband has hand controls in his car. These have enabled him to continue to go to work, earn a living, pay taxes. The cost of the hand controls are not covered by our insurance. We have a stair glide in our house. It cost $3,000. It was not covered by our insurance. We have a lightweight wheelchair. It costs a great deal more

than a standard wheelchair - the type that Medicare would reimburse, for instance. We were lucky with that. Our insurance paid 80%. But no insurance will cover the $5,000 we just spent to make our home more accessible so that my husband can shower without my help.

Paying for things that provide the ill and disabled - and their caregivers with a better quality of life, these are the things that will be purchased with the $500 tax credit.

CONCLUSION

The proposed Elder Care Tax Credit will assist a great many people. It is a critically needed first step towards recognizing the contribution of America's family caregivers and their need for help in caring for their loved ones. The extra money may be spent on respite care, doctor's bills, at home therapies, better medical equipment or quality of life items. It will even be spent by some on paying the rent and buying nourishing food.

The Home Care Coalition is firmly convinced that the Elder Care Tax Credit is money well spent. The Coalition has identified a number of other similar legislative initiatives that it believes will strengthen the family and that recognize and support home care as a cost-effective patient-preferred alternative to institutional care. Once the Committee completes consideration of the Contract and moves on to other legislative issues, we hope that you will consider these additional proposed changes.

The Home Care Coalition applauds your initiative and appreciates the opportunity to testify on this important provision which will provide needed relief to America's family caregivers and recognition of their valuable contribution and the benefits of home care.

Finally, I would like to read you one more quote from a family caregiver - a woman who should be in her prime of life, who is caring for her spouse.

> "I feel that my life has become a day to day existence with no hope of a "happily ever after" - I feel like a very old 46 year old. I am needed, but get no strokes or warm fuzzies. I care for him - but who cares for me."

Help me, and other caregivers, find an answer to that question. Thank you. I am happy to respond to any questions you may have.

The Home Care Coalition

Advocate for the Elderly and Disabled
American Academy of Home Care Physicians
American Society of Consultant Pharmacists
American Association for Continuity of Care
American Association for Respiratory Care
American Cancer Society
American Federation of Home Health Agencies
American Red Cross
Daughters of Charity National Health System
Health Industry Distributors Association
Help For Incontinent People
National Association of Retail Druggists
National Hemophilia Foundation
United Ostomy Association
The ALS Association

Mr. COLLINS. Thank you, Ms. Mintz.

We will first go to Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman. Mrs. Summerfield, Ms. Mintz, Mr. Halamandaris, thank you very much for being here.

Ms. Mintz, I am not sure we can answer the question which you pose to us, because that is far broader and has much deeper implications than anything we can discuss today. But I would like to ask all of you—maybe you would like to make a comment on a couple of things.

I guess we all feel that if you had a preference, the home care issue is something we really ought to wrestle with and tie down because people would prefer to be at home than other places. But in terms of the ongoing considerations about the cost, about speed of recovery, is it better there? I mean, is this something that we really should be putting a major push toward? Or is it sort of a marginal consent? What about it? What about those specific things?

Ms. MINTZ. Studies have shown that people do better at home with a care giver than if they are left on their own, that people follow their medical regimens more successfully and return to hospitals or emergency rooms much less often.

Mr. HOUGHTON. What about the costs? Do you find that on an overall basis in terms of the care given over a period of time really the costs are less or much more? What is your experience?

Ms. MINTZ. Well, what you have to realize is that dealing with home care isn't just a medical issue. A lot of the things that people do to care for somebody are what are generally referred to as custodial kinds of things. So it is not strictly a medical—a medical issue that we are dealing with. If I am interpreting your question correctly, you are asking this on a medical level. Am I misinterpreting?

Mr. HOUGHTON. Absolutely. On a medical level.

Ms. SUMMERFIELD. May I answer that or try?

Mr. HOUGHTON. Yes.

Ms. SUMMERFIELD. On a medical level, like Suzanne said, a lot of times the home care is not—you don't need a professionally trained registered nurse for home care because it is custodial care. So it is going to be less expensive to keep a person in your home versus a rest home when the average cost of a rest home is, in our State, in Nevada, is about $3,100 a month. It does not cost $3,100 a month to keep somebody at home.

For my mother, it didn't cost me that much. It probably cost me about $1,000 a month because you don't have to pay as much for custodial help as you do a registered nurse, for instance.

Mr. HALAMANDARIS. If I could chime in, Mr. Houghton. Thank you for asking the question.

Our studies indicate that home care is always, to the extent that you can generalize, always less expensive than providing similar care in a hospital. This is because hospitals are very expensive places. I have not been able to find one example of where it costs more to take care of somebody at home than in a hospital.

Take, for example, chronically ill children. The cost of taking care of a child with a ventilator is over $50,000 on average in the hospital and, at home, the same child can be cared for for about $5,000.

With respect to nursing home care, generally it is less expensive. All the studies indicate that. But there are some circumstances where some of these needs are so acute it becomes more expensive to take care of somebody at home than it does in a nursing home setting.

Mr. HOUGHTON. Well, there is an argument that the health care—present health care reimbursement is skewed toward caring for people in institutions. So, therefore, I would assume that you feel that this tax credit is going to try to have a better balance.

Mr. HALAMANDARIS. Yes, sir. I think that is exactly right. All the studies, as you have said yourself, indicate that people prefer to stay at home. Whether you poll the seniors or whether you poll children or families, the fundamental part about home care and about these hearings and the reason they come together is the Contract With America is about keeping families together. That's the best argument I can give you for home- and community-based services.

Because when you place somebody in a hospital or a nursing home, any kind of institution, by definition you shatter your family. You put your mother into a nursing home or an institution of any kind, the families are broken apart. That always is more expensive in the long run, not only to society but to the individuals involved.

Mr. HOUGHTON. Well, also, if I understand from Ms. Summerfield, that in addition to keeping families together it costs about one-third of what it would in an institution.

Ms. SUMMERFIELD. In my particular case. As he said, it really depends on the medical problem. My mother had Alzheimer's. She didn't have any medical expenses. Her expenses were for paying a care giver while I continued to try to work and support my family—the rest of my family.

Mr. HOUGHTON. Well, that is very helpful, and I appreciate it very much, your comments.

Thank you, Mr. Chairman.

Mr. COLLINS. Thank you, gentlemen. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. I have no questions at this time.

Mr. COLLINS. Thank you. Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

I appreciate all three of you being here today.

I happen to be a veterinarian by profession, and I know some people compare animal behavior to that of people, and in my experience, even animals that are boarding in an animal hospital are not nearly as happy. They don't do nearly as well, especially some different breeds of dog.

Certainly I think that different animals are like different people. I mean, they function much better, they are happier. I think it has been proven in medical circles across the board that the happier that people are and the more satisfied that they are, the healthier that they are. I don't think that there is any question in any medical circles about that.

So I appreciate your being here. I think that this is the first step toward encouraging as much home health care as we possibly can because it is cheaper and more compassionate.

When we ask how the government can help, this is one way the government can quit hurting people by directing them toward institutionalized type care.

I applaud your efforts for being here today. I don't really have a question for you other than just to say thanks for your efforts, and, hopefully, this is just a good first step for us.

Thank you, Mr. Chairman.

Mr. COLLINS. We thank the gentleman.

Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman.

I just want to say that I agree very much with the gentleman from Nevada, and I would like to just express some of my own personal experiences. Not only are we saving the taxpayer—I think we mentioned that it is probably about one-third—I don't know what it breaks down to, but at least one-third I believe you mentioned, Ms. Summerfield, in the State of Nevada.

But I believe there is another aspect that really we can't put monetary value on, and I am thinking of my own experience growing up. My own grandmother lived with us. She finally passed away at the age of 84 when I was 12.

But the value to children of having their grandparents or loved ones with them in the home, the extra love, the affection, the hearing of stories that went on, family history, we can go on and on and on of what it adds to a family atmosphere, being able to have these loved ones around, in addition to the monetary saving, many, many taxpayer dollars, again I think is really value. We cannot really put a value on that. So I want to commend you for what you are doing and lend my support to it.

Thank you.

Mr. COLLINS. We thank the gentleman.

Ms. Summerfield, you used a name earlier that I haven't heard used in a long time, and that was rest home.

Ms. SUMMERFIELD. Oh.

Mr. COLLINS. What that brings to mind is my boyhood days, because my mother and father opened our big two-story house in Georgia to senior citizens, and it was called the Bessie Collins Rest Home. It is a phrase I have not heard in a long time. Not especially since the nursing home came into play.

Mr. Halamandaris, you mentioned the States and the cost of providing institutional care and the cost of Medicaid. Of course, the States bear a big portion of that cost. We had a couple of Governors here last week, and they mentioned, too, the cost of Medicaid. They mentioned the fact that States can obtain waivers. Do you have any idea how many States do have waivers?

Mr. HALAMANDARIS. Sir, I don't have that exact number, but I will be very happy to submit it for the record. I know the number is increasing, and the administration early on liberalized the waiver procedures and made it possible for more States to get them. So I don't have the exact total, but I will submit it.

Mr. COLLINS. Very good.

[The information was not received at the time of printing.]

Mr. COLLINS. Why is there so much resistance to the fact that States be allowed to use Medicaid funds for other than just institutional care?

Mr. HALAMANDARIS. I can't really tell you.

I have been in this town, as you have, many, many years. I go back some 30 years. We helped write the Medicaid program when I was counsel to the Senate Aging Committee. At that time, we decided to start slow and to begin with hospital and institutional care.

Years later, some of the architects of both Medicare and Medicaid—Wilbur Cohen and Wilbur Mills and others—testified before Claude Pepper's committee when I was counsel there and said the biggest mistake we made when we enacted those programs is that we did not allow for greater use of long-term care and community-based care.

As you remember, Congressman Pepper spent most of his final years in the House arguing that we should do exactly what you said, give the Governors more flexibility and broaden the scope of long-term care coverage to make up for some of the gaps in the existing programs. But I think there was just an early resistance and that resistance has not been overcome until just lately.

Mr. COLLINS. There is evidence by most States that have obtained waivers that they have reduced their costs. Is that not true?

Mr. HALAMANDARIS. Yes, sir. That is correct. There are very good studies. I referenced previously the State of New York that in many ways has been ahead of us, not to say that they have totally reduced all their problems. But they have reduced their costs a great deal, as I understand it.

Mr. COLLINS. Very good. Thank you.

Mrs. Johnson.

Mrs. JOHNSON. I am sorry I haven't been able to get here earlier. I have worked with most of you in some context in home care and am very pleased with this portion of the Contract. It is beginning to reshape the package of health care subsidies that seniors but also families need in America as we learn to care for people outside of institutional settings and help people live satisfying lives, even with serious disabilities, over many years but also needing far more support care. So I just wanted to recognize the good work that you all do in the area of home care and appreciate your support of these provisions. Thank you.

Mr. HALAMANDARIS. Thank you, Mrs. Johnson.

Mr. COLLINS. Thank you, Mrs. Johnson.

If there are no further questions, the panel is dismissed; and we appreciate your coming and sharing your thoughts and testimony with us.

Ms. SUMMERFIELD. Thank you.

Mr. HALAMANDARIS. Thank you, Mr. Chairman.

Mr. COLLINS. The next panel: Richard Lank, Elizabeth Liska, Carol Abaya, Carmen Queen-Hines, and Barbara Adolf. Come forward. We will receive your testimony.

OK. We appreciate each of you joining us this afternoon. We will go by order.

Richard Lank, executive director of the National Eldercare Coalition. Mr. Lank.

STATEMENT OF RICHARD LANK, EXECUTIVE DIRECTOR, NATIONAL ELDERCARE COALITION

Mr. LANK. Thank you, Mr. Chairman, ladies and gentlemen of the committee. I want to congratulate you all for recognizing elder care as an issue that must be addressed in this year's Congress.

Elder care is a term that redefines the way America accepts the reality of an aging population and increasing longevity. Instead of isolating the concerns of the elderly from the general population by couching all policy discussions in the passive terms of long-term care and dependency, elder care is a term that actively involves the adult children of the elderly, and it emphasizes the interdependence of the generations.

The Contract With America calls for a refundable tax credit of $500 per eligible taxpayer. As admirable as this provision is, let's examine the specifics of the proposed credit in view of the laudable goals of this committee and this Congress.

First of all, we will begin with the premise that amending the Tax Code has one of two basic objectives: No. 1, to increase revenue for the Treasury or, No. 2, to modify a specific behavior or set of behaviors in the marketplace.

Clearly, this committee is not seeking to increase taxes. If the intent, then, is to encourage families to provide care to elderly relatives in a home environment in lieu of a nursing home, or at least to postpone placement into a skilled nursing facility, then it has fallen short of the mark, and here is why.

No. 1, the tax credit is too narrow in defining eligibility. The language of the proposed credit is similar in every way to section 129 of the IRS Code, known as the Dependent Care Assistance Program, which was originally drafted as a flexible benefit for employed persons with child care responsibilities.

Because children are by definition "dependents," living with the taxpayer or the parent, section 129 codifies total dependence. It was broadened to allow for elder care also, but is so restrictive that very few employees can qualify for eligibility. No one, elders and adult children alike, would want their circumstances to become so severe that the elder becomes a dependent in the same way as a 3-year-old child.

In order for a family to be eligible for this new $500 credit, the elderly parent or parents must be living in the same primary residence as the taxpayer or care giver, must be disabled or mentally impaired, and must be incapable of taking care of themselves. Mr. Chairman, relatively few taxpayers are in this situation, and fewer still would want to be, if other choices are viable.

Many people are caring for an elderly parent who is still living independently but who could not remain independent without the efforts of the younger family members.

No. 2, the tax credit would be too small to offset significant elder care support costs which are nonreimbursable.

The $500 in tax credits is definitely helpful to offset some nonreimbursable expenses and may actually replace income lost to taking nonpaid leave for care giving, but unless working families have other relief, then nursing home placements with Medicaid coverage will remain the less expensive, though frequently least desirable, alternative.

No. 3, most elder care pressure is felt by women. The majority of working-aged women are now in the work force. Most of the new jobs created since the recession has abated have gone to women. Therefore, both section 125 and section 129 of the IRS Code should be amended to enable more employees to have access to tax-advantaged earnings for elder care benefits in conjunction with the proposed $500 credit.

Regardless of intent, our current Tax Code and the Medicare and Medicaid program have skewed the choices of the care for elderly toward dependency and nursing home care. The Federal system does not yet provide incentives for families to choose elder care over institutional long-term care, nor does it reward employers to add meaningful benefit plans to active or retired workers, but it can.

A rational policy for addressing an aging population should seek to reduce the drain on the Treasury for outlays by HCFA for institutional long-term care by providing relief through the Tax Code and Medicaid waivers long before an older person becomes eligible for "dependent care" status. Such a policy should reinforce, No. 1, ongoing management of chronic, not acute, health care conditions; No. 2, wise management of financial resources of the entire family unit; No. 3, the coordination of applicable benefits between the generations; No. 4, reviewing medications through drug utilization review; and, No. 5, assessing home safety and making home modifications to accommodate aging.

Therefore, I am recommending that a selective tax credit be allowed for all wage earners who are expending money out of pocket for elder care support when the parent is still living in his or her own home. This credit should not be allowed for a random grab bag of services, determined solely by the taxpayer, but rather for private case management to oversee the implementation of the care plan.

Case management provides advocacy for the family, arbitration and mediation in the event of a conflict with a vendor of services in the community, and can provide the accountability that is needed when the constraints of time and distance make it difficult for the adult child to oversee the parent's situation.

Mr. Chairman, I thank you very much for this opportunity to present these recommendations. I know that the committee is looking at multiple approaches to financing services for the elderly, which we have addressed in written testimony. Ultimately, this tax credit is a very important part of the solution. A thoughtful combination of tax strategies and managed care waivers will meet the needs of older Americans and their families in choosing the best prospects for a long life in this and the coming millennium.

Thank you, sir.

[The prepared statement follows. Due to the size of attachments, they are being retained in committee files.]

TO: HOUSE COMMITTEE ON WAYS AND MEANS
Ms. Norah Moseley, Joint Committee on Taxation

FROM: THE NATIONAL ELDERCARE COALITION
Mr. Richard Lank, Executive Director

RE: WRITTEN TESTIMONY
for Hearings held on Wednesday, January 18, 1995

Ladies and Gentlemen of the Committee:

As this Congress endeavors to develop new approaches to the most vexing challenges facing this society now and into the next millennium, members of the Committee on Ways and Means will be examining the inter-related topics of long-term care and eldercare benefits. As you have begun in earnest to address all of the many issues that face our aging population, you are investigating the means by which tax credits and tax incentives can assist working people and other relatives caring for older family members. I respectfully suggest that, while such tactical moves are urgently needed, what has been proposed so far is not a whole strategy. Before sending any legislation to mark-up, I urge you to first look at the larger perspective, and see the connection between all of the confluent trends that should impact your decisions in shaping public policy during the 104th Congress.

In light of the demise of employer mandates in the sweeping health care reform proposals made last year, and in acknowledgement of the goals of the more recent Contract with America, it is obvious that the keystone to the new Congress's legislative agenda will be encouraging solutions to many problems in private sector innovations. For eldercare and long-term care issues, the family is recognized as one critical force in caring for the nation's elderly citizens; H.R. 6, H.R. 8, H.R. 9, and H.R. 11 do address tax strategies designed to assist families care for older, frail relatives.

However, the nation's employers, voluntary associations and labor unions remain central players in providing benefits to vast numbers of people; employers have an enormous role to play in financing benefits and pensions that complement every entitlement program that the federal government offers. Businesses, big and small, must be given every incentive to offer new approaches to eldercare and group long-term care benefits.

The National Eldercare Coalition ("The Coalition"), in analyzing this matter for Congress, had to first establish a list of pertinent issues and trends that each should be factored into the public policy equation. By articulating each issue (trend/policy) as a preface to the recommendations contained herein, it is the intent of the Coalition to give the Committee on Ways and Means a broad context in which to understand the critique of the pertinent proposals contained in the Contract with America and the additional recommendations made by the Coalition.

The Market Value of Eldercare -- Paid and Unpaid

The Health Care Financing Administration (HCFA) estimated in 1982 that 4.6 million elderly people relied upon some form of assistance to remain living independently and in their own home. Without the assistance, this population is "at risk" of being placed in a nursing home or equivalent institutional facility. The help required was in the form of either IADL or ADL assistance* -- some formal (paid), some informal.

It was further estimated that about 100,000 elderly persons are joining the ranks of these older people (with moderate-to-severe functional impairments) each year; thus, by 1995, another 1.3 million elders need help to stay in their own homes. That means the number now stands at about 6 million and is rising steadily.

HCFA estimated in that survey that 73.9% of all elderly persons who were then living at home, who fit this profile, received some kind of informal (unpaid) eldercare support, provided by family members and/or volunteers with a community-service organization. 5.2%

of that group was receiving help solely through paid services. The remaining 20.9% of that "at-risk" population received a combination of paid and unpaid services. Eldercare services were pre-dominantly paid for by the recipient of care and his/her family, then Medicare, Medicaid, and private non-profit ("helping") organizations -- in that order, with about ten other sources trailing behind. Private long-term care insurance had not yet made a dent in this market niche at that time.

Based on HCFA and Administration on Aging (AoA)** reports, the Coalition has estimated that paid services, supporting elders in their own homes, cost families and the government about $39 billion in 1992. Since the paid services constitute about one-fourth of the volume of all such support services, the market value for the unpaid or informal support provided by family and friends would have a value of about $117 billion. The less care that can be provided by the family, the more that will have to be paid. Either mode -- formal or informal care -- contributes mightily to keeping older people from pre-mature institutionalization.

Given the fact that nursing home admissions rose 24% between 1980 and 1990, and given the fact that Medicaid outlays for elderly recipients alone rose from $1.9 billion in 1972 to $29 billion in 1992, it is apparent that nursing home costs are hemorrhaging the public till. Demographics show the 85+ age group -- those most likely to need nursing home care -- doubling between 1990 and 2000, strongly suggesting that this trend towards more outlays for institutional long-term care will continue unabated.

The demographics won't change, but the federal policies and incentives can... and they must.

As a countervailing force (to pre-mature and inappropriate nursing home placements) in today's marketplace, what is needed now is a cohesive and compassionate public policy supporting (1) the expansion of workplace eldercare benefits through tax incentives for employers and (2) tax relief for family caregiving that is instrumental in preserving the independence of the elderly. These federal actions would demonstrably enhance the economic viability of a full range of options to institutional (SNF) care. After all, now is the time when the tax code must be amended to truly affect behavior in the marketplace -- and make alternatives to nursing home care more realistic and sustainable.

By simply slowing the growth of nursing home admissions, there will be savings realized to HCFA. By adding eldercare benefit programs, the additional productivity in the workplace (through better recruitment, retention and job satisfaction among workers with eldercare responsibilities) will assist in strengthening the existing tax base. New private services will emerge to serve the eldercare market, thus creating new jobs in the private sector and additional tax revenues. These goals are compelling in their universal appeal. By adopting the general principals outlined herein, the resulting tax policies give the eldercare provisions of the Contract with America the best prospects to ultimately be truly revenue neutral.

---

* Though the distinction isn't made in any of the Congress's currently proposals -- and probably should be -- there are technically two complementary systems for measuring independence. ADLs (activities of daily living) are all regarded as personal care skills, such as bathing, dressing, eating, getting out of bed, toileting, and so forth. IADLs are Instrumental ADLs, a term which includes managing financial affairs, shopping, getting to appointments, and taking medication. These IADLs deal more with managing a person's personal affairs rather than bodily functions and grooming activities. ADLs and IADLs are distinct, but thoroughly integrated in everyone's daily life.

** The Administration on Aging, in its newly released State Source Book on Home and Community-based Services (HCBS) for the Functionally-Impaired Elderly, documented that Medicaid outlays for all HCBS services for elderly persons living in the community was $6.43 billion in 1992. Medicaid payments account for approximately one sixth of all paid eldercare services, according to the 1982 HCFA study cited above.

Other significant factors to consider include:

1. SUPPORT RATIOS: The support ratios between those in the workforce (in the peak earning and spending years) and those who are retired (drawing pensions, relying on major federal entitlement programs) are shrinking rapidly. In certain industries, the number of retirees equal or exceed the number of active workers. For example, among the United Steelworkers members at the Bethlehem Steel Plant in Baltimore, Maryland, there are 4,500 active workers and 22,000 retirees represented by five locals. Eldercare and group long-term care take on a special significance in these instances, where the workforce is mature and the retiree population is swelling.

2. ELDERCARE AS A WORKPLACE BENEFIT; PART OF THE BENEFIT PACKAGE FOR ACTIVE AND RETIRED WORKERS:

   (a) Most people rely on their employer or their spouse's employer to have access to health care benefits and pensions/annuities. It is evident that the workplace will continue to be the engine driving the health care system, since group benefits are where the big dollars are for insurance carriers, HMOs and other managed care plans. Eldercare services for the middle-aged generation and retirees should be designed as a conventional benefit, and purchased by employers/employees through traditional benefit channels, just like health plans and dental riders.

   (b) Most eldercare pressure is felt by women; they have been the traditional caregivers. Now a majority of working-aged women are in the workforce. Most of the new jobs created since the recession has abated have gone to women. Therefore, pertinent tax incentives for both employers and employees are crucial to addressing eldercare requirements and should be advanced vigorously. Both Section 125 and Section 129 of the IRS code should be amended to enable more employees to have access to tax-advantaged earnings for eldercare and related long-term care insurance benefits, in conjunction with the $500 refundable credit proposal. As a combination, this tax strategy will have the greatest impact.

   In 1994, the U.S. General Accounting Office released two excellent reports on workplace eldercare: one for public sector employers, one for the private sector. The following paragraph is from GAO/HEHS-94-64 Public-Sector Elder Care:

   "Because women's participation in the workforce and the number of disabled elderly have grown, more employees are caring informally for older Americans in their homes and communities. Approximately two million working Americans provide informal caregiving assistance to their disabled elderly relatives, including help with eating, bathing, moving around the home, housework, and financial management. Nearly three-quarters of all caregivers are women, many of whom are employed outside the home. An additional six million employees have a disabled spouse or parent who may also require help with these and other activities. As the population ages, the number of employed caregivers are expected to grow. Potential caregivers, spouses and children of disabled elders currently account for about 9 of the workforce of full-time employees."

   (c) At least 9.3 million retirees and their dependents rely on their employer for extended health care benefits, according to the Employee Benefit Research Institute (EBRI) in Washington. Further, approximately 25% of the population over 65 years of age receives an employer-provided retiree benefit (health care and/or pension plan), according to Boston University researchers. They found that even though well over 90% of the largest employers do provide such benefits (those that employ 10,000 people or more), the 25% estimate includes those who have never worked, have worked part-time only, and those who worked for smaller employers who do not offer retiree benefits.

3. THE FASB REGULATIONS: During the late 1980s, the Financial Accounting Standards Board (FASB) issued a complex and controversial ruling concerning the

pre-funding of retiree health care benefits and their tax treatment. This entire issue is comparable to the current debate over unfunded federal mandates: programs are promised that have no current funding pledged to them. In this situation, companies have been promising current employees a retiree health care package as part of their employment contract, but the company had not yet funded these future obligations. Corporate balance sheets looked much better than the reality that these companies faced because these costs were not shown anywhere as a current liability.

Under the provisions of the FASB ruling, there would be several phases in establishing a pre-funding mechanism. The first phase required companies to treat a portion of the future costs as a current expense each year, regardless of the employee's age or length of service. In the second phase, all companies would be required to create a reserve to fund benefits for retirees and active employees eligible for retirement under company plans; this reserve is to be shown as a liability on the balance sheet. This would put the retiree health care obligations in much the same category of treatment as pension plans. The Coalition has not been tracking the FASB regulations and their implementation recently, but is aware that court challenges have delayed some of the phasing-in of the compliance activities.

The Coalition also researched earlier models of pre-funding retiree obligations, in order to create the following recommendations in the next section. In this research, there were references to Voluntary Employees' Beneficiary Associations (VEBAs), a tax-advantaged means for employers to set-aside funds for retiree obligations. The Congress apparently eliminated this method of pre-funding in 1984 with the Deficit Reduction Act (DEFRA).

In light of the long-term implications of the FASB ruling and the ever-mounting pressure on companies caused by swelling retiree populations, the Coalition recommends that the tax committee exhume and seriously re-examine the VEBA model, among other options. Employers must be given every means to pre-fund retiree health care obligations. Otherwise there will continue to be tragic stories of companies ruthlessly cutting off benefits to deserving workers days before they are fully vested in their retirement plans.

Therefore, those shaping federal eldercare policy should take into account that all employers -- especially those with fiduciary responsibilities to large retiree populations, including all levels of government -- would benefit from a new system that can mitigate retiree health care cost liabilities.

4. DEMOGRAPHICS for population 85 and over:

(a) Those aged 85 and over will double from 1990 to 2000, according to the U.S. Census Bureau.

(b) Only 25% of those over 85 are in nursing homes. The balance are either still living independently or with an adult child.

(c) The oldest age cohorts require the greatest number of community-based services to remain independent, as functional ability declines and chronic care requirements grow.

The costs associated with providing community-based services are variable, but are most likely to be in the $5,000 to $10,000 range for those requiring a moderate levels of home health and domiciliary care. Nursing home care (in a skilled nursing facility or SNF) costs between $25,000 and $50,000 per year.

(d) According to the Census Bureau, there will be 9 million people over age 85 by 2040. However, their projections are based on extrapolation of static data concerning mortality and morbidity. Researchers have demonstrated that a decline of mortality of just 2% per year, due to the anticipated steady advances in technology and

treatment modalities, would increase the numbers of those 85 and over to 25 million by 2040. Source: "Projecting the Older Population of the U.S.: Lessons from the Past and Prospects for the Future," The Milbank Quarterly (Volume 66, No.2, 1988).

5. ASSISTED LIVING ARRANGEMENTS: Finally, because most elderly persons are likely to have a slow, steady decline of ADL functions, there must be more options in the continuum of care between the elder's residence and the nursing home. In recent years, a form of congregate care called "assisted living" has become an important niche in the long-term care continuum. Many tens of thousands of elders who need some assistance and a live-in "supervisor" of care could manage very well in an assisted living environment. However, assisted living is not defined in the medical terminology needed for third-party reimbursement; such care would not be allowable, for example, as a "qualified facility" as defined in the Contract for America.

Therefore, such residential alternatives, though very desirable, are not covered under the definitions applicable under Medicaid or private long-term care insurance. The minimum charge to stay in such a residential facility in the Washington, D.C. area is about $2,500 per month and is private pay. Those who are affluent can afford such an alternative... and they do. Despite the lack of third-party payments, this niche is one of the most rapidly growing segments of the residential long-term care industry.

The Coalition is not proposing extending the entitlement programs to cover assisted living, though some exceptions may be examined through the various experimental Medicaid waiver programs as supplements. What is being proposed is an entirely new way to entice middle-income families to save through tax-advantaged accounts and new risk-pooling methods for the options of assisted living and similar congregate living arrangements. For these proposals, see Part Two, Section One -- "A Multi-Employer Trust Model for Portable Retiree Benefits."

PART ONE: CRITIQUE OF RELEVANT PORTIONS of H.R. 6, H.R. 9, H.R. 8, & H.R. 11

In the report entitled "Description of Tax Proposals contained in the "Contract with America," prepared by the Joint Committee on Taxation and dated January 9, 1995, four separate tax issues were presented, which were all scheduled for hearings. The four pertinent items the Coalition reviewed were:

1. The so-called "Refundable $500 Eldercare Tax Credit"
   (referred to "Refundable Credit for Custodial Care...")

2. Tax Treatment of Accelerated Death Benefits under
   Life Insurance Contracts

3. Treatment of Long-term Care (LTC)

4. American Dream Accounts (variation on the IRA)

In general, the Coalition supports the principles embodied in each proposal. But the particulars of certain proposals leave many questions. To maintain our focus on advancing eldercare benefits, the Coalition's critique will center on items One and Two above. Item Three -- which addresses the ability to deduct LTC coverage in much the same way as health care insurance premiums -- is a good idea. Item Four -- the "Dream Accounts" -- has merit, but as a vehicle for meeting long-term care needs per se, the Coalition is recommending a more thorough approach through a multi-employer trust model.

One characteristic we noted was that the proposals were internally inconsistent with each other, in certain cases, with respect to terminology and qualifying for the tax treatment being proposed. Most of the questions below pertain to the $500.00 eldercare credit.

1. Refundable Credit for Custodial Care of Certain Elderly Dependents
(sec. 201 of the bill & new sec. 36 of code)

Currently, an exemption for a "dependent" -- whether a child or a parent -- does exist in the IRS code. It does allow for an exemption of $2,500.00 to be subtracted from Adjusted Gross Income (AGI), with phasing-out of the exemption at specific six-figure income levels.

The refundable tax credit of $500.00 is presumably in lieu of the exemption; if the credit is adopted, then the exemptions will be eliminated concurrently. At least, that is how this language is interpreted. The guaranteed $500 tax credit is certain to provide cash-flow relief for those tax payers who are in the low- and middle-income brackets, whose tax liability will not be significantly altered by the exemption. The credit would be tantamount to a reimbursement for out-of-pocket costs associated with providing the eldercare in the tax payer's home.

As meritorious as that outcome is, unfortunately the language of the proposal raises many troubling questions and it raises doubts about the efficacy of the proposal as written:

1. For determining eligibility, why does the proposed credit rely on the same severe dependency test (e.g., residency and disability) as the present law?

2. The Present Law cited involves a personal exemption for dependents. Does this law remain on the books or is it eliminated? If it is eliminated, isn't that a little bit like throwing out the baby with the bath water? Why not keep the current dependent exemption for eldercare purposes as written and then add the refundable (or guaranteed) credit, as proposed, in one of the following two scenarios:

(a) For the taxpayer who is the son/daughter/guardian of the elder and who incurs out-of-pocket expenses, travel expenses and/or experiences loss of income for unpaid leave associated with caring for the elder who still is residing in his or her own home, or

(b) For the taxpayer who is the spouse and caregiver sharing the same primary residence with the "qualified individual" and who needs to be reimbursed for associated costs, including, but not restricted to, respite services. For this category, whether the spouses file a joint return or if they file individually, then the caregiving spouse can claim both the $2,500 exemption and receive the credit.

3. Why should the professional who is qualified to determine the ADL deficits (hence, the tax payer's eligibility) be only a physician in this proposal and yet the person can be a "licensed health care practitioner" in the Tax Treatment of Accelerated Death Benefits under Life Insurance Contracts proposal? A registered nurse (RN) or a licensed clinical social worker (LCSW) seem to be the most appropriate choice to conduct an assessment of ADL functioning in the home setting.

4. Who pays for the licensed health care practitioner or physician to conduct the initial assessment for determining ADL deficits, which in turn determine eligibility for the credit? Assuming a physician or a nurse/social worker combination costs $200.00 to conduct an assessment in the home, which is required for the taxpayer to qualify for the tax credit, bear in mind that the taxpayer may be declined. With no guarantee of getting the proposed $500.00 credit, regardless of the outcome and determination of the assessment, a bill for the services rendered will be presented to someone for payment. It is not fair for the taxpayer to pick up the tab. They may be out $200.00 with no tax credit in a worst case scenario or end up with a net $300.00 benefit in a best case scenario. As written, is this not an unfunded federal mandate?

Why not re-write the eligibility parameters of the credit, increase the credit to cover the cost of the initial assessment and then the credit itself can reimburse the tax payer for the RN or LCSW in full? If the taxpayer does not qualify for the credit, a Medicaid waiver will pick up the tab.

5. Why does the "qualified individual" have to undergo a test to determine "disability" in this proposal and yet the criteria is to be a "chronically ill individual" in the aforementioned Accelerated Death Benefits proposal? The latter phrase is more accurate and less troubling.

6. Again, borrowing from the technically superior language of "Accelerated Death Benefits," the $500.00 refundable credit should apply to situations wherein the taxpayer is (a) a younger family member, such as a son or daughter, (b) the elderly parent is still in his/her own home, and (c) if a licensed health care practitioner certifies that, without the paid and unpaid assistance with IADLs/ADLs* provided (in part or in full) by the taxpayer, then the elderly individual would have to be cared for in a qualified facility (nursing home, etc.).

7. Why does the proposal read "maximum refundable credit" of $500.00? There is no language in the proposal that suggests any conditions upon which the credit is to a nickel less than $500.00.

8. Treatment for Long-term Care (secs. 301-305, and 307 of the bill). Specific LTC plans are vital as an employee benefit-- especially those that have a cash payment that can allow the adult child/caregiver income replacement for providing informal caregiving as part of the overall eldercare support system. This is a natural complement to the Family Leave Act. This proposal does not permit any Qualified LTC coverage to be provided through Section 125 cafeteria plans (pg.27). This blanket exclusion is a mistake and the code should be amended to permit their inclusion (subject to the conditions expressed below in Section Two -- "Section 125 - Cafeteria Plans.")

This Section concludes the summary of questions raised in the review of pertinent portions of Contract with America, as provided to the Coalition in mid-January, 1995.

PART TWO: THE COALITION'S PROPOSALS AND RECOMMENDATIONS

I. A Multi-Employer Trust Model for Portable Retiree Benefits, featuring provisions for a Group Long-term Care Benefit:

The Coalition strongly urges Congress to examine a new model for financing specific long-term care benefits, while also providing working men and women a portable benefit during their lives. The foundation of the vehicle being proposed is based on variations of a multi-employer trust, now most commonly utilized in collectively-bargained contracts in the construction trades industries.

This trust model would rely upon a tax-exempt status for all of the elements of the corpus. Some of the features for this trust would include:

(1) Individual savings accounts for all participants: Called an Individual Eldercare Account (or IECA), this is a savings account for all members of a participating union or employee group. These individual accounts, in an aggregate trust model, would provide the portability for the benefits and the individual would be free to work for different employers within the same industry, so long as the employer of choice is making contributions to the trust.

(2) Individual savings accounts for participating families: for accumulating, tax-free, the entrance fees needed to gain admission into a Continuing Care Retirement Community (CCRC) or to create an annuity capable of paying the monthly fees required for residing in an assisted living facility. This would be called an Entrance Fee Account (or EFA).

(3) A Consolidated Trust Mechanism for the pre-funding of corporate retiree health care benefits, as they relate to sustaining the independence and well-being of eligible retirees of covered plans.

The Group Long-term Care benefit is created by establishing an accumulated fund from earnings of the Trust and re-insuring the group with a qualified LTC program.

Plan details for the Trust are proprietary, but available to the Committee upon request.

II. Section 125 - Cafeteria Plans: Using the Committee's term of Qualified Long-term Care Insurance ("Qualified LTC"), the Coalition advocates certain new LTC products that are based on a disability model, rather than a medical model. These plans feature the use of ADLs as the trigger point for commencing the payment of a cash benefit; this is not a reimbursement for a medical or clinical service. The home care component of the cash benefit does not require previous institutionalization, in either a hospital or a nursing home. The monthly cash payment is assignable, if need be, to prevent abuse of funds.

Such a plan is available today through one carrier, but obtaining the eldercare benefit requires a group plan and individual "add-ons" for the beneficiary's parents. But it can provide a cash benefit, available for any eldercare expense, including income replacement for working middle-aged children acting as an informal caregiver for the elderly beneficiary. The proceeds can be used for any eldercare expense, including case management, estate planning or architectural modification to the home.

Therefore, the Coalition strongly, yet conditionally, urges amending Section 125 of the IRS code to permit inclusion of the premiums for such long-term care coverages as a Qualified LTC elective benefit selection in cafeteria plans. The Coalition is aware of the fact that there are other implications and considerations involved in deciding to amend Section 125 to allow long-term care (LTC) insurances to be so qualified. Generally, the Coalition does concur with the industry-held position that prices of individual LTC policies will go down if ever-larger pools of younger cohorts are given the incentive to buy them. As an option on a "cafeteria plan," this effect can be accomplished to a considerable degree by making the premiums available on a tax-advantaged basis. Some industry analysts also maintain the premise that opening the market in this way will then compel underwriters to tailor more variety into the plans, as well.

LTC insurance is already going through a big transition period as it is, responding to the financial and social imperatives to add more alternatives for eldercare support outside of institutional care, though mostly the benefit amounts to some variation of home health care coverage. Many long-term care policies, for example, do have a home health benefit that can be triggered by "ADL" deficits and do not require a prior hospital stay as a condition to trigger the benefit.

As an industry trend, this is meritorious. But simply making any LTC plan a qualified benefit under Section 125 is a specious act. Because we want to help the middle-aged child care for a parent now, by providing new incentives, we ask you to examine the extent to which the language and intent of this proposal advances eldercare specifically. Long-term care insurance is notorious for its exclusions; the Coalition is diligent in its efforts to carefully phrase eldercare definitions and be certain they are eligible for coverage.

Eldercare benefits can be a part of long-term care coverage, especially a plan with a straight monthly cash payout. The Coalition wants applicable benefits to enure to the middle-aged beneficiary now, to enable people in their peak years of productivity to carry out duties that come with eldercare and their work. Everyone is arguing whether or not a policy will provide home health care (over nursing home care) to a typical 45 year old employee forty years from now at the age of 85. For employees who are thirty and forty years old, coverage for an event that may (or may not) happen 40 years hence is a bit of an abstraction, especially in contrast to the need of having protection against immediate risk: disability, life and health insurance all rank high for people in their middle years. To the extent that eldercare means an exposure to financial loss that could be imminent, people will seek insurance to offset lost income for taking time off without pay and for out-of-pocket expenses associated with taking care of an aging parent.

Accordingly, the Coalition recommends that the Congress look closely at the following language for amending Section 125 to permit long-term insurance to be a qualified tax-advantaged benefit:

1. Let's use the tax code to modify behavior, and that includes the behavior of insurance companies, not only the U.S. taxpayer.

(a) Broadly speaking, in order to meet the criteria needed to be added to a Section 125 cafeteria plan, all insurance companies should have their plans evaluated for suitability by an independent review board.

(b) Specifically, there should be an extra incentive given to those insurance companies whose policies give a cash payout, based on a disability model. As already mentioned, the emphasis should be on income replacement for the middle-aged beneficiary, providing the eldercare support personally.

2. Let's broaden the definition of what can qualify as "long-term care insurance" to be inclusive of other pre-paid programs that aid in meeting the needs of older people and their middle-aged children, such as managed care plans for seniors and other emerging models designed specifically to carry out the many duties that are a part of providing eldercare support. Everything the federal government can do enable families to keep their eldest members independent and active should be considered at this juncture.

III. Section 129 - Dependent Care Accounts: Rewrite the provisions of S. 129 to drop all "dependency" language from eldercare cases and instead permit a functional assessment of the elderly parent and an analysis of the eldercare support system, both formal and informal, for the parent(s) in question. As the functional deficits increase, so do the tax-advantaged dollars available to the beneficiary/working caregiver.

For example, in a plan where a $5,000 maximum limit exists for contributions into the Dependent Care Account, the eligibility for the set-aside (from taxable income) could be as follows, with the ADLs expressed as deficits in function:

- One-to-Two ADLs = maximum available benefit is $2,500
- Three-to-Four ADLs = maximum available benefit is $3,750
- Five-to-Six ADLs = maximum available benefit is $5,000

IV. Tax Credit for Case Management: The Coalition is recommending that a selective tax credit be allowed for all wage earners who are spending money out-of-pocket for eldercare support when the parent is still living in his or her own home. This credit should not be allowed for a random grab-bag of services, determined solely by the taxpayer, but rather for private case management to oversee the implementation of a care plan. The case manager would assess the need of the elder in the community in which they reside; they then match appropriate services with a thoughtfully prepared budget. Case management provides advocacy for the family, arbitration and mediation in the event of a conflict with a vendor of services, and can provide the accountability that is needed when the constraints of time and distance make it difficult for the adult child to oversee the parent's situation.

V. The Power of Federal Procurement Practices

The federal government has other immensely strong forms of persuasion at its disposal to encourage private firms to adopt specific benefits through contracting policy. A case in point is the rapid expansion of employee assistance programs (EAPs) within the last ten years. In the mid-1980s, a federal mandate was passed that made it a necessity to have a certifiably "drug-free" workplace in order to be a successful bidder on a federal contract, and the way to ensure compliance was for the bidder to contract for the services of an EAP. The government itself had to be in compliance with this mandate, and so installed an EAP

in each agency to be available to all federal employees, military and civilian. I can cite one example of the impact that that law had: a small hospital-based EAP in the D.C. area served only 1,000 hospital employees before the law passed; five years and one federal contract later, this same EAP firm was serving over 75,000 clients, mostly federal workers and employees of firms that had (or wanted to have) federal contracts.

The Coalition does advocate that the EAP is the best place to begin an effective "managed care" kind of approach to introducing eldercare benefits at the workplace. Therefore, why not use a variation of the "drug-free" campaign that caused the EAP industry to blossom in the 1980s to further the introduction of eldercare EAP enhancements. The procurement process could award those vendors whose EAPs have a well-defined eldercare program with some preferences over those who do not. It is a given that government contractors must have an EAP to be in compliance with federal law; why not give an extra consideration to those with eldercare adjuncts in addition to the EAP requirements?

As a matter of compliance, these programs should be well-advertised to the employees/beneficiaries.

In Conclusion

At the Coalition's conference last December, which was a pre-White House Conference on Aging event, Jim Musselwhite of the U.S. General Accounting Office observed, in response to a question from the audience, that providing tax assistance and other incentives would increase home care utilization -- but there would also be some increase in applicable Medicare and Medicaid expenditures for a higher volume of intensive home care. Nonetheless, the overall effect would be lower nursing home admissions and lower federal outlays for skilled nursing home care, which is by far more expensive per capita.

For the U.S. Treasury, such a policy of tax credits and Medicaid waivers may not yield major net savings for the Medicare/Medicaid program in the long-run, but the same number of tax dollars spent would provide services to far more people in the community -- and by providing "early intervention," fewer serious problems would arise, which have far higher per capita costs.

The value to both the quality of life and to the U.S. Treasury in providing meaningful incentives to families and employers alike to in turn provide for eldercare is incalculable and compelling. Please analyze all the trends and options; a comprehensive strategy -- not a piece-meal approach -- will yield the greatest results. Thank you.

Mr. COLLINS. Thank you, Mr. Lank.

Elizabeth Liska, the executive director of Prince William Interfaith Volunteer Caregivers Program, Manassas, Va.

STATEMENT OF ELIZABETH LISKA, EXECUTIVE DIRECTOR, PRINCE WILLIAM INTERFAITH VOLUNTEER CAREGIVERS PROGRAM, MANASSAS, VA.

Ms. LISKA. Thank you. I am testifying in favor of the $500 tax credit for families caring for an elderly member as a beginning of providing assistance to families who care for elderly members. At this point, the $500 tax credit would cover some small portion of costs that would give encouragement to families, acknowledgment, recognition that families are caring for each other. Often these families become so absorbed that they feel that no one knows of their plight nor cares.

Currently, I serve as executive director of Prince William Interfaith Volunteer Caregivers Program, am a founding member and regional facilitator for the National Federation of Interfaith Volunteer Caregivers. There are 400 interfaith volunteer care giver programs across the country and Guam. We are in the process of developing another 900 funded by the Robert Wood Johnson Foundation.

For 11 years, these programs have worked primarily with elderly persons and their care givers to identify and meet needs and to bring formal and informal resources together to meet them, with a focus on allowing care givers to continue over the long term and enable independence for as long as feasible.

Family care giving begins with simple tasks, responsibilities, and progresses to full care. A phone call now and then, or daily, transportation to appointments, buy the groceries, help with housework and other household chores, escalating to hands-on daily care. Responsibilities continue to escalate while the health of the older person becomes more and more fragile. Financial, emotional energy costs escalate.

Recent information shows that children are likely to be care givers of a parent for at least 9 years. Because we are all living longer, the time that we care for parents may exceed the time that we actually rear children in the home.

We know that 85 percent of care given to the elderly is given by families even when formal services are in place. At the same time that a person cares for a parent, they are caring for children and often grandchildren. For the first time, 50 percent of American families are comprised of four generations. The cost of caring for a parent or grandparents is added to the cost of physical and educational needs of children. At the same time college tuition is due, mom may need a walker, a wheelchair, an added prescription. We need not to forget that family members other than parents and grandparents are cared for with the same costs and that traditionally we do not live with the person cared for, unless a spouse. Long-distance care givers have the additional cost of travel and phone expense.

A shift is needed to allow elderly persons to remain independent for as long as possible in their own homes or in the home of another family member, to allow families to continue to care for each

other, to reduce unnecessary institutionalization. The cost of home care, even assisted by formal care providers, would still be less costly than institutional care. The cost of care giving in the home is high but not as high as care in an institution.

By making it financially feasible for families to care for elderly members in the home, a full program of assisting family to care for elderly at home, costs to government will be reduced greatly, unnecessary emergency room visits will diminish, the actual dumping of some elderly can be stopped, and we can reduce the hurting these families are experiencing.

Many care giving families with two incomes have no other alternative than to give up one income because they cannot afford to pay for in-home care, and someone must be there. Even so, that family will still not be able to remain financially stable. A family assisted to provide 8 to 10 hours of care during working hours will be less costly than providing total 24-hour nursing home care. Helping a family to provide assisted living care would also be less costly and appropriate in many cases.

What might the proposed $500 cover? The most frequent and highest costs are for prescriptions, equipment, and home care supplies.

Thank you for this opportunity, and God bless you. You have a difficult task.

Mr. COLLINS. We thank you.

Next, Ms. Abaya.

STATEMENT OF CAROL ABAYA, PUBLISHER, SANDWICH GENERATION

Ms. ABAYA. Yes. I sincerely appreciate the opportunity to speak to you today because what Congress does or does not do will impact skyrocketing health care costs and the quality of life for millions of our elderly as well as the sandwich generationers, those involved in elder care.

I come before you as a sandwich generationer, a working woman with elderly parents who in 1991 was forced to give up my own work so that my parents—then 85 and 90—were taken care of. My sister and I were thrown into elder care giving without warning or preparation. I live 55 miles away. I lost my own business clients as I could not service them, nor could I develop new business because of my care giving responsibilities. I struggled then to make ends meet financially and am still doing so.

My sister, a nurse, came up from Florida and stayed 5 weeks. She took a leave of absence from her work. She came up again in March, May, August, and November.

Travel expenses mounted. But more important was the fact that she was unable to put enough work hours in to qualify that year for her pension benefits. This impacts the number of years she has to work to be eligible for full benefits. During that time, no contributions were made to her Social Security account, and the government lost income tax. If she is unable to make up the work time over time, it will impact her ability for care when she gets older.

I won't go into the details of 1991 here, but more are in my written statement. As a result, in 1992, I founded a magazine called

The Sandwich Generation. Since then, I have spoken with family care givers and professionals in geriatrics across the country.

But this begs the issue we are here to discuss today. You undoubtedly have reams of statistics in relation to the aging of America and the cost attached.

I would like to point out that the 85-plus age group is the fastest growing sector of our population. For every such person, there is a sandwich generationer, a care giver, today or tomorrow. Seventy-three percent of women who are today 65 will live out their last years in poverty unless you people take positive action.

Some more important facts. The top three reasons older people go to costly emergency rooms, are admitted and then may go into nursing homes are, No. 1, adverse interaction from medicine; No. 2, malnutrition and dehydration; No. 3, falls which result in broken bones.

The health dollar cost as a result of just these three things is $40–$50 billion a year. This is no small number. Probably 90 percent of these costs don't have to be because all three of these illnesses can be prevented with early intervention and better home care services.

Wouldn't it be better to overhaul the preventive and home care service systems now than to continue as we are with the future costs skyrocketing even faster because the number of seniors is increasing so dramatically?

It certainly would be more cost effective to have someone go into a senior's home even 1 hour a day to make sure medicine is taken properly and at least one good meal is prepared.

Allowing a small tax refund each year, such as is being proposed, will do little to solve the overall problems, as noted above.

A major change in public policy is needed. Today's policies, focusing on ADLs and approved agencies, defeat the basic objective of keeping older people safely in their own homes, healthy and independent as long as possible and, importantly, affordably. By using the ADL criteria, it is already too late. The objective must be to establish a framework for early intervention in relation to custodial care types of needs.

What can you do to help families better take care of aging relatives and yet preserve the integrity of their nucleus family, the older person's self-image, and the sandwich generationers—what I call the "I" Self?

No. 1, allow seniors themselves to itemize deduction for home care services from their income taxes. This would help more people remain at home at a lesser cost than being hospitalized or institutionalized. It would help prevent the three top reasons why seniors end up in costly emergency rooms.

No. 2, if another member of the family is paying for services or expenses of a parent, grandparent, aunt or uncle, regardless of where the elder lives, allow that person to deduct the cost from their income tax.

No. 3, change the ADL criteria and broaden it to include various nonpersonal care items such as shopping, cooking, cleaning, supervising, medicine. Early intervention must be actively promoted and must be affordable.

No. 4, set up a tax relief framework for private companies that supply needed services to seniors so that user costs can be kept down. Such services could include home health care, home chores, transportation, meals on wheels.

Words of caution. It is not wise to legislate family living arrangements. Moving an elder from his or her home, unless there is no alternative, jeopardizes the elder's emotional well-being. Emotional negatives equals depression equals medical problems equals higher health care use and cost. Such a policy will end up costing the government dramatically more in Medicare.

In closing, I would like to say that I was talking to a friend of mine who is an RN and community social worker about my coming before your committee. When I told her the subject and the amount of proposed relief, her immediate reaction was, that is a joke. We hung up, and 1 hour later she called back. I have been talking with my 20-year-old daughter about that $500, she said. We have come up with some words you should tell the committee.

So in following her suggestion and my own gut feelings when I read the proposal, here are words we feel are appropriate in describing 500 dollars' worth of relief: an insult to millions of dedicated care givers, denigrating the care giver's responsibility and hard work, demoralizing. We sandwich generationers and adult children care givers, as well as the millions of senior care givers, certainly need relief, but it must be meaningful.

I thank you for your time, and I would be willing to answer any questions you might have.

[The prepared statement follows. An attachment is being retained in committee files.]

FOR ADULTS CAUGHT IN THE MIDDLE
THE SANDWICH GENERATION
BOX 132 • WICKATUNK, NJ 07765-0132 • (908) 536-6215

HOUSE WAYS AND MEANS COMMITTEE

Testimony January 18, 1995

by Carol Abaya, Publisher and Sandwich Generationer

I sincerely appreciate the opportunity to speak to you today because what Congress does -- or does not do -- in the next year or so will impact the skyrocketing health care costs in this country and the quality of life for millions of our elderly as well as the Sandwich Generationers -- those involved in elder care.

It will take great courage on your part to initiate dramatic changes both in public policy and the public's perception of what aging means today and more importantly in the years to come.

I come before you as a Sandwich Generationer -- a working woman with elderly parents who in 1991 was forced to give up my own work so that my parents (then 85 and 90) were taken care of properly. My sister and I were suddenly thrown into the situation of having to take over total care responsibilities for elderly parents. We were forced to learn a lot -- and fast -- about aging and the needs of elders when my mother became ill and almost died

I won't go into the details of 1991 -- which to date was the worst year of my life. But as a result of my own experiences, in 1992 I founded a magazine called **The Sandwich Generation.** Editorial deals with aging issues from the financial to legal, health and most importantly, the emotional.

Being a Sandwich Generationer is the most difficult role on what I call the stage of life. No one can rehearse for it. No one prepares you for it. Because this is the first generation to have the longevity factor as a generation, there are no societal role models.

My sister and I were thrown into elder care giving without warning or preparation. I live 55 miles away. I lost my own business clients as I could not service them nor could I develop new business because of my caregiving responsibilities and tasks. In addition I had to take over the day to day operations of my mother's business. I struggled then to make ends meet financially and am still doing so, both personally and professionally.

My sister, a nurse, came up from Florida when my mother became ill and stayed 5 weeks. She took a leave of absence from her work. She came up again in March, May and August and then a couple of other times during the year.

Travel expenses mounted. But more important was the fact that my sister was unable to put in enough work hours to qualify that year for pension benefits. This impacts the number of years she has to work to be eligible for full benefits. In addition, during that time no contributions were made to her social security account, and the government lost income taxes because she wasn't working. And if she is unable to make up the work time over time, it will impact her ability to pay for care when she gets older.

At that time, my niece (whom I had helped raise) began her own business. A child day care center. She could have used our help, both in the marketing aspects, using my expertise, and financial from both my sister and I. Because our own income streams were reduced, we were unable to help her -- hence being caught in the middle.

When my mother was in the hospital, given her pain and confusion level, we had health aides two shifts, when my sister was not there, at a cost of $1,500 a week. Insurance refused to pay for it. At the time my father's savings account had maybe $12,000, and that was his only liquid asset. He did not have enough income to pay for such nursing either in the hospital or when she got out, two months later. And neither my sister nor I had that kind of money - or even assets that we would sell to pay for my mother's care.

Most American families -- the 30+ million over 65 and accompanying Sandwich Generationers -- cannot pay for such extensive care and also pay taxes and pay their daily bills. The numbers, the dollars, just aren't there.

While my sister was at the hospital, I was running my mother's real estate business and trying to figure out my parents total financial picture. It took me 4 months to do this.

Let me tell you, that aside from the financial considerations, the emotional stress took a great toll on all of us that year. On myself, my sister and my father. Many a night I cried myself to sleep.

But this begs the issue we are here to discuss today.

As a member of this committee, you undoubtedly have read reams of statistics in relation to the aging of America and the costs attached. But I would like to just mention a few here, perhaps to give a broader picture of reality and what society's challenges are going to be within the next decade.

Of all the people in the history of man who ever lived to the age 65, half are alive today. Why? The installation of public sanitation in the beginning of this century, greater availability of food, and last but not least, medical advances have resulted in the first generation in substantial numbers to live well into their 80s and 90s.

As a result, the 85+ age group is the fastest growing sector of our population. For every such person there is a Sandwich Generationer -- a caregiver, today or tomorrow.

73% of women who today are 65 will live out their last years in poverty -- unless you take positive action.

CRISIS TO COME

Let's take a look at the future if relief and help are not made available to families.

57% of women today work outside of their home. They now contribute both to the productivity of this country and the tax base. Many will have to leave their jobs to take care of aging parents. This means a great loss of taxes, because many of those who will have to leave their work are in key organizational, managerial and executive positions.

This also means families will have less money to pay for their children's education and less money to save for their own retirement years and aging care. The next generation of young could well have fewer educational opportunities or have to borrow (from public coffers which are increasingly empty), thus being less prepared to face the work place of the 21st century and/or starting out life burdened with high debts.

Sandwich Generationers will have less money put away for their own retirement needs -- thus making them more vulnerable.

With so many working women leaving their jobs to care for parents (12% have already done so) , business and industry will face shortages of qualified and reliable employees. This then could have a dire dramatic impact on productivity and business in this country and in the country's basic ability to meet the challenges of a world marketplace in the 21st century.

I need not go into the snowball effect on the loss of taxes and increased pressure on public expenditures.

The problems attached to elder care giving compromises the ability of millions of Americans (today's Sandwich Generationers, including the baby boomers who are becoming Sandwich Generationers) to live out their elder years in comfort -- not luxury -- but having the money for basic necessities and care.

$40 BILLION IN HEALTH COSTS CAN BE AVOIDED

Some more important and very key numbers -- and they are all tied into the cost of health care. The 3 top reasons older people go to expensive hospital emergency rooms, are admitted, and may then go onto nursing homes are

- adverse interaction from medicine;
- malnutrition and dehydration; and
- falls, which result in broken bones.

The health dollar cost as a result of just these three things is $40 to $50 BILLION a year. This is no small number. Quite frankly it is a national tragedy because probably 90% of these costs don't have to be. Because all of these three illnesses can be prevented with early intervention and more affordable home care services.

Wouldn't it be better to overhaul the preventive and home care system now than to continue as we are, with future health care costs skyrocketing even faster because the number of seniors is increasing so dramatically??

It would be cost effective to have someone go into a senior's home even 1 hour a day to make sure medicine is taken properly and at least one good meal is prepared. Also, the safety proofing of a home or apartment . Removing electric cords or scatter rugs. Increasing the size of light bulbs so the senior can see better and not trip over something. Simple things. Very inexpensive to do. But very costly repercussions if not done.

It certainly would be cost effective from a federal point of view to have the adult woman -- the Sandwich Generationer -- maintain her higher paying job -- and hence continue to contribute to the tax base -- and at the same time, provide the opportunity for someone else to earn at a lower level -- also contributing to the tax base -- by caring for older people.

Allowing a small tax credit as now proposed each year will do nothing to solve the overall problems, as noted above.

A major change in public policy and perspective is needed. Today's policies, focusing on ADLs and approved agencies, defeat the basic objectives of keeping older people safely in their own homes, healthy and independent as long as possible. By using the ADL criteria, it's already too late. The objective must be is to establish a framework for early intervention in relation to custodial care types of needs.

As more and more women have to give up their jobs -- like my sister and I did -- to care for aging parents and other relatives, the economic situation of American families is going to deteriorate. While women traditionally have been the nurturers, the care givers, today they are an integral part of the working fabric of the country. Families desperately need help and tax relief. Women cannot be super people. And only you can provide that help.

What can you do to help families take care of aging relatives and yet preserve the integrity of their own immediate family, the older person's self image and the Sandwich Generationer's "I" Self??

1. Allow seniors themselves to itemize deductions for home care services from their income taxes. This would allow more people to remain at home, at a lesser cost than if hospitalized or institutionalized. It will help prevent the three top reasons why seniors end up in costly emergency rooms -- and therefore would help control health care costs.

2. If another member of the family is paying for services or the expenses of a parent, grandparent, aunt or uncle, regardless of where the elder lives, allow that person to deduct the costs from their income tax.

3. Change the ADL criteria and broaden it to include various non-personal care items such as shopping, cooking, cleaning, supervising medication, etc. Early intervention MUST be actively promoted and must be affordable.

My father, who passed away last year at age 94, was a prime example of this need. At 93, he could still do all the ADLs, and even take his own breakfast and lunch. It was only in the last year that he needed ADL help. But he couldn't shop, cook, clean the house and do laundry -- all tasks which directly impact health. When my mother was in the hospital,, he was totally dependent on my sister and myself. Later, he was dependent on the housekeeper. If a person does not eat properly, all kinds of physical and mental health problems arise.

Words of Caution! It's not wise to "legislate" family living arrangements. Moving an elder from his or her own home -- unless there is indeed no alternative -- jeopardizes the emotional well being of that elder. Emotional negatives = depression = medical problems = higher health care use and cost. These negatives also apply to the Sandwich Generationer, the care giver. Increased stress impacts all facets of a person's life. Attached here are articles about families who took in aging relatives and some of the problems that developed.

Such a policy, forcing elders to move in with children in order to qualify for help, can only backfire and end up costing the government dramatically more in Medicare and the American economy more in lost productivity and taxes.

I sincerely hope today's discussion is only a beginning of your looking at family needs in relation to elder care. What you do -- or don't do -- will set the stage for life of Americans forever in the future. What you do -- or don't do -- will effect America's ability to compete in a highly technical world market. This is an enormous challenge.

In closing, I would like to say that I was talking to a friend of my mine last week who is a RN and community social worker about my talking before your committee.

When I told her the subject and the amount of proposed relief, her immediate reaction was "That's a joke." We hung up, and an hour later she called back.

"I've been talking with my 20-year-old daughter about that $500," she said. "We've come up with some words you should tell the committee."

So, in following her suggestion and my own gut feelings when I read the proposal, here are the words we all agree are appropriate in describing $500 worth of relief. An insult to millions of dedicated care givers. Denigrating the care giver's responsibilities and hard work. Humiliating. Demoralizing.

We Sandwich Generationers and adult children caregivers as well as the millions of senior caregivers certainly need relief. But it must be meaningful .

Mr. COLLINS. Thank you.
Ms. Queen-Hines.

STATEMENT OF CARMEN QUEEN-HINES, BALTIMORE, MD.

Ms. QUEEN-HINES. Good afternoon, Mr. Chairman and members of the committee. I appreciate this opportunity to share my personal experiences in the area of elder care.

I would like to begin by describing myself to you. I am a wife, a mother, and daughter, daughter-in-law, aunt, niece, and cousin to a very large and extended family. I have been a care giver in each of those roles, with the exception of cousin, but I am sure that will happen soon.

I will be sharing with you my family's experience in caring for my mother-in-law who suffers from glaucoma, diabetes, and high blood pressure. In addition, 4 years ago she underwent a triple bypass. She also takes a variety of prescription medications to control her various diseases and illnesses.

Two years ago, when my mother-in-law indicated that she was not feeling well, my husband encouraged her to get her blood pressure taken at a local health center. When she went to the health center, she was informed that her blood pressure was high and she was instructed to contact her physician. However, while driving home from the center, she was involved in an accident and subsequently was transported to the hospital.

While being examined by her physician, she admitted that instead of taking the full dosage of her medication, she had only been taking half doses to extend the medication because of the cost.

Of course, we were shocked to learn this. We contacted various information and referral services provided by our employers. initially, we thought, because of her age, which was 69 at the time of the incident, we would be able to find a discount pharmaceutical program to meet her needs. However, we found from the information and referral service that because my in-laws lived together and owned their own home, their combined pensions must be considered and, therefore, they are not eligible for any discounts other than the standard 10 percent senior citizen discount. But if my mother-in-law were considered separately based on her own pension, she would qualify.

Some of the options presented to us included putting their home in our name, considering a legal separation and divorce, or caring for her in our home. None of these options were acceptable to us, because we feel that a contributing factor to their mental health is their independence, which we do not want to take away unless it is absolutely necessary. While the information on the pharmaceutical services was not utilized in this situation, we were provided with valuable information on meal services and senior citizen programs which we were able to use.

So the only viable option that we felt left to us was for us to subsidize her medical expenses ourselves. As a result, during calendar year 1994, we spent more than $2,000 on prescription drugs and related medical costs. In addition, we have also subscribed to Blue Cross/Blue Shield supplemental medical coverage which complements their Medicare.

In closing, while my husband and I have been able to manage our care giver responsibilities, it has been a strain financially and emotionally. A person in this situation must have support from their spouse and their employer. A supportive employer is one that will allow you to take leave to accompany family members to medical appointments and will provide information and referral services. Finally, what we have found is you need a sense of humor that will help you balance work and family responsibilities.

I appreciate this opportunity to share my personal experience, and I hope my testimony will be beneficial to you in making decisions on health care benefits for the elderly. Thank you.

Mr. COLLINS. Thank you and we appreciate your sharing those comments.

Ms. Adolf.

STATEMENT OF BARBARA P. ADOLF, CONSULTANT, TOWERS PERRIN, NEW YORK, N.Y.

Ms. ADOLF. Good afternoon. My name is Barbara Adolf. I am a work and family consultant with Towers Perrin, which is a management and benefit consulting firm. My area of expertise is work and family, and what I do is address issues that employers face in helping their employees balance work and personal life. In my testimony, I would like to point out some key issues in employer—supported elder care. I am not advocating a specific position, but I am just providing information.

Towers Perrin recently conducted a study of more than 100 work/life benefits of our clients. Our goal was to identify trends in employer support of work/life benefits. Elder care benefits are among the work/life benefits that we looked at and we found that elder care benefits are growing. They are not commonplace yet, but many are in the pilot or the planning stages, so we are predicting that they will become baseline in the next few years, given certain conditions.

There are two reasons for the growth. First, elder care is starting to be seen as a business issue that affects a company's bottom line. It can affect employee productivity, absenteeism, and recruitment, for example. The second reason is the financial incentives in employee benefit legislation.

In my experience, between 10 percent and 25 percent of employees at a given company have elder care needs and these numbers are growing. This means that they assist usually their aging parents with a wide range of activities. Often they provide care on an emergency basis.

The dependent care spending account, one of the most prevalent of the elder care benefits, and this is also the benefit that is for child care, is used for elder care by less than 1 percent of a typical employee population where it is offered. The reason for the low utilization is that to qualify for the tax favored treatment, the employee's elder must live with him or her at least 8 hours a day and be the financial dependent of the employee. These requirements are similar but not exactly the same, as those in the proposed tax credit.

Long-term care, another area of growing interest among employers, is not tax favored, as I am sure you know. This limits employer funding of the benefit. Cafeteria plans, which allow employees to select among a menu of benefits, currently cannot include the benefit.

Elder care resource and referral programs, which employers provide to help employees access elder care services, are also growing, but their growth may be thwarted as elder care services are reduced as a result of budget pressures on government.

Government policy could stimulate corporate involvement in the creation of new programs and services. For example, senior day care and transportation services. Tax credits and grants that encourage the development of consortia would also allow smaller employers to get involved.

These are some of the ways that the government could stimulate the private sector to get involved in elder care support. But, of course, any initiatives should take into account revenue pressures on government.

Thank you.

[The prepared statement follows. An attachment is being retained in committee files.]

STATEMENT OF BARBARA P. ADOLF
CONSULTANT, TOWERS PERRIN, NEW YORK, NY.

Good morning. My name is Barbara Adolf. I am a work/life consultant with Towers Perrin, a management and benefits consulting firm. We consult to employers on management and employee benefit issues.

My area of expertise is work/life — also called work and family. Work/life addresses issues that employers face in helping their employees balance work and personal life. Consultants like Towers Perrin identify the barriers to productivity and design programs to remove these barriers. An important aspect of our work is employee-needs research. We also research existing employer programs, as companies frequently benchmark their programs against competitors'.

In my testimony today I will discuss trends in employer — particularly private sector — support for elder care and the incentives for employer action in this area. I will draw on research we have done with clients on their employees' elder care needs. I will relate this discussion to the proposed elder care tax credit. As a consultant I do not advocate a specific position. Rather, my goal is to inform the discussion with facts and observations gleaned from practicing in this field for more than ten years.

PURPOSE AND DESIGN OF THE WORK/LIFE BENEFITS STUDY

Towers Perrin recently completed a study of more than 100 work/life benefits of our clients. One hundred seven companies are represented, from small businesses (130 employees to very large organizations (96,000 employees). With the average employee population in the survey at about 7,000 we feel the group is representative of companies in general.

Many of the work/life benefits, directly or indirectly, relate to the elder care needs of employees and, in some cases retirees. We identified the current prevalence of these benefits, including those that are *baseline* — offered by a significant number of employers in our study. In addition, we tried to predict the future trends in employer-provided work/life benefits. We did this by identifying those benefits that are to a great extent in the pilot or planning stage. We expect that in this emerging field, such programs are likely to become *baseline* within the next few years.

Many of these benefits are relatively new — developed within the last 10 years. They are sometimes called "life cycle" benefits, because they address issues employees face at critical points throughout the life cycle. Often, they are integrated with the more mainstream benefit programs — such as medical, disability, life insurance and retirement plans — through "flexible benefit" or "cafeteria" benefit plans. Flexible benefit plans allow employees to choose from an array of offered benefits. Life cycle benefits can also be provided to all employees; in this case they are called "core" benefits.

The benefits can be paid for entirely by the employer, the employee or by some combination of the two. When provided through a flexible benefit plan, in some cases the benefits can be paid on a pre-tax basis.

In our study, we also identified a group of employers — approximately 20% of the survey group — who have implemented a large number of work/life programs. Compared to the survey group in general these High Commitment Companies employ more people, have higher average salaries and employ higher percentages of female employees and employees under 40. We conducted in-depth interviews with employers in this group to determine what lay behind their greater commitment to work/life. I will share these findings with you, as well.
In our research methodology, we positioned elder care as an employee need that is addressed within the following work/life areas:

- **Supporting employees through the financial life cycle**
- **Helping employees take care of dependents**
- **Making work more flexible**
- **Keeping employees physically and mentally fit**
- **Saving employees time**
- **Aligning the environment with "the deal."**

FINDINGS OF THE STUDY

Elder Care Benefits Are on the Rise

Our study showed that along with other work/life benefits *elder care benefits are increasing.* While most elder care benefits are not *baseline* yet, we expect rapid growth because so many are in the planning or pilot stage. Significantly, we found that once elder care benefits had been implemented virtually none were ever eliminated.

Reasons for Growth of Elder Care Benefits

From an employer perspective there are two major forces behind the expansion of elder care: *1) elder care is starting to be seen as an issue that affects a company's bottom line* and 2) *financial incentives in employee benefit legislation encourage employer-involvement.*

- Elder Care as a Bottom Line Issue

Work Force Demographics
The U.S. population and work force are changing in profound ways. We are aging — the fastest-growing segment of the overall population is the over 85 year olds. Most of the "traditional" caregivers — women — are no longer at home available to care for elderly and disabled family members on a full time basis. The full time female homemaker is now rare — the vast majority of women work because their earned income is crucial to their families' well-being.

Elder Care Responsibilities of Employees
Approximately 10% to 25% of employees in a given company have elder (adult disabled) care needs. This means that these employees spend at least some time during most weeks caring for disabled relatives. The care they provide includes a wide range of activities: monitoring aging parents, doing chores, shopping, transporting them to medical and other appointments, taking care of their finances, and assisting with personal care, such as bathing and feeding. Besides the various types and levels of physical and medical assistance, care often involves negotiating complex tax and insurance systems, such as Medicare and Medicaid. Some provide elder care on a regular basis throughout the week. The largest group — more than one-third of employee-caregivers — provide care on an emergency or as-needed basis. Financial expenditures for a small proportion of caregivers can be substantial, up to several hundred dollars per week, just for part-time assistance.

Many employees are responsible for family members who live far from them. For these employees, the stress of having to negotiate arrangements for elders from a distance can be especially difficult.

Impact on Productivity and Recruitment
Employee-caregiving can be costly to the employee not only in time and money spent; the demands are often emotionally and physically draining. Employees say that the distress they feel witnessing an elder's deterioration and not knowing exactly what to do about it can make them ill or depressed.

At work, such problems cause low morale, reduced productivity, increased absenteeism and turnover. The impact on employers can be great; managers say that employees with the greatest elder care problems — those who feel the strongest commitment to their elders — are often among the employees most committed to their jobs.

According to employers, more and more employees are asking for work/life benefits, including elder care benefits. In surveys, many employees say they are willing to contribute financially to programs that help them better manage work and caregiving. These concerns are not limited to older employees. In our research we find that an increasing number of younger employees are taking care of aging relatives, such as grandparents. At the same time, surveys show that employees' values and expectations about work are changing; increasingly, younger employees want more life cycle benefits. As a result, employers are starting to promote these benefits in their strategy to recruit certain employee groups.

Tie-in to Business Objectives
The employers in our survey reported that work/life benefits contribute positively to the work environment, specifically the following:
- employee perception that the company is a good place to work
- employee appreciation for human resource programs
- enhanced job satisfaction
- productivity and loyalty
- reduced absenteeism.

Nearly twice as many of the High Commitment Companies we identified, which have a large number of programs in place, reported these advantages. For example, 65% of the High Commitment Companies reported that these programs increase employee loyalty, compared to 35% of the total group and 40% said they improve employee productivity compared with 24% of the total group.

- Financial Incentives in Employee Benefit Legislation

The dependent care tax exclusion (Section 129 of the Tax Code) has, to some extent, encouraged employers to support dependent care initiatives. The most significant plan affecting elder care is the dependent care flexible spending account (Section 125). I will discuss this plan in detail in the next section.

Except indirectly through general savings vehicles, such as the 401(k) plan exclusion, employees are not encouraged to save for elder care "custodial" expenses in the future. Non-medical care expenses do not receive tax favored treatment. Premiums for long term care coverage and the cost of care itself are not tax favored.

CURRENT ELDER CARE BENEFITS

■ **Financial Supports Throughout the Financial Life Cycle**

- The Dependent Care Spending Account (Sections 129, 125 of the Tax Code)

This allows employees to use pre-tax dollars, to $5,000, to pay qualifying dependent care expenses, expenses that cover care of a dependent — child or elder — so the employee can go to work. The money is deducted from the employee's pay check. The plan also saves the employer payroll taxes on the money. Approximately eight in ten of the employers in our survey offer this benefit to their employees.

The utilization rate of the benefit is approximately 3% to 5% of an employee population. Reasons for the low utilization include:

1) the "use it or lose it" provision (the requirement under Section 125 regulations that any amount set aside in a flexible spending account be either used or forfeited at the end of the plan year)
2) the fact that payments to caregivers (particularly for child care) frequently are not reported for tax purposes as they must be as a condition for the tax exclusion
3) availability of the child care tax credit
4) confusion about how the benefit works.

Of the small number of users of this benefit, only about 20% qualify for elder care tax exclusions, less than 1% of the employee population. The reason for this is that the dependent eligibility requirements are so narrowly defined. To be eligible the employee's parent must be *financially dependent on the employee and live with the employee at least eight hours a day* — such dependency is a condition of receiving the dependent care tax exclusion.

We understand that you are considering implementing a $500 refundable tax credit for custodial care of dependents, specifically, for a taxpayer's parent or spouse who is disabled — certified by a physician as being unable to perform at least two *activities of daily living*. The dependent would have to reside with the taxpayer for more than half the year. The taxpayer would also be required to have primary financial responsibility for maintaining the household.

Given the financial and residential requirements of the proposed legislation, the same problem that currently bars many employed caregivers from using the dependent care exclusion (and therefore, the spending account) would still apply. If one purpose of the credit would be to provide employed caregivers with financial relief, the law as proposed would not do this for the vast majority. In addition, the amount proposed — $500 — is minimal, considering the typical expenditures incurred by employees who assist elderly/disabled persons.

Should the proposed tax credit be implemented, employees who qualify and also have access to a dependent care flexible spending account, as with child care, would probably have to choose between the two. Making such a choice can be confusing.

In any case, the value received from extending an elder care tax credit must be balanced against the cost in revenue.

- Long Term Care Insurance for Relatives

Long term care is non-medical care (feeding, moving, bathing, and so on) of a disabled individual. The care may be provided in an institution — usually a nursing home — or private home. This care can be extremely expensive. One solution is for individuals to purchase insurance coverage for long term care. Another is to save to pay for the care. In either case, starting young can make a big difference in the cost to the individual; the older a beneficiary is when first purchasing the insurance, the more expensive. Also, the longer the period of saving the larger the accumulation of funds to pay for the care.

Employers can help employees with the insurance by providing long term care insurance at group rates. In our study, we found that 15% of the employers provide long term care insurance as an option for employees, their spouses and parents. About the same number offer this only to employees. Another 15% are piloting or planning to implement this benefit. In our work, we find that a growing number of our Fortune 500 companies provide this benefit. Therefore, we expect long term care insurance to become *baseline* in the near future.

This benefit is almost always employee-pay-all. Its appeal to employees is that, as a group plan, it costs less and provides a richer package of benefits than the employee could obtain individually. In addition, the benefit is designed to fit within a total benefits scheme, thereby reducing the potential for gaps in service options or duplication of services.

Interestingly, few employees purchase the benefit. Among the reasons are: 1) a lack of disposable income, particularly among younger employees and 2) a lack of awareness of the potential value. Among our larger clients, however, utilization of the benefit is increasing. This reflects growing awareness of its importance.

If the benefit received tax-favored treatment, employers would be encouraged to contribute to its funding. Also, if the benefit could be included within a flexible benefit plan employees would have the option to purchase it with pre-tax dollars, and to the extent they did it would reduce the employer's potential liability exposure.

Any such tax-favored treatment must be weighed against the revenue cost.

■ **Helping Employees Take Care of Dependents**

- Elder Care Resource and Referral Programs (ECRR)

These programs provide employees with information about elder care programs and services. Vendors that offer this service usually inventory a wide array of programs and providers — including "meals-on-wheels" (services that deliver a hot meal to a disabled person during the day), practical nursing services, case management services and attorneys who specialize in elder law.

Although this is a relatively new benefit, one-quarter of the companies in our study provide the service, which has been offered to employees only within the last few years. Since nearly 20% of the companies are piloting or considering implementing this program we expect it to become *baseline* relatively soon. Ironically, many of the social service programs that employees access through resource and referral programs are likely at risk of elimination with the increasing budgetary pressure on government expenditures. Such an action could initially inhibit the growth of elder care resource and referral programs in corporations, as employee-users register frustration at not receiving the care "promised."

- Elder Care Fairs, Support Groups

Elder care fairs, usually held once or twice a year, are forums in which representatives from elder care agencies provide employees with information directly at the work site. While only 8% of employers currently provide these programs another 7% are piloting or planning them. Similarly, elder care support groups, which enable employees with elder care problems to help one another, are provided by 4% of the respondents; however, another 5% are likely to have these programs in place in the next few years.

- Use of Sick Days to Care for Ill Dependents

One-third of employers allow employees to use their own sick days to care for dependents, including disabled relatives. This benefit is the result of employer recognition that when an elder or other dependent is ill, the employee caregiver takes the time off anyway, reporting the absence as personal illness. Employers are saying that such "forced" deception conflicts with the organization's values.

■ **Making Work More Flexible**

- Personal Days, Vacation Day Carryover, Purchase of Additional Vacation Days

A majority of employers in our study allow employees personal time off (62%) and the ability to save unused vacation days (59%). About one-third of employers have implemented programs which put all paid time off — vacation, illness and personal — into one package for the employee to access as needed.

Approximately 12% of employers allow employees to purchase additional vacation time, frequently as part of a flexible benefit plan. Such a benefit is often used by employees with caregiving responsibilities. Another 7% of employers are piloting or planning to implement this benefit, placing it among the fast-track group.

- Alternative Work Arrangements

Alternative work arrangements have been developed in response to a wide range of employee lifestyle needs. These options are particularly helpful to employees caring for the aging and disabled. They include: flextime, compressed work week, job-sharing, part-time work and telecommuting.

Flextime allows an employee to vary starting and ending times of the work day. Forty-four percent of employers offer flextime within a one-hour time band and another 12% are planning to do so, making flextime an option that will become *baseline* very soon. Wide-band flextime, in which employees are given greater leeway in starting and ending the work day, is offered by 38% of employers and another 12% are planning or piloting it.

The compressed work week, usually consisting of four ten-hour days, is popular among employees with caregiving responsibilities. This, along with job-sharing in which two employees share one job, will also become *baseline* in the near future. At the same time, employers are expanding benefit coverages for part-time employees. Forty-one percent offer at least pro-rated benefits for these employees, while one-quarter provide full benefits for part-time workers.

Telecommuting allows employees to work at home. While currently 23% of employers offer this, another 26% are planning or piloting this option. In addition, programs in which employers provide equipment for work-at-home are increasing.

■ **Keeping Employees Physically and Mentally fit**

- Employee Assistance Programs (EAP)

These confidential information/counseling programs help employees cope with personal and family problems, including the difficulties of elder care. EAPs, the most prevalent of the benefits we researched, are provided by nearly nine in ten of the survey respondents.

Numerous other benefits can apply to elder care needs of employees. However, for our purposes here, I have touched on those most relevant.

■ **Saving Employees Time**

Employers, aware of the time pressures many employees feel trying to balance work with family responsibilities, are providing services at the work site. Banking and company medical services are programs offered by a substantial number of employers in the survey. A company store, which is offered by one-quarter of employees, and dinners-to-go demonstrate awareness that employees have limited time to shop for the basics. A corporate concierge service, although offered by a small number, is under consideration by several. This information service gives employees access to such services as errand runners and ticket vendors, and can help employees access recreational facilities appropriate for the disabled.

■ **Aligning the Environment with the Deal**

There is growing recognition among employers that benefits and programs are not enough; employees must feel comfortable about using them. In some companies employees believe they cannot admit that they have a personal problem. In others, they feel comfortable about discussing a solution to an elder care problem.

A majority of companies conduct employee attitude surveys, and the numbers are growing. More than a third now give managers work/life sensitivity training, and another 13% are planning to do so. Similarly, nearly one-third conduct employee focus groups or surveys on work/life issues and another 17% have these in the works. One in five has a work/life manager to attend to employees' work/family needs and 6% have the position planned or piloted. All are indications of corporate cultures poising themselves for change.

STIMULATING PRIVATE SECTOR ELDER CARE INITIATIVES

Findings from our study suggest that employer-involvement in elder care will continue to grow. However, the question arises: What impact will changes in government policy and funding have on these initiatives and subsequently on employees' needs for elder care relief? Further, what impact would the proposed tax credit have on employer-involvement and the growth of programs and services in elder care? What other programs might be considered?

Tax Exclusions, Credits and Grants

- Making Custodial Care A Tax Excluded Benefit

Few would disagree with the need to encourage employees to purchase "protection" against the immense costs of long term care for themselves and their elders. Making long term care insurance tax advantaged to employee and employer would encourage employees to purchase the benefit and employers to contribute funds to the benefit.

It would also be to everyone's advantage if employees were encouraged to save to cover the costs of long term care needs. A tax advantaged vehicle specifically set up for this would focus attention on the need and enable employees to accumulate the monies to cover expenses in the future.

If either or both long term care insurance and a savings vehicle were included in a flexible benefit plan, employers would more likely contribute to the extent that the plan they have designed limits their liability to the amount already funded. With effective plan design, they can limit their liability to each year's contribution.

- Changing Eligibility for the Dependent Care Spending Account

In many families, several adult children share financial and other caregiver responsibilities for parents. Because no one person is responsible for more than 50% of the cost of care, none is eligible for the dependent care spending account. To alleviate this problem, and encourage employees to assist aging parents, some relief might be offered. For example, a partial tax exclusion might be allowed based on a schedule of expenses and income — not unlike the child care tax credit. Such relief might help keep some elders out of nursing homes and off public assistance.

- Encouraging Private Sector Elder Care Initiatives

As elder care needs increase, and government support comes under further pressure, it is unlikely that the slack can be picked up by family members, particularly those who are in the work force. The challenge will be to find a way to establish new or expanded programs and services will be needed if we are to maintain quality of life for employees and their aging relatives.

The proposed tax credit will provide little relief in the long run for the increasing numbers of caregivers and elders. One way government policy might make a greater impact would be to use tax credits and grants to stimulate corporate involvement in developing programs and services. Corporate child care initiatives might serve as a model for some programs. For example, an effective structure for establishing a child care center is through a consortium, in which several employers jointly sponsor a program. A major advantage to this arrangement is that the participants, by sharing costs and risks, reduce their potential liability and commitment. This is a particularly appealing option for smaller employers, who might otherwise be unable to provide support.

Although our study identified a small number of employers (1%) who participate in child care consortia, we also found that this is one of the greatest areas of growth — 12% of the survey group is piloting or planning such a program. Another model, emergency (temporary, drop-in) child care — centers and in-home services — could be a model for elder care development. While 4% of employers currently have implemented emergency child care, 12% are planning or piloting it.

Adult day care, a relatively low cost form of care, might be targeted by providing companies that develop such programs with grants or tax credits. Similarly, intergenerational day care, in which programs are designed for children and elders together, transportation programs for the aging, or emergency elder care, are other initiatives that could be encouraged.

SUMMARY

The proposed elder care tax credit would provide some financial relief to a small percentage of the work force. For some employees it would duplicate a benefit already available, the dependent care flexible spending account. The employee would have to determine which benefit would save him or her more money (similar to the current flexible spending account option and the child care tax credit available to employees with dependent children).

Employers are implementing elder care benefits, recognizing that such life cycle benefits meet a wide range of employee needs that, if unmet, can cost employers in reduced productivity and other human resource losses. However, their initiatives are limited by the lack of tax advantage of certain benefits, specifically those that relate to long term care. As always, such initiatives must take into account revenue pressures on government.

Another issue that should be considered is pressure on elder care services coming from budget pressure on government. Certain elder care benefits, such as resource and referral services, will have fewer programs to meet an increasing need. Monies freed up by the proposed tax credit are not likely to make a difference in the availability of these services.

Government policy could stimulate corporate involvement in the creation of new programs and services, for example, senior day care and transportation services. Tax credits and grants that encourage the development of consortia would also allow smaller employers to become involved.

Mr. COLLINS. Thank you.

Mrs. Johnson.

Mrs. JOHNSON. I thank you for your testimony. I did want to point out that this package, while the section that you are testifying on is the $500 tax credit, there are other provisions in the bill that we intend to move forward that would allow a deduction of home care expenses to be treated as medical expenses and therefore deducted if it exceeds 7.5 percent of adjusted gross income. There are an awful lot of seniors who that will really help and who are probably going to be more greatly assisted by it than by the $500 credit.

There is also in this legislation the right to deduct the premiums of long-term care insurance, up to $2,000, if you are 60 to 65 or 60 to 70, I have to look, and $2,500 above that. So that, combined with some other things that make it easier to purchase long-term care insurance, and most long-term care insurance now does address long-term home care as well as long-term institutional care, should begin to significantly expand the resources for our seniors to protect themselves against the burden of long-term care and/or to help them with that burden of long-term care.

As one of the sandwich generation who is struggling with these very problems, we certainly do need to recognize them and we need to reshape that concept of health services as more of our citizens are living longer.

Ms. ABAYA. May I respond to that? The long-term care insurance is also tied in with ADLs, which are eating, bathing, dressing, toileting, getting up and down. Many elderly people who are still able to live in home and still able to do the ADLs, and my father was an example of that, still at 93 he was able to do everything except he needed some help in bathing, but he was not able to shop, he was not able to cook, he was not able to clean, he was not able to do laundry, and all those kinds of chores impact basic health.

If somebody is not able to cook, then they are not going to eat properly and they are going to end up sick. If they cannot do laundry, then they are going to wear their clothes until they are falling off and then that impacts various kinds of sores on elder's skin, which is much frailer than ours, et cetera.

So that is why I have said that the ADL criteria should be broadened to include the support, the kinds of help that are needed to maintain the ADLs and to enable a person, then, to live healthier, particularly with nutrition and medication.

Long-term care insurance, when it is applicable to the home, is, as I said, tied in with the ADLs, but also most are tied in with an approved agency. The cost to use an approved agency is two to three times more than if you hired somebody privately.

Mrs. JOHNSON. Those kinds of things I think we can certainly look at in the section on deductibility of medical costs.

To hold out to you that we could be quite as flexible in the definition of needs-based services, as you are suggesting, would be to mislead you. The Federal Government did do very significant studies in this area in the seventies and found the cost to be extraordinary if we really went as far as shopping services, cleaning, and

things like that. Some of those tasks can be managed by families in a way that is more periodic than daily.

But I do think the point you make, that the ADL requirement is too restrictive for our seniors today is a very good point and we will look at that as we examine these provisions in detail.

Ms. ABAYA. I think if you compare the costs of providing these kinds of services or the availability to deduct compared with a working woman who has to give up a $30,000 or $40,000 a year job to be able to do all these errands and be able to cope, that the cost is going to be a small percentage of the loss of income tax and the loss of all these other things that a woman is able to provide her family by going out there and working.

Mrs. JOHNSON. Thank you.

Mr. COLLINS. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman.

I would like to welcome all of our witnesses and thank them for being here to give us accounts of real examples in our community where we need to provide more incentives for people to provide appropriate care for their loved ones.

I particularly want to welcome Carmen Queen-Hines from Baltimore. Since I represent Baltimore, it is nice to have a person from my city here. I really want to compliment you for what you have done to take care of your parents. Your testimony demonstrates vividly the problem we have in this country.

If I understand it correctly, your mother-in-law was not taking the right medication because she could not afford it so she was taking half the prescription thinking it would do the job while trying to save money. These are stories that we often hear but it is important that you testify to show that those types of circumstances exist in our community. People literally cannot afford the medication they need in order to remain healthy.

Of course, if they take the prescriptions, then they are less likely to need more intrusive medical care. This will save us all money. They will be happier and healthier and everyone comes out better.

I am not very encouraged that the legislation before us will help in your circumstance. What we should be doing is looking at ways of expanding the health care system to cover prescription drugs for our people. It is a less costly alternative. We know medicine can really perform miracles today. We should remove that financial burden from those who cannot afford to take their right medication because of cost.

Unfortunately, health care reform is not on the front burner any longer, and it does not look like we are going to be dealing with that issue, at least in the first part of this Congress. I regret that because I do think that health care reform would take care of the problems that many people have similar to yourself.

The legislation before us would provide some incentives for people to provide health care to loved ones in less restrictive environments. I would hope as this legislation works its way through, Mr. Chairman, we would carefully scrutinize the testimony of all the witnesses on this panel to try to tailor the legislation to meet the real-life examples that have been brought forward. I am very grateful for all of your testimony today, and want you to know how important your testimony is to those of us trying to do the right thing

to help you in the very difficult struggles you and they have today in taking care of family members.

Thank you for your testimony.

Mr. COLLINS. We thank the gentleman. Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman, and, again, I also want to join in thanking each of you for coming here and for your testimonies. I believe if there is one thing I have heard this afternoon, it is that there is a role for the Federal Government to play in helping to encourage and assist individuals to be able to save and provide for their senior family members.

Perhaps a question I might have for you, Ms. Adolf, if you might expand a little bit, if you would, on your recommendation regarding how we can best implement this $500 dependent care credit.

Ms. ADOLF. I am not recommending anything. What I am trying to do is give somewhat of an employer perspective. I just see a connection between what already exists, the dependent care flexible spending account, which allows an employee to reduce their salary by up to $5,000 for qualifying dependent care expenses. The elder care expenses are limited based on the fact that the elder has to live with the employee at least 8 hours a day and be their financial dependent.

What we are seeing is a very, very low utilization of that benefit. The main reason is that many of the elders do not actually live with the employee. The elders are often not technically the financial dependent. For example, you might have several siblings sharing in the responsibility financially and in terms of living or helping out.

So what we are saying is there is a whole group of employees who really are not getting access to at least some financial support. I think that employers are looking at this group of employees because they are having trouble with absenteeism and lateness and even leaving the job because of elder care burdens.

One of the examples you might look at is the child care tax credit. Employees receive a credit based on a schedule of expenses against income. Therefore, they can receive a partial credit. The idea would be to design the benefit so that employees who are contributing to their parents support can get some tax relief.

Mr. HERGER. Fine. Thank you very much.

Mr. COLLINS. We thank the gentleman.

We also would like to thank each of you for taking your time to be with us this afternoon. Your input is very valuable to us. This Congress and this committee, and on behalf of Chairman Archer, who is very committed to seeing the aspects and provisions of the Contract With America move forward, as they do move forward to the floor of the House. Hopefully, the full House will vote favorably on behalf of these provisions which will help seniors, and the other provisions of the Contract which will help those families with dependent children, as well as the provision of the Contract With America that will also help married couples and these provisions that will help the elderly.

Again, we thank you for being here. We appreciate your input and your time. The committee is dismissed.

[Whereupon, at 3:15 p.m., the hearing was adjourned.]

TAX PROVISIONS IN THE CONTRACT WITH AMERICA CONCERNING THE SENIOR CITIZENS' EQUITY ACT

THURSDAY, JANUARY 19, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 10:05 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

Chairman ARCHER. For the benefit of the Members, we did not anticipate that there would be a vote. It would be preferable for us to go and vote and come back as soon as possible so that we can commence the hearings without interruption. So the committee will not commence its activities until we are back from this vote.

[Recess.]

Mr. THOMAS [presiding]. If we can ask our guests to take their seats, please, we would like to begin the hearing.

Today we will consider the Senior Citizens' Equity Act in the Contract With America with particular focus on two provisions in that act—the repeal of the 1993 increase in the tax on Social Security benefits, and the proposal to allow terminally ill or chronically ill individuals to receive tax-free accelerated death benefits.

Both of the provisions we will consider today are of extreme importance to our senior citizens, and they are a vital part of this committee's agenda for the next century. In addition, the accelerated death benefits provisions will also be of assistance to many younger taxpayers and their families.

According to calculations based on Census Bureau data, the 1993 increase in taxes on Social Security benefits will amount to $3.68 billion in the first year alone. Twenty-one percent of this amount will be shouldered by seniors with total yearly incomes under $50,000, and 57 percent by those with incomes under $75,000—not the usual category of the so-called rich.

This tax increase does not benefit Social Security in any way. In addition, it is bad news for retirees of all ages who have earned average wages or above. The 1993 tax increase on benefits will rapidly increase the number of retirees who will never get their money's worth from the Social Security system.

This is, of course, because of dramatic increases in the amount of payroll taxes average workers pay—and because of taxation of Social Security benefits.

The 1993 tax increase places far more retirees, current and especially future, in the situation of not living long enough to get a fair return on what they paid in.

The accelerated death benefit provision in the Contract With America responds in a balanced and reasonable way to a current development in the field of life insurance.

To assist extremely ill individuals and their families meet various medical and general living expenses, some life insurance companies have allowed these individuals to receive the proceeds of their life insurance policies prior to their death.

To meet the needs of those extremely ill individuals whose life insurance policies do not provide for accelerated death benefits, viatical companies also have been formed to purchase life insurance policies from severely ill individuals.

Unfortunately, the current Tax Code does not specify whether these benefits are taxable or not taxable. Today's hearing is intended to provide the committee with the background and information needed to clarify the tax treatment of accelerated death benefit transactions so that those in need can receive their benefits tax free, as intended.

The Chair wants to especially thank the witnesses who will be testifying on our first panel concerning accelerated death benefits. It is the Chair's hope that the witnesses on the first panel, most of whom are in a weakened condition, will be questioned in a relatively brief period of time so that their appearance before the committee can be as pleasant and comfortable as we might be able to make it because their testimony is important, and we do want to receive it.

Prior to going to our colleague from Wisconsin, I would yield to Mr. Jacobs for an opening statement.

Mr. JACOBS. Thank you, Mr. Chairman. The second part of the hearing today dealing with the insurance proceeds makes all the sense in the world to me. The first part makes almost none of the sense in the world to me. In fact, I might even, when we mark it up, move to have it amended to say the Social Security Payroll Taxpayers Inequity Act of 1995.

First, we should consider a little history on this subject. In 1983 the Social Security system was in dire danger of, for the first time in history, being unable to pay its obligations, and there was a so-called Social Security bailout. This bailout was an agreement among President Reagan, then Majority Leader Dole and now Majority Leader Dole, and Tip O'Neill, the Speaker of the House at the time. They had a problem. They needed more money to pay the trust fund obligations, and they struck a reasonable agreement which was, a reduction in Social Security benefits for those best off on Social Security, and an increase in the payroll tax for everybody else, people still in the work force.

Contrary to fairly established opinion, the 1972 enactment of the cost-of-living formula for the Social Security system was not for the purpose of aiding retirees. It was for the purpose of aiding taxpayers because each of the election years and some of the off years preceding the enactment of that formula, Members of Congress had tripped over each other to see how much they could prove with other people's money, taxpayers' money, that they loved the senior

citizens. These senior citizens, of course, have a tendency to vote in great numbers. That was one of the weakest points of democracy about which de Tocqueville wrote in his Democracy on America.

There was an error made, of course, and we all know about that, in the formula, and some people are even now being vastly overpaid in benefits. But the fact is that on average, those who are today retired under Social Security have paid in on average about 5 percent of the benefits they can expect to receive. That 5 percent has earned interest untaxed in an amount equal to about another 10 percent of those benefits.

Eighty-five percent, then, of the average person's benefits who is now retired under Social Security is a freebie. It is something that is a strict transfer payment that does not reflect previous payments. Now—I mean payments into the system.

Now, we come, 1983, up to 50 percent of the freebie could be included in one's taxable income. If somebody hit the lottery, nobody would question whether there should be tax on that windfall. This is a windfall. It is not a windfall I oppose. I fully support it, but the fact is that it is income that is a gift from the taxpayers to retirees. So in 1993, the amount exempt from Social Security for people at a certain level of income was reduced to 15 percent that had been paid into the system and earned interest, but only in the case—I am confused, Bill, about that statement of 21 percent of the people under $50,000 because by definition let's say a person had $13,000 in Social Security income. I mean a couple had $13,000 in Social Security income. If you add the $44,000, you take half of the $13,000, you would still be above the $50,000 point.

In order to include the entire 85 percent of one's benefits, the entire freebie, in one's taxable income, not at any higher rate, just whatever that individual's rate might be unless, of course, there was some bracket creep, went into another bracket, a person would have to have, or a couple would have to have income up around $80,000, including all of the Social Security benefits, not half. So for those—and I might add that it is a contribution. It is another reduction of benefits, without a doubt.

It is means testing of the Social Security system. The proceeds are returned to the trust fund, the one of the three trust funds that is in most trouble, the Medicare trust fund. So everybody says we have to do something about the entitlements. It is logical that if you did something about this entitlement you would use means testing.

Many Members of Congress have said that Medicare should be means tested. Why should a Rockefeller, to pick a name, be subsidized by the taxpayers, even in old age, for medical expenses? So it is logical that if you were going to do anything about the entitlements, you would start by a kind of means testing with the people, who are best off in retirement. That is what this was all about.

So I just want to put in a word for the Social Security taxpayers and especially the baby boomers who will be retiring 20 years from now or so and where will Medicare be by then? I thank you.

[The opening statement of Mr. Ramstad follows:]

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON CONTRACT WITH AMERICA

Mr. Chairman, as a strong supporter of the Contract With America's provisions for accelerated death benefits and a strong opponent of President Clinton's 1993 Clinton tax increase on social security, I look forward to today's hearings on these important reform issues.

The Contract provides terminally and chronically ill individuals with a new means of paying their drastically increasing medical bills and living expenses by allowing them to receive tax-free distributions from their life insurance policies prior to their death.

By enabling the terminally ill to use their own means to cover medical expenses, they will maintain the dignity and financial independence they deserve at the most trying time of their lives. In addition, this provision could substantially reduce the incredible financial drain on the families of terminally ill people.

It is also important we hear from middle-income senior citizens who were impacted by increased taxes on Social Security benefits. The 1993 Clinton tax bill requires individual senior citizens who earn more than $34,000 or couples who earn more than $44,000 to pay income taxes on up to 85% of their Social Security benefits.

The federal government should not be in the business of discouraging middle income seniors from continuing to be active members of the working community beyond the normal age of retirement. I am anxious to hear how the tax relief included in the Contract -- which would lower the amount of benefits potentially subject to tax to 50% -- would impact the witnesses before us today.

I thank you all very much for being here today and look forward to your testimony.

Mr. THOMAS. Thank the gentleman for his comments. Prior to the first panel, we have our colleague, Toby Roth, from Wisconsin who wishes to address the committee on a number of issues and Toby, the floor is yours.

STATEMENT OF HON. TOBY ROTH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. ROTH. Well, thank you very much, Mr. Chairman. Mr. Chairman and members of the committee, I applaud your diligence in working on this Contract With America. I know you have been putting in many long hours and a majority of the Contract With America rests heavily on your shoulders, and we are all very thankful to you for your work and your diligence.

I appreciate the opportunity to testify in support of those areas in the Contract which fall under the jurisdiction of the Ways and Means Committee.

Mr. Chairman and Members, I know you have a panel of people who have come here at a great sacrifice in many ways, and so I will abbreviate my remarks, but as Chairman of the Republican Task Force on Social Security last session, I welcome the opportunity to speak about the Senior Citizens' Equity Act. This act will make a big difference in the lives of average seniors by protecting their earned Social Security benefits.

Under an archaic policy dating back to the thirties, as you so well know, Social Security recipients aged 65 to 69 are denied $1 in benefits for every $3 they earn over $11,160. Seniors earning above that limit face an additional effective tax rate of some 33 percent on top of Federal, State, and local taxes they already pay.

As a result, hundreds of thousands of skilled and talented seniors are being driven from our work force. This is a blatant age discrimination. Moreover, the earnings test hurts our Nation's competitiveness by discouraging seniors with valuable work experience from contributing to society. It is time to stop this inequity.

From President Clinton to the senior citizens in my district, to many of us here today, we are all in agreement on this, and I would like to point out that President Clinton pledged to lift the earnings limit. You will recall in his book, "Putting the People First," the President wrote, "Bill Clinton and Al Gore will lift the Social Security earnings test limitation so that older Americans will be able to rebuild our economy and create a better future for us all."

Mr. Chairman and Members, today in America senior citizens who work are the highest taxed people in America. I ask you is that fair to our senior citizens or fair to any American to be so singled out? That is why I am here before this committee, to urge you to bring the fairness back to our tax system. By allowing seniors to keep more of their hard-earned money, we are restoring that fairness that is so essential.

Beyond that, let's make sure that we cut government spending so all Americans, yes, all Americans, can keep more of the money they earn. I thank you, Mr. Chairman and members of this committee, for allowing me to appear, and I would like to insert into the record my entire testimony.

[The prepared statement follows:]

STATEMENT BEFORE
HOUSE COMMITTEE ON WAYS AND MEANS
BY CONGRESSMAN TOBY ROTH

Mr. Chairman and members of the Committee, I appreciate the opportunity to testify in support of those areas of the Contract With America which fall under the jurisdiction of the Ways and Means Committee.

Specifically, I am glad to have the opportunity to speak about the Senior Citizens' Equity Act, H.R. 8. This Act will really make a difference in the lives of average senior citizens by protecting their earned Social Security benefits.

Social Security represents a trust between government and its citizens. Social Security is not a welfare program, but a benefit that workers earn through their contributions in order to plan for a secure retirement. In fact, most seniors look at Social Security as a kind of annuity.

When government takes away those earned benefits, however, government breaks this trust with its citizens. Unfortunately, in two instances the government does confiscate the earned Social Security benefits of senior citizens. The first instance is the earnings limit, which causes seniors to lose Social Security benefits if they continue to work in the labor force. The second is the tax increases on Social Security that became law in 1993.

Thankfully, this Congress can undo these unfair Social Security penalties and taxes by passing the Senior Citizens' Equity Act. As the past chairman of the Republican Task Force on Social Security, I take particular satisfaction in being able to finish our work during the last Congress. In the next 100 days, we can at last accomplish the agenda so many of us have worked on for years.

First, the Senior Citizens' Equity Act raises the Social Security earnings limit for working seniors.

No American should be discouraged from working. It's a betrayal of the American Dream to penalize people for their hard work. Yet, that's exactly what the earnings limit does. It penalizes seniors for attempting to be financially independent.

Under an archaic policy dating to the 1930's, Social Security recipients aged 65 to 69 are denied $1 in benefits for every $3 they earn over $11,160. Seniors earning above that limit face an additional effective tax rate of 33 percent, on top of the federal, state and local taxes they already pay.

As a result, hundreds of thousands of skilled and talented seniors are being driven from the work force. This is blatant age discrimination. Moreover, the earnings test hurts our nation's competitiveness by discouraging seniors with valuable work experience from contributing to society.

Is that the message we want to send to seniors--that their skills are unwanted and unneeded, and that we will actually take away 33 percent of their Social Security benefits if they earn too much?

Furthermore, as one couple in my district noted, the earnings test taxes seniors twice--first when wages are earned while working, and a second time when those benefits are paid. This couple wrote: "These funds have already been taxed when earned as income. In fact, we believe Social Security benefits received after retirement should be exempt from any penalty by the earnings limit."

The earnings test exempts wealthy seniors who receive dividends and interest payments. The earnings test hits working seniors who toil at low-paying jobs, however, by punishing them for attempting to remain financially independent. The earnings test hurts those citizens who need that extra income the most.

I will point out that President Clinton pledged to lift the earnings limit. In his book Putting People First, the President wrote:

> Bill Clinton and Al Gore will...lift the Social Security earnings test limitation so that older Americans are able to help rebuild our economy and create a better future for all.

It's time to stop this inequity. President Clinton, the senior citizens in my district, many of us here today, and I, are all in agreement on this.

The Senior Citizens' Equity Act will raise the earnings limit threshold over five years to $30,000. This reform is long overdue, and I am delighted that Congress will finally take action in the coming weeks.

The Senior Citizens' Equity Act also will roll back the unfair Social Security tax increases that were passed in 1993. As we all know, these Social Security taxes affected 5.4 million senior citizens.

These retirees are set to lose $24.6 billion of their earned Social Security benefits over five years. I remind the Committee that the Social Security taxes unjustly singled out seniors in particular. Seniors were the only middle income group required to pay higher income taxes by the 1993 tax bill. This is particularly unfair to those seniors who planned their retirement finances under the assumption that their Social Security benefits would not be taxable income. Of course, seniors are the one group least able to afford this kind of tax burden. That's why H.R. 8 is such an important part of the Contract with America.

The Senior Citizens' Equity Act will roll back this undeserved tax increase on older Americans, and let them keep the money they worked so hard to earn for retirement.

My constituents in Wisconsin overwhelmingly support this tax repeal. Let me just read a few comments I received in my annual questionnaire as examples.

One senior citizen in Green Bay wrote: "Social Security benefits should never be taxed." Two more seniors write simply: "Repeal the Clinton tax on Social Security benefits." And from another: "Reverse 1993 Social Security tax increase."

Mr. Chairman, I am delighted that this Congress will finally hold a vote to raise the earnings limit and roll back the Social Security taxes to allow seniors to keep the retirement benefits they earned.

The taxpayers of America--including senior citizens--have sent us a message loud and clear. I look forward to implementing the changes they have called for--the changes that are contained in the Contract With America.

In conclusion, Mr. Chairman, I look forward to working with you and the Committee to return our government to a government that is truly of the people, by the people, and for the people.

I thank you for your consideration.

Mrs. JOHNSON [presiding]. Thank you, Mr. Roth, for your testimony. Are there questions by the committee? If not, thank you very much.

Mr. ROTH. Thank you, Madam Chairman. I appreciate, again, all the work you are doing and all the diligence you are bringing to the Contract With America. Thank you.

Mrs. JOHNSON. If our first panel will come forward, Annette Keown of Birmingham, Ala.; Don Paul of Austin, Tex.; Rosemary Paul accompanying him; Paul Phinney of Santa Rosa Beach, Fla., and Teresa Kane Rawoot of Timberville, Va.

I want to welcome also Mrs. Carballo. Thank you for being with us. I want to welcome this panel because some of you have come at great personal effort, and we value your input and we are looking forward to it. Let's start with Annette Keown.

STATEMENT OF ANNETTE KEOWN, BIRMINGHAM, ALA., ON BEHALF OF HER HUSBAND, DAVID B. KEOWN

Ms. KEOWN. Good morning and thank you, Madam Chairman. Thank you for inviting me to appear before the committee today to read a statement from my husband, David. He regrets that he is not well enough to be here to testify in person. He asked me to come because of how strongly we feel about people having the option of using the money from their life insurance while they are still alive. It truly saved us. This is my husband's statement.

In February 1993 my physicians suggested that I make every effort to put my affairs in order. They told me I had less than 6 months to live.

None of us knows what the future holds. I learned as a Golden Gloves boxer in high school and from having graduated from the U.S. Army Artillery Officers' Candidate School to never, never, never give up.

I am a Christian with absolutely no fear of dying—I know where I am going.

But the last days of my life and the lives of my wife, son, and daughter would be very different today, very difficult, if we did not have the money we received from my Prudential insurance policy.

In early 1990 my wife and I were asked by our agent if we wanted a new policy option called "living needs benefit." We were told that if we chose to include the option in my life insurance policy, at no additional premium cost, an accelerated death benefit would be paid in the event that I was confined to a nursing home for 6 months and was expected to remain there permanently or if I became terminally ill and was expected to live less than 6 months.

At the time, I was 56 years old and in relatively good health. While we were not especially impressed with the option, we decided to add it to our policy. The decision seemed insignificant at the time. Now, it has proven to have been one of the most important decisions we ever made.

That November I suffered a major stroke. I was hospitalized for 2 weeks. After extensive physical rehabilitation, I overcame most of the adverse effects of my illness and was able to return to part-time employment in January 1991. Just 2 months later, I was able to return to work full time.

Then in the fall of 1991, I suffered another stroke. This time, it took me nearly 6 months to return to work.

My third and most serious stroke occurred on September 24, 1992. This time, a blood clot developed on the left side of my brain that left me comatose for 8 days and paralyzed on my right side. During the next 2 years I have experienced abnormal heart rhythm and heart pauses. I have a pacemaker, but my heart problems, diagnosed as terminal, continue.

My wife and I own a small business, Health Care Staffing Services, Inc. It was incorporated in 1986 to provide temporary staffing services to business and industry and occupational health staffing and management services to industrial clients in Alabama.

I was the primary marketing person, and my illnesses began to impact the business. Prior to my third stroke, we asked our son, Richard, and our daughter, Kathy, who is a registered nurse, to help us manage our company. We also took out a significant small business loan because of the increased marketing and management costs.

Just 2 weeks after my son joined the business, I had my third stroke.

Our personal financial situation was becoming acute and our business was suffering because my wife and daughter were giving me 7-days-a-week, around-the-clock care. My medical expenses were piling up because our employee health insurance policy refused to include me when we tried to renew the policy.

We were in a personal and business crisis of major proportions. What made it worse was that because of my condition, there was nothing I could do to help.

We had managed to save during our married life, but those savings had been seriously eroded when I became ill and we began to eat into the equity we had in our business.

Following my diagnosis of terminal illness, my wife contacted our Prudential agent and requested the accelerated death benefit. Had we not received this money from the accelerated death benefit, our lives would have been devastated. We would have lost the business my wife and I worked so hard to establish. I would have ended up in a nursing home, leaving my wife with little or nothing to live on.

We received the money from Prudential in April 1993. That allowed us to repay bank loans, meet past-due medical bills, and make it possible for my son to assume ownership of the temporary help portion of our business in early 1994. Our daughter manages the remaining part of the business.

What was most important to me and my wife was that the money made it possible for me to remain at home and to be cared for by my wife, instead of being in a nursing home. That part has been a blessing.

Madam Chairman, what I want to say to you today is that the money from the accelerated death benefit really helped us. It helped us keep our business, our home, and our dignity. I know firsthand how important the benefit has been for me and for my family. I know it can help other people, too.

Please, whatever you do, keep this important benefit available for all the people who find themselves in the same situation I am in.

Thank you again for inviting us to address you and for taking the time to listen.

Mrs. JOHNSON. Thank you very much for your testimony.

Mr. and Mrs. Don Paul and Mrs. Carballo.

STATEMENT OF DON PAUL, AUSTIN, TEX., ACCOMPANIED BY ROSEMARY PAUL, WIFE, AND MARTHA CASTILLO CARBALLO, MOTHER-IN-LAW

Mr. DON PAUL. Madam Chairman and members of the committee, my name is Don Paul. I have traveled here from Texas with my wife, Rosemary, for the privilege of talking with you today. We both wish to urge you and your fellow legislators to help individuals take full advantage of all the scarce resources that remain once a terminal illness has devastated their emotional and financial lives.

We encourage you to enact legislation that allows people to receive, tax free, the critical financial resources gained by accelerating the death benefit of their insurance policy or, as in our case, if they sell a life insurance policy outright through a process called viatication. I would like to briefly share our story with you so you can better understand the perspectives of the many people in our position.

In April 1992, Rosemary developed Lou Gehrig's disease, a debilitating and terminal neuromuscular disease for which there is no known cure. I am retired, and when my wife first fell ill, I worked very hard to take care of her, to make her comfortable, and give her what she needed. We believed that together we could handle anything that would eventually come our way.

Among other things, we were able to involve Rosemary in an experimental drug treatment program at the University of Texas Health and Science Center in San Antonio. The drug they are testing is supposed to stimulate the neurons that manufacture the food for the nerves that haven't been damaged in her body and hopefully double the life expectancy for someone with her condition.

The normal course of the disease ranges from 2 to 5 years and is usually terminal in 3 years. Rosemary's illness became very expensive, requiring us to remodel our home and purchase a modified van to accommodate her electric wheelchair. Those changes alone cost more than $60,000. I was soon dipping into our savings just to pay basic living expenses. I can hardly describe to you how frightening it is to see your entire life savings rapidly evaporating, knowing that there is much more ahead. But what was, perhaps, worse was the terrible emotional cost of caring for Rosemary 24 hours a day.

Because of our financial situation, I needed to be her sole care giver. It took a very heavy toll on me. When you watch the person you love die a little bit every day, it is worse than anything you could imagine. Things really hit bottom after 2 years when I also started getting sick from the stress of the situation. But then we learned of a new financial option called the viatical settlement.

Before she became ill, Rosemary was general manager of Grandy's Restaurant in our town. She had been with Grandy's 10 years. The last 6 months of her illness she worked there from a wheelchair. When Rosemary could no longer work, we had gone to the benefits coordinator of the company to see what our options were.

My wife had paid a little extra out of her paycheck for years to buy extra life insurance coverage, but it was for a group term policy that had no cash value at all, nor did it offer an accelerated death benefit. At that point we really believed we had exhausted all of our options.

Then out of the clear blue sky the company's benefits coordinator called and said that she had heard about something called viatical settlements on a radio talk show. In fact, it turns out that the gentleman being interviewed was John Banks from a company called Viaticus, who will also be talking with you today.

We called the company and found out that we could viaticate Rosemary's policy. The company paid a percentage of the policy based on my wife's life expectancy, which in her case is 2–5 years. Right now we say that she is living on time that God has given us.

I don't want to go into the specifics of the transaction, but I can tell you that we received money we would not have had access to, and we both believe we were treated very fairly. I can also tell you that the money has allowed us to enjoy our remaining days together and relieve much of the terrible stress that comes from facing the type of physical and financial hardships life has dealt us, suffering I wouldn't wish on my worst enemy.

We are now able to have a nurse come in 2 days a week to help care for Rosemary. Her mother has come up from Mexico City to stay with us. These two things have given us great freedom to travel around Texas in our van, enjoying Rosemary's time up to the very end. In short, we feel this option has literally given us new life.

Again, we are here today to ask you to please consider making this kind of benefit part of any legislation you are considering that would make accelerated death benefits and viatical settlements tax free. It just isn't fair for people who have worked and saved their whole life to be stripped of everything as they face a terminal illness. To then further tax them on the last remaining funds they can use to maintain a sense of dignity, security, and a simple sense of enjoying their last remaining days on Earth is simply, we believe, not what this great country is about.

Thank you, Madam Chairman, and to the entire committee our thanks for this opportunity to talk with you today.

[The prepared statement follows:]

Statement of Don Paul

BEFORE THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Committee:

My name is Don Paul. I've traveled here from Texas with my wife Rosemary Paul to talk with you today. We both wish to urge you and your fellow legislators to help individuals take full advantage of all the scarce resources that remain once a terminal illness has devastated their emotional and financial lives.

We encourage you to enact legislation that allows people to receive, tax-free, the critical financial resources gained by accelerating the death benefit of their insurance policy or--as in our case--if they sell a life insurance policy outright through a process called viatication. I'd like to briefly share our story with you so you can better understand the perspectives of the many people in our position.

In April of 1992, Rosemary developed Lou Gehrig's disease, a debilitating and terminal neuromuscular disease for which there is no cure. I'm retired and when my wife first fell ill I worked very hard to take care of her, to make her comfortable and give her what she needed. We believed that together we could handle anything that would eventually come our way.

Among other things, we were able to involve Rosemary in an experimental drug treatment program at the University of Texas Health and Science Center in San Antonio. The drug they are testing is supposed to stimulate the neurons that haven't been damaged in her body and hopefully double the life expectancy for someone with her condition; the normal course of the disease ranges from 2 to 5 years, and is usually around 3 years. This, combined with the sense of stability we had achieved through years of hard work and savings made us feel like we were in control of the situation.

I was terribly wrong. We had both worked hard for years and had bought a house, saved a few dollars and started to receive a small Social Security pension. For these reasons, they told us we were too well off to receive any social services because our income was considered too high.

But Rosemary's illness required a lot of medical equipment, and insurance only covered about 80 percent of the costs. First there was a cane, then a walker. Next we needed to widen the doorways in the bathroom to accommodate her electric wheelchair, which she needed after she began losing control of her legs and back muscles.

We also had to trade in our station wagon for a special vehicle, build ramps into our home, purchase a lift to help Rosemary in and out of her bed. These changes alone cost more than $60,000. I was soon dipping into our savings just to pay basic living expenses. I can hardly describe to you how frightening it is to see your entire life savings rapidly evaporating--knowing that there is much more ahead. But I had promised that as long as I was able to find a solution Rosemary would not have to leave our home. Even if it took our last cent, I'd keep her there to her dying day.

What was perhaps worse was the terrible emotional cost of caring for Rosemary 24 hours a day during this period. Because of our financial situation I needed to be her sole care giver. It took a heavy toll on me. When you watch the person you love die a little bit every day it's worse than anything else. She used to do small craft projects or do painting after she became confined. But eventually each activity predictably became progressively more difficult for her. She would say "look how the muscles are going in my hands, honey, I guess I can't paint anymore."

Things really hit bottom after two years, when I also started getting sick from the stress of the situation. I began breaking out in large ulcers on my leg, which was complicated by the fact that I'm diabetic. My health has since gotten worse. We were broke and new problems were mounting.

Then we learned of a new financial option called the viatical settlement. Before she became ill Rosemary was general manager at Grandy's restaurant in our town. She'd been there 10 years--from the time they opened. The last 6 months she worked there she did her job from a wheelchair.

Grandy's is part of a large company and they offered good group health and life insurance policies. When Rosemary could no longer work, we'd gone to the benefits manager to see what our options were. My wife had paid a little extra out of her paycheck for years to buy extra life insurance, but it was for a group term policy that had no cash value at all, not did it offer an accelerated death benefit. At that point, we really believed we had exhausted all of our options.

Then out of the clear blue sky the company's benefits manager called and said that she had heard about something called viatical settlements on a radio talk show. In fact, it turns out that the gentleman being interviewed was Mr. John Banks from a company called Viaticus, who will also be talking with you today. We called the company and found out that we could actually sell the policy to receive a significant amount of money. It really was like a gift from God.

We began working with the viatical settlement company to assess her case. The company paid a percentage of the policy based on my wife's life expectancy, which in her case is 2 to 5 years. Right now we say that she is living on time that God has given.

I don't want to get into the specifics of the transaction, but I can tell you that we received a lot of money and we both believe we were treated fairly. I can also tell you that the money has allowed us to enjoy our remaining days together and relieve much of the terrible stress that comes from facing the type of physical and financial hardships life has dealt us--suffering I wouldn't wish on my worst enemy.

In addition to allowing us to spend quality time together and enjoy our remaining life together, Rosemary has also had the joy of personally making a legacy to her grandchildren--she always wanted to start a college fund for them. Most importantly, and what is really beautiful, is that she can now enjoy what is left of her remaining days on this earth. There is nothing I want more than this.

We are now able to have a nurse come in 2 days per week to help care for Rosemary. And her mother has also been able to come to stay with us for a while. These two things have given us great freedom to travel around Texas in our van--enjoying Rosemary's time up to the very end. In short, we feel this option has literally given us new life.

Again, we're here today to ask you to please consider making this kind of benefit part of any legislation you are considering that would make accelerated death benefits and viatical settlements tax free. It just isn't fair for people who have worked and saved their whole life to be stripped of everything as they face a terminal illness. To then further tax them on the last remaining funds they can use to maintain a sense of dignity, security and simple sense of enjoying their last remaining days on earth is simply, we believe, not what this country is about.

Thank you Mr. Chairman and to the entire Committee for this opportunity to talk with you today.

Mrs. JOHNSON. Thank you very much, Mr. Paul, for your excellent testimony.

Paul Phinney.

STATEMENT OF PAUL PHINNEY, SANTA ROSA BEACH, FLA.

Mr. PHINNEY. Madam Chairman and members of the committee, my name is Paul Phinney, and I am HIV positive. I am also a certified public accountant and a member of both the American Institute of CPAs and the New York State Society of CPAs.

Currently, I am retired on disability and have received proceeds from viatications of several of my life insurance policies. A viatical settlement or viatication is different from an accelerated death benefit in that proceeds from the former are paid by a third party viatical settlement company, whereas proceeds from an accelerated death benefit are paid directly from the life insurance company.

Accelerated death benefits were not an option for me since either my life expectancy was too long or else the specific insurance company did not offer accelerated death benefits. Through receiving proceeds from life insurance policy viatications, I have been able to afford better health care and am able to avoid being a financial burden upon society.

In my experience, insurance companies only consider entering into an accelerated death benefits transaction if the applicant's life expectancy is 6 months or less or 1 year or less. This limits individuals with longer life expectancies to only have recourse to viaticate life insurance policies to third-party viatical settlement companies.

I feel that it is unfair to individuals with longer life expectancies to have to pay income taxes on viatical settlement proceeds received from third-party viatical settlement companies. Whereas individuals with very short life expectancies would not, under proposed tax regulations, have to pay income taxes on accelerated death benefits received directly from the insurance company.

A terminally ill individual who is viaticating a life insurance policy or receiving an accelerated death benefit should not be penalized just because their life expectancy is 6 to 12 months longer than an arbitrary cutoff point. The point is that viatical settlements should be nontaxable just as certain accelerated death benefits are to become.

Additionally, eligibility for nontaxable status should extend to all viatical and accelerated death benefit settlements, which are by definition in connection with a terminal illness, irrespective of whether the proceeds are paid directly by the insurance carrier or by a third party viatical settlement company, and eligibility should not be based on any further cumbersome or needless requirements, but solely upon a physician's diagnosis of terminal illness.

As a CPA and tax specialist, my work regimen was very stressful and demanding, and the pressures of tax season, I feel, were leading me to an early grave. My decision to leave work on disability was a difficult decision to make fraught with major uncertainties, but viatical settlement proceeds have provided me with the means to financially support myself after ceasing work due to disability, and by doing so to be able to reduce my stress and to dedicate more time to the maintenance of my health.

I feel that my longevity has been increased in this way, and I feel that leaving work and viaticating my life insurance policies sooner rather than later was the right thing to do. Further, this approach has allowed me to remain financially solvent and to make and implement plans for the future, such as my plan to move to Florida to a healthier climate and to be closer to my family.

There is a significant positive correlation between financial solvency and longevity for individuals afflicted with HIV. Adequate financial resources can provide the means for a more comfortable existence with reduced stress and the means to afford better health care, both of which increase longevity and quality of life.

I clearly believe that it is better to viaticate sooner rather than later, since this allows viators to afford better medical care and to realize other lifetime goals while they still have the time and health to do so. They shouldn't have to wait until they are in the hospital.

For many, HIV disease means suffering through an agonizing decline, leading to despair, impoverishment, bankruptcy, and then death. Many terminally ill individuals do not have adequate disability insurance on which to live once they are entitled to leave work on disability, and so they delay disability retirement to the point that their health deteriorates more rapidly due to increased stress from continuing to work, sometimes continuing working until they are fired due to deteriorating work performance.

Although I am no saint, I would like to make reference to Matthew 26:7 and Mark 14:3 in the King James version of the Holy Bible, to the time just before Jesus' crucifixion when a woman knelt to anoint Jesus' feet and body by pouring upon him a very expensive ointment prior to his burial.

There was indignation among some of those present, including his disciples, that such an expensive ointment would be wasted instead of sold for much and given to the poor. But Jesus commended the woman for her good deed, and pouring the expensive ointment on his body for his burial. To paraphrase how this was depicted in the movies, he asked them whether they would begrudge him this one small act of anointment, and he said they would always have the poor with them, but that he would not always be with them.

By the same token, I strongly believe that it would not be right to begrudge a terminally ill individual the full enjoyment of the proceeds of a viatical settlement by subjecting it to an income tax. I want to thank the committee for allowing me this opportunity to express my views today. Thank you.

[The prepared statement follows:]

TESTIMONY BY
PAUL PHINNEY ON 01-19-95
BEFORE
THE COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

My name is Paul Phinney, and I am HIV positive. I am also a Certified Public Accountant and a member of both the American Institute of Certified Public Accountants and the New York State Society of Certified Public Accountants. Currently, I am retired on disability and have received proceeds from viatications of several of my life insurance policies. A **viatical settlement** (or viatication) is different from an **accelerated death benefit** in that proceeds from the former are paid by a third party viatical settlement company, whereas proceeds from an accelerated death benefit are paid directly from the life insurance company. Accelerated death benefits were not an option for me since either my life expectancy was too long, or else the specific insurance company did not offer accelerated death benefits. Through receiving proceeds from life insurance policy viatications, I have been able to afford better health care and am able to avoid being a financial burden upon society.

In my experience, insurance companies only consider entering into an accelerated death benefits transaction if the applicant's life expectancy is six months or less or one year or less. This limits individuals with longer life expectancies to only have recourse to viaticate life insurance policies to third party viatical settlement companies. I feel that it is unfair to individuals with longer life expectancies to have to pay income taxes on viatical settlement proceeds received from third party viatical settlement companies, whereas individuals with very short life expectancies would not, under proposed tax regulations, have to pay income taxes on accelerated death benefits received directly from the insurance company. A terminally ill individual who is viaticating a life insurance policy or receiving an accelerated death benefit should not be penalized just because their life expectancy is six to twelve months longer than an arbitrary cutoff point. The point is that viatical settlements should be non-taxable just as certain accelerated death benefits are to become. Additionally, eligibility for non-taxable status should extend to all viatical and accelerated death benefit settlements which are by definition in connection with a terminal illness (irrespective of whether the proceeds are paid directly by the insurance carrier or by a third party viatical settlement company), and eligibility should not be based on any further cumbersome or needless requirements, but solely upon a physician's diagnosis of terminal illness.

As a CPA and tax specialist, my work regimen was very stressful and demanding, and the pressures of tax season, I feel, were leading me to an early grave. My decision to leave work on disability was a difficult decision to make fraught with major uncertainties, but viatical settlement proceeds have provided me with the means to financially support myself after ceasing work due to disability, and by doing so to be able to reduce my stress and to dedicate more time to the maintenance of my health. I feel that my longevity has been increased in this way, and I feel that leaving work and viaticating my life insurance policies sooner rather than later was the right thing to do. Further, this approach has allowed me to remain financially solvent and to make and implement plans for the future, such as my plan to move to Florida to a healthier climate and to be closer to my family.

There is a significant positive statistical correlation between financial solvency and longevity for individuals afflicted with HIV. Adequate financial resources can provide the means for a more comfortable existence with reduced stress and the means to afford better health care, both of which increase longevity and quality of life. Individuals with private medical insurance coverage live longer than those receiving only Medicaid benefits. Additionally, the Gay Men's Health Crisis organization in New York City conducted a small study of terminally ill patients and found that approximately seventy-five percent of the long term survivors had private health insurance. Therefore, access to viatical funding means access to good medical care and increased longevity.

I clearly believe that it is better to viaticate sooner rather than later since this allows viators to afford better medical care and to realize other lifetime goals while they still have the time and the health to do so. They shouldn't have to wait until they are in the hospital. Also, viaticating sooner rather than later allows a terminally ill person to afford quality mainstream and alternative medical care continuously from an earlier point in time.

For many, HIV disease means suffering through an agonizing decline leading to despair, impoverishment, bankruptcy, and then death. Many terminally ill individuals do not have adequate disability insurance on which to live once they are entitled to leave work on disability, and so they delay disability retirement to the point that their health deteriorates more rapidly due to increased stress from continuing to work, sometimes continuing working until they are fired due to deteriorating work performance. Due to the current taxable status of viatical settlements, prospective viators may unfortunately delay viatication and continue to work past the point of diminishing returns until they meet the arbitrary twelve month maximum life expectancy required for non-taxability status for accelerated death benefits. Non-taxability of viatical settlements would provide additional financial resources to these individuals, allowing them to leave work on disability earlier with more financial security and without becoming a financial burden upon society. While approximately eighty-five percent of employees have employer-provided medical insurance, only about forty-seven percent have employer-provided disability insurance, and only about eight percent have private long term disability insurance. Long term disability insurance coverage typically pays only sixty percent of regular earned income. However, afflicted individuals need more financial resources once they have ceased working since they generally have dramatically increased health care costs and other increased living costs associated with their health afflictions.

In the following section of my written testimony, I would like to share my thoughts and experiences by focusing on the best way to approach the viatical process so that others may benefit from the distillation of my experiences, as summarized in conjunction with my recent interview in a television documentary about HIV and viatical settlements soon to be aired on major European networks.

INSURANCE ISSUES AND RULES OF THUMB

1) **OBTAIN BIDS FROM SEVERAL VSC'S:**
APPLY FOR BIDS FROM SEVERAL VIATICAL SETTLEMENT COMPANIES (VSC'S) AND SELECT HIGHEST OFFER.

2) **ADDITIONAL PAID UP INSURANCE:**
DON'T OVERLOOK ADDITIONAL PAID UP INSURANCE WHICH IS IN ADDITION TO THE REGULAR FACE AMOUNT OF THE POLICY.

3) **SELL SMALLER POLICIES FIRST ONLY AS YOU NEED THE MONEY:**
SELL SMALLER POLICIES FIRST, ONE AT A TIME, AS YOU NEED THE MONEY, AND "SAVE" THE LARGER POLICIES FOR LATER. THIS WAY YOU REALIZE MORE MONEY SINCE THE VIATICAL OFFERS WILL INCREASE (AS A PERCENTAGE OF THE POLICY FACE VALUE) AS TIME ELAPSES AND YOUR LIFE EXPECTANCY DECREASES.

4) **ENGAGE A QUALIFIED ATTORNEY TO REPRESENT YOU:**
ENGAGE A QUALIFIED ATTORNEY TO REVIEW ANY VIATICATION CONTRACTS BEFORE YOU SIGN THEM. ONLY SELECT AN ATTORNEY WHO IS EXPERIENCED WITH VIATICATIONS AS WELL AS INSURANCE AND DISABILITY MATTERS.

5) **ENGAGE A QUALIFIED FINANCIAL CONSULTANT:**
A QUALIFIED FINANCIAL CONSULTANT (ONE WHO IS EXPERIENCED WITH VIATICATIONS AND INSURANCE AND ONE WHO HAS A NETWORK OF ESTABLISHED BUSINESS CONTACTS) CAN BE EXTREMELY HELPFUL IN

NEGOTIATING HIGHER VIATICAL BIDS, IN HELPING YOU THROUGH THE VIATICAL APPLICATION PROCESS, AND IN SELECTING APPROPRIATE VSC'S TO CONSIDER. ONLY SELECT A CONSULTANT WHO IS EXPERIENCED WITH VIATICATIONS AS WELL AS INSURANCE AND DISABILITY MATTERS.

6) **PAY LEGAL & FINANCIAL CONSULTANT FEES ON HOURLY BASIS ONLY:**
FEES PAID TO AN ATTORNEY OR FINANCIAL CONSULTANT SHOULD BE ON AN HOURLY BASIS RATHER THAN BASED ON A PERCENTAGE OF THE VIATICAL SETTLEMENT PROCEEDS.

7) **INCLUDE ESCROW AGREEMENT:**
IT IS USUALLY BEST FOR THE VIATICAL CONTRACT TO INCLUDE AN ESCROW ARRANGEMENT WITH AN INDEPENDENT ESCROW AGENT IN ORDER TO SAFEGUARD YOUR INTERESTS.

8) **AVOID BROKERS:**
AVOID VSC'S WHICH ARE BROKERS (BROKERS ARE USUALLY "MIDDLEMEN" WHO DO NOT HAVE ANY MONEY TO INVEST AND WHO RECEIVE A COMMISSION PAID BY WHOMEVER ACTUALLY BUYS YOUR POLICY). IT IS BETTER TO DEAL DIRECTLY WITH VSC'S WHICH HAVE THEIR OWN MONEY TO INVEST SO THAT THERE IS NO NEED TO PAY FOR A BROKER'S COMMISSION, AN UNNECESSARY EXPENSE THAT WOULD NO DOUBT EFFECTIVELY REDUCE THE AMOUNT OF THE VIATICAL SETTLEMENT PROCEEDS THAT YOU ULTIMATELY RECEIVE. NOTE THAT CERTAIN STATES ARE BEGINNING TO REGULATE THE VIATICAL SETTLEMENT INDUSTRY, ENFORCING GREATER ETHICAL STANDARDS.

9) **LIFE EXPECTANCY ESTIMATE & SELECTION OF PHYSICIAN:**
SELECT A PRIMARY PHYSICIAN WHO NOT ONLY PROVIDES YOU WITH QUALITY HEALTH CARE, BUT ALSO IS HELPFUL IN FILLING OUT INSURANCE FORMS, IS DILIGENT IN MAINTAINING YOUR MEDICAL RECORDS TO PROPERLY DOCUMENT YOUR HEALTH ISSUES, AND IS COOPERATIVE IN QUICKLY PROVIDING DOCUMENTATION (MEDICAL TRANSCRIPTS AND LAB TESTS) AND OTHER INFORMATION AS NEEDED. FIND A PHYSICIAN WHO IS SYMPATHETIC TO YOUR SPECIAL NEEDS AND WHO UNDERSTANDS THAT HIS ESTIMATE OF YOUR LIFE EXPECTANCY WILL HAVE A SIGNIFICANT IMPACT ON THE SIZE OF YOUR VIATICAL SETTLEMENT OFFERS.

10) **OBTAIN COMPLETE MEDICAL RECORDS:**
JUST BEFORE YOU START THE VIATICAL APPLICATION PROCESS, OBTAIN FROM YOUR PRIMARY PHYSICIAN (AND ANY OTHER PHYSICIANS YOU HAVE CONSULTED) PHOTOCOPIES OF COMPLETE AND UP-TO-DATE MEDICAL RECORDS, INCLUDING MEDICAL TRANSCRIPTS WRITTEN BY YOUR DOCTORS AND LAB TEST REPORTS. THIS WAY, YOU CAN EASILY AND QUICKLY MAKE MULTIPLE PHOTOCOPIES OF THESE RECORDS TO SEND ALONG WITH EACH OF YOUR VIATICAL SETTLEMENT APPLICATIONS.

OTHER IMPORTANT CONSIDERATIONS

1) IF YOU HAVE GROUP TERM LIFE INSURANCE COVERAGE PROVIDED THROUGH YOUR EMPLOYER AND YOUR EMPLOYMENT ENDS, YOU GENERALLY CAN CONTINUE THE INSURANCE COVERAGE, BUT YOU MUST APPLY TO CONVERT IT TO AN INDIVIDUAL WHOLE LIFE POLICY, AND THE APPLICATION (AND FIRST PREMIUM PAYMENT) DEADLINE TO CONVERT IT IS USUALLY 20 TO 30 DAYS AFTER THE DATE YOU LEAVE WORK.

2) IF YOU ARE HIV+, BY ALL MEANS KEEP ANY EXISTING LIFE INSURANCE POLICIES AND DISABILITY POLICIES IN FORCE. KEEP PAYING THE

PREMIUMS ON TIME SO THAT THE POLICIES DO NOT LAPSE. IF FOR SOME REASON A POLICY LAPSES, YOU MAY BE ABLE TO HAVE IT REINSTATED.

3) IF YOU ARE HIV+ AND ARE EMPLOYED, YOU CAN USUALLY OBTAIN HEALTH (MEDICAL) INSURANCE, LIFE INSURANCE, AND DISABILITY INSURANCE THROUGH YOUR EMPLOYER. OBTAIN THE MAXIMUM INSURANCE COVERAGES AVAILABLE SINCE YOU MAY NOT BE ABLE TO OBTAIN THIS LATER.

4) MOST INSURANCE COMPANIES WILL NOT OFFER TO SELL LIFE INSURANCE OR DISABILITY INSURANCE TO INDIVIDUALS WITHOUT EVIDENCE OF INSURABILITY, INCLUDING BLOOD TESTS. HOWEVER, EVEN IF YOU ARE HIV+, YOU MAY STILL BE ABLE OBTAIN CERTAIN LIFE AND DISABILITY INSURANCE POLICIES, BUT PREMIUMS FOR THESE ARE USUALLY MORE EXPENSIVE AND THE COVERAGE IS MORE LIMITED. YOUR FINANCIAL CONSULTANT CAN PROVIDE YOU WITH MORE INFORMATION ON THIS.

5) MOST VSC'S WILL ONLY CONSIDER BUYING YOUR LIFE INSURANCE POLICY IF YOUR LIFE EXPECTANCY IS TWO YEARS OR LESS; HOWEVER, THERE ARE VSC'S WHICH WILL CONSIDER A LIFE EXPECTANCY UP TO FIVE YEARS. GENERALLY, THE LESS YOUR LIFE EXPECTANCY IS, THE LARGER THE VIATICAL SETTLEMENT OFFER WILL BE, AND VICE-VERSA.

6) INDIVIDUAL TERM OR WHOLE LIFE INSURANCE POLICIES ARE USUALLY EASIER TO VIATICATE THAN GROUP TERM LIFE INSURANCE POLICIES. MOST VSC'S WILL ACCEPT A GROUP TERM LIFE POLICY AS IS, BUT SOMETIMES ONLY IF THE POLICY IS FIRST CONVERTED TO AN INDIVIDUAL LIFE POLICY. IF THE VSC REQUIRES THAT THE POLICY MUST FIRST BE CONVERTED, THEN THE VSC SHOULD AGREE TO PAY THE INITIAL PREMIUM AND ALL LATER PREMIUMS ON THE CONVERTED POLICY. NOTE THAT A DISABILITY WAIVER OF PREMIUM PROVISION IS USUALLY NOT AVAILABLE FOR A CONVERTED INDIVIDUAL LIFE POLICY.

7) MOST VSC'S WILL CONSIDER PURCHASING A LIFE INSURANCE POLICY ONLY IF IT IS AT LEAST TWO YEARS OLD (FROM THE POLICY EFFECTIVE DATE), SO THAT THE USUAL TWO YEAR PERIOD OF CONTESTABILITY HAS EXPIRED.

8) **VIATICAL SETTLEMENT BIDS ARE USUALLY COMPUTED AS FOLLOWS:**

   A) ADD: VALUE OF POLICY TIMES % OFFERED BY VSC
   B) ADD: ADDITIONAL PAID UP INSURANCE TIMES % ABOVE IN (A)
   C) LESS: OUTSTANDING LOANS AGAINST POLICY (APPLIES TO INDIVIDUAL LIFE POLICIES, NOT TO GROUP TERM POLICIES)
   D) LESS: PREMIUMS TO BE PAID FOR TWO YEARS (UNLESS DISABILITY WAIVER OF PREMIUM IS IN EFFECT; NOT ALL VSC'S DEDUCT THIS ADJUSTMENT)

9) IF YOU HAVE A GROUP TERM LIFE INSURANCE POLICY WHICH YOU OBTAINED THROUGH MEMBERSHIP IN A PROFESSIONAL OR TRADE ASSOCIATION, MAINTAINING YOUR MEMBERSHIP IN THE ASSOCIATION MAY BE ESSENTIAL FOR THE POLICY TO REMAIN IN FORCE. ALSO, YOU MAY HAVE TO MAINTAIN FULL-TIME WORK STATUS FOR THE POLICY TO REMAIN VALID. IF YOU STOP WORKING, YOU MAY BE ABLE TO KEEP THE POLICY IN FORCE DEPENDING UPON THE POLICY'S REQUIREMENTS (SUCH AS CONTINUED MEMBERSHIP IN THE ORGANIZATION AND TIMELY PAYMENT OF PREMIUMS). ALSO, YOU MAY HAVE THE OPTION TO CONVERT THE GROUP TERM POLICY TO AN INDIVIDUAL LIFE POLICY, AND THE CONVERSION APPLICATION USUALLY MUST BE FILED WITHIN A

DEADLINE TIME PERIOD ONCE YOU BECOME ELIGIBLE TO CONVERT THE POLICY. CONSULT YOUR FINANCIAL CONSULTANT IN THIS REGARD.

10) IF YOU HAVE A GROUP TERM LIFE INSURANCE POLICY WHICH YOU OBTAINED THROUGH MEMBERSHIP IN A PROFESSIONAL OR TRADE ASSOCIATION, AND IF THE VSC REQUIRES THAT THE POLICY BE CONVERTED TO AN INDIVIDUAL LIFE POLICY IN ORDER FOR YOU TO VIATICATE IT, YOU WILL NEED TO MEET THE POLICY'S REQUIREMENTS IN ORDER FOR YOU TO BE ELIGIBLE TO CONVERT IT. IF YOU ARE REQUIRED TO TERMINATE YOUR ASSOCIATION MEMBERSHIP BEFORE YOU COULD BE ELIGIBLE TO CONVERT THE POLICY, MAKE SURE THAT YOUR ASSOCIATION MEMBERSHIP TERMINATION DOES NOT UNEXPECTEDLY CAUSE YOU TO LOSE OTHER MEMBER BENEFITS. SPECIFICALLY, IF YOU HAVE DISABILITY INSURANCE THROUGH THE SAME ASSOCIATION, YOU WOULD PROBABLY LOSE YOUR DISABILITY COVERAGE IF YOU EITHER STOP WORKING (WITHOUT SIMULTANEOUSLY GOING ON DISABILITY) OR IF YOUR ASSOCIATION MEMBERSHIP TERMINATES. IF YOU HAVE A GROUP TERM LIFE INSURANCE POLICY FOR WHICH THE DISABILITY WAIVER OF PREMIUM IS IN EFFECT, THERE MAY BE NO NEED TO CONVERT IT TO AN INDIVIDUAL POLICY IN ORDER TO VIATICATE IT. A VSC'S REASONS AND CONCERNS FOR WANTING YOU TO CONVERT THE POLICY (BEFORE THEY WOULD CONSIDER BUYING IT FROM YOU) SHOULD MORE THAN LIKELY DISAPPEAR ONCE THE DISABILITY WAIVER OF PREMIUM IS IN EFFECT; HOWEVER, CONSULT YOUR FINANCIAL CONSULTANT IN THIS REGARD.

11) IF YOU PLAN TO STOP WORKING AND GO ON DISABILITY, BE SURE TO CONSULT WITH YOUR PRIMARY PHYSICIAN, ATTORNEY AND FINANCIAL CONSULTANT WELL IN ADVANCE BEFORE YOU DO SO THAT YOU CAN ADEQUATELY PLAN THE TIMING OF YOUR ACTIONS AND AVOID ANY PITFALLS WHICH MIGHT CAUSE YOU A LOSS OF ANY BENEFITS OR INSURANCE COVERAGE FOR WHICH YOU ARE ELIGIBLE.

12) YOU DO NOT HAVE TO WAIT UNTIL YOU ARE IN THE HOSPITAL TO VIATICATE A LIFE INSURANCE POLICY. MANY HIV+ INDIVIDUALS VIATICATE THEIR POLICIES WHEN THEY ARE ASYMPTOMATIC, WHILE THEY ARE STILL WORKING, AND WHILE THEY HAVE THE TIME AND THE HEALTH TO ENJOY THE FINANCIAL BENEFITS OF VIATICATION ENABLING THEM TO ENSURE THAT THEIR HEALTHCARE NEEDS ARE MET AND TO REALIZE LIFETIME GOALS PREVIOUSLY UNATTAINABLE.

13) **INCOME TAX AND ESTATE TAX PLANNING:**
CASH PROCEEDS RECEIVED BY A VIATOR (THE PERSON SELLING A LIFE INSURANCE POLICY) IN CONNECTION WITH A VIATICATION ARE GENERALLY CONSIDERED TO BE TAXABLE INCOME SUBJECT TO FEDERAL INCOME TAX FOR WHICH THE VIATOR IS LIABLE. IN CERTAIN CASES, A VIATOR'S LIFE EXPECTANCY OF ONE YEAR OR LESS MAY RESULT IN NO INCOME TAX LIABILITY ON ACCELERATED DEATH BENEFITS PAID TO THE VIATOR DIRECTLY FROM THE INSURANCE COMPANY. NOTE THAT CURRENTLY PENDING FEDERAL TAX LEGISLATION AND REGULATIONS MAY RESULT IN NON-TAXABLE STATUS FOR PROCEEDS RECEIVED IN CONNECTION WITH THE VIATICATION OF A LIFE INSURANCE POLICY. ALSO, CERTAIN STATES (SUCH AS NYS) SPECIFICALLY EXEMPT VIATICATION PROCEEDS FROM INCOME TAXATION IF CERTAIN CONDITIONS ARE MET. TO ADEQUATELY PLAN FOR INCOME TAX AND ESTATE TAX CONSEQUENCES WITH REGARD TO ANY CONTEMPLATED VIATICATION, CONSULT A QUALIFIED PROFESSIONAL EXPERIENCED IN TRUSTS, TAX LAW, AND ESTATE PLANNING FOR ADVICE ON ESTATE AND INCOME TAXES FOR FURTHER GUIDANCE IN THIS REGARD BEFORE YOU ENTER INTO A VIATICAL CONTRACT.

My message today is that I believe that income taxation of viatical settlements unjustly reduces the financial resources of terminally ill individuals who viaticate their life insurance policies. Income taxation as such is counterproductive since it serves to motivate terminally ill individuals to avoid income taxation by postponing life insurance viatications and waiting until their life expectancy drops to a low point which qualifies them to later receive non-taxable accelerated death benefits instead of taxable viatical settlement proceeds. In the meantime, though, receipt of additional financial resources is delayed, and the stricken individuals are deprived of the financial means with which to meet rising medical costs for quality health care and are deprived of the ability to afford to leave work earlier on disability in order to reduce stress to enhance their longevity.

Although I am no saint, I would like to make reference to Matthew 26.7 and Mark 14.3 in the King James Version of the Holy Bible to the time just before Jesus' crucifixion when a woman knelt to anoint Jesus's feet and body by pouring upon Him a very expensive ointment prior to His burial. There was indignation among some of those present, including His disciples, that such an expensive ointment would be wasted instead of sold for much and given to the poor. But Jesus commended the woman for her good deed in pouring the expensive ointment upon His body for His burial. To paraphrase how this was depicted in the movies, He asked them whether they would begrudge Him this one small act of anointment and said that they would always have the poor among them, but that He would not always be with them. By the same token, I strongly believe that it would not be right to begrudge a terminally ill individual the full enjoyment of the proceeds of a viatical settlement by subjecting it to an income tax.

I want to thank the Committee for allowing me this opportunity to express my views today.

Mrs. JOHNSON. Thank you, Mr. Phinney. I want to thank you for your testimony which, in its detail, does tell how these settlements are calculated and will give us a lot of information that will be useful to us.

Mrs. Rawoot.

STATEMENT OF TERESA KANE RAWOOT, TIMBERVILLE, VA.

Ms. RAWOOT. Thank you, Madam Chairwoman and members of the committee. My name is Teresa Rawoot. I am an attorney. I practiced in Northern Virginia and in Georgetown and more recently in the Shenandoah Valley, but I am appearing before you this morning as a private citizen who has personally benefited from a viatical settlement of life insurance.

I have with me this morning my husband Abbas Rawoot, and children Safia and Damian, ages 14 and 8. My practice as an attorney never gave rise to the opportunity to attend a congressional hearing, so I am particularly pleased to be here this morning and to allow my children this wonderful firsthand civics lesson.

I appear before you this morning to add my voice to those requesting the modification of H.R. 8 to allow for the tax-free treatment of proceeds from a viatical settlement. Viatical settlements appropriately regulated to avoid any abuse are truly reflective of the free enterprise system working at its best. There arises a tremendous need for ready funds when a life insurance policyowner, such as myself, has to deal with a terminal illness and is unable to continue working. It is a greater tragedy still when someone in that position has to deal with the added burden of realizing that their loved ones will be relieved of great financial need only upon the policyowner's death. Companies offering viatical settlements have emerged just in the past several years to fill that need. They provide life insurance policyowners with lifetime funds through a purchase of all or a portion of their life insurance policy. Thus, they truly help to fulfill the promise of life insurance, the hopes that are contemplated by an individual when they purchase a life insurance policy; namely, to provide for the financial needs of their loved ones when they are no longer able to do so themselves.

By exempting from taxation the death benefit of life insurance, our Tax Code reflects the value that society has always placed on individuals making financial provisions for their loved ones in order that they not become wards of the State upon the death of a breadwinner.

Clearly, the same rationale exists for exempting the proceeds of a viatical settlement. There is no cause for concern here that a policyowner would be able to take unfair advantage of the tax-free buildup in a life insurance policy, since viatical settlements are available only under very specific circumstances and, indeed, only under very tragic circumstances.

In my case, at a time when I was in the process of establishing my law practice in our newly adopted hometown of New Market, Va., in the Shenandoah Valley, I received the devastating news that my increasing back pain and flagging energy were due to a cancer that had already spread throughout my spine and liver. Soon I was no longer able to pursue my law practice in any appreciable way. At the same time, my husband was forced—had to

leave his job with a major hotel company because of the amount of time it required him to travel away from home, and he was just needed too much. For a short period of time we were able to depend on our savings. Thereafter, while my husband commenced establishing an accounting practice, we ran up considerable debt. I can tell you that the stress of dealing with the accumulating debt on top of the complete upheaval of a terminal illness just truly brings you near the breaking point.

Because viatical companies were fairly new, I was unaware of their existence. I desperately began trying to pursue obtaining some lifetime benefit from my life insurance policy, truly the only remaining asset that we had once our savings were depleted, apart from our home. But my policy had no advanced death benefit, and it had no significant cash surrender value or loan value.

Finally, upon learning of the availability of the viatical settlement mechanism, I cannot begin to describe to you the relief that my husband and I experienced. It was with great dismay, however, that we learned that the viatical settlement proceeds were not accorded the same tax-free treatment that are accorded to death benefits under the same life insurance policy. Nevertheless, I assure you, at that point we had no choice. Some funds were certainly better than no funds.

I worked with a very fine firm, Benefits Advocates from California, that was able to negotiate with their various funding sources to arrive at favorable terms for the purchase of a portion of my life insurance policy. That was last spring. Since that time we have been able to breathe much easier.

We have been able to rejoice at the time we have had and continue to have with each other. We were able to pay off our accumulated debts. We were able to purchase a van that allows me to recline whenever we travel. I have been able to purchase costly vitamin and mineral supplements which I am quite certain have been helpful in controlling my pain and increasing my stamina.

By the grace of our Lord, I am doing much better than any of my doctors had predicted. We have, as a family, been able to enjoy several lovely excursions with each other, and my children have rejoiced in being able to do these things with their mom, and these times we have spent together have made for some very special memories. Thus it is that I heartily repeat to you now that I am truly delighted to be here this morning with my family, and I thank you for the consideration of this request.

Mrs. JOHNSON. I thank the panel for your excellent input. As one of a number of members on this committee who have introduced and worked for the passage of legislation providing favorable tax treatment for accelerated death benefits on a bipartisan basis, the testimony you have given us both as to how important those benefits have been and how useful they are in managing terribly difficult challenges in life has been very helpful, but also this testimony on viatical settlements was very useful to us and will enable us to structure this legislation in an appropriately supportive fashion.

Mr. Bunning will inquire.

Mr. BUNNING. Thank you, Madam Chairman. For the record, and I know that you all are not experts in insurance, but it has come

to my attention that less than 5 percent of the policies in this country have accelerated death benefits included in their policies, and less than 1 percent of the population with insurance policies have any kind of settlements, viaticated settlements as some of you have experienced.

Do you know if that is anywhere near the correct figures? I got that figure from other insurers and insurance companies, but the accelerated death benefits language in H.R. 8 doesn't make the viaticated settlements tax free. It is my understanding from your testimony that you really strongly believe that a viaticated settlement should be the same as a death benefit. Am I correct?

Ms. RAWOOT. That is correct.

Mr. BUNNING. The parameters in H.R. 8 are restrictive within 1 year. In other words, for an accelerated death benefit it says if a terminally ill—or if certain types of illnesses are diagnosed that a person must be diagnosed to have a 1-year life expectancy or less to receive an accelerated death benefit.

I think those are rather restrictive, and I think that they ought to be looked at in relationship to doing something and also to making that viaticated settlement a tax-free settlement because, obviously, we all know if it were a life insurance settlement, it would not be taxable, so I deeply appreciate your testimony. It is part of H.R. 8, which I am a cosponsor of, and, obviously, with the addition of your testimony we will obviously look at viaticated settlements and we will look at expanding or lessening the restrictions on them with the proper documentation from physicians of people who have terminal illness. I deeply appreciate your coming so far to testify for our committee and thank you for your testimony.

Ms. RAWOOT. We thank you for the opportunity.

Ms. KEOWN. Thank you, sir.

Mrs. JOHNSON. Mrs. Kennelly, an author of this kind of legislation over many years will inquire.

Mrs. KENNELLY. Thank you, Madam Chairman. We have on this committee looked at this situation and worked very hard to make it better.

As you said, Mrs. Rawoot, it has just been a couple years that viatical companies have been in existence. It has only been a brief amount of time that the large insurance companies have addressed this problem, and it has been very tedious to move this legislation forward.

We have seen solicitations that are really questionable mentioning the T-cell count of an individual. This practice is individuals buying and selling insurance policies. Also we have seen cases where the insurance policy, because of your testimony saying that you really had no other choice, have been discounted to such an extent that it really is unfair. Yet both your stories are good stories, and you are very happy. You seem satisfied.

Can you give us—I don't want to get into your personal business, the discount rate and whether it was satisfactory or not: Could you help us so other people could profit by your experience?

Ms. RAWOOT. Yes. In my case I felt very keenly the potential for abuse there and was concerned about an uneven bargaining power. I satisfied that concern myself by, when I checked with various viatical companies, I concluded that I would feel much safer work-

ing with a company, more of a brokerage type operation that dealt with several funding sources.

In order to obtain a viatical settlement, it requires quite a bit of paperwork, your medical records, and for people with terminal illnesses, quite often it entails having to visit several different medical institutions, getting second opinions and whatnot, and all those records need to be submitted and reviewed and, obviously, they are all very confidential records.

Once you do that and you only have so much energy as well at that point, that I felt if I were going to be working with a company that actually did the bargaining for itself, I felt that I would have been committed to staying with that company because I wouldn't have wanted to have to repeat the whole process with someone else. Whereas working with a brokerage company where they collect all this information and then are able to approach their various funding sources to arrive at the most favorable terms for you, and there was some negotiation involved.

They came back to me with an offer, and, frankly, my doctor thought I was crazy to viaticate my policy because he just didn't think there was enough time. The prognosis was too poor for my family to give up any amount on a viatication, so with that tension on this side I did not accept the first offer that was communicated to me, and benefits advocate, Nancy Kane, with Benefits Advocates negotiated further for me and came up with a more favorable discount rate, and just the checking that I had done, I realized that that was just about the best discount rate that I could possibly arrive at.

I think, just with the life insurance industry in general, regulation is needed to avoid abuses. Clearly there is regulation needed in this area as well, because certainly the potential is there for abuse, but I also think that there are market forces there that are at work that tend to support the integrity of the entire industry and the entire effort, and I would just hope that anyone in my situation would do the checking around and the homework or would have someone to do it for them.

I know that is a concern for someone that is really ill and, of course, I am an attorney and have that background, but you can never have a completely fail-safe situation in any aspect of life, and there is always going to be some potential for abuse, but I think overall my experience, the experience of the other panelists here was highly, highly favorable, and I think that the risk of abuse is outweighed by the great potential for being a tremendous service to individuals in our position and warrants this sort of favorable tax treatment.

Mrs. KENNELLY. Thank you. Mr. Phinney.

Mrs. JOHNSON. The gentlelady's time has expired. It is Mr. Herger's time to question.

Mr. HERGER. Thank you very much, Madam Chair. I would just like to thank each of you for the courage that you have shown for coming before us and sharing with us. The information that you have shared with us has been very helpful to me.

I certainly intend to do everything I can, working with this legislation and with others, to be able to help you and those that are in similar situations be able to access funds that they have already

contributed to. I really don't have a question, but maybe during my time, Mr. Phinney, were you going to comment?

Mr. PHINNEY. Yes. I just wanted to state my experience in obtaining viatical settlements. I approached several viatical settlement companies each time. I have done this more than once, and in using a bidding process I was able to obtain what I think were fair bids, and I accepted the best bid. However, I am no politician, but I would like to see some kind of regulation of the industry possibly in the form of a model act which could be adopted by the States with a national insurance association which might promulgate any standards for the industry, such as the same way as generally accepted accounting principles are governed by the American Institute of CPAs, but that is all I wanted to say. Thank you.

Mrs. KENNELLY. Thank you.

Ms. KEOWN. May I speak? David received accelerated death benefits, and I was so devastated physically, emotionally, and financially to be faced with a situation like this that I can't imagine having to take bids on life insurance as opposed to the accelerated death benefit. I speak only for myself. Emotionally, I couldn't have handled it. Thank you again.

Mr. DON PAUL. I second that, madam.

Mrs. JOHNSON. Thank you. Mr. Hancock will inquire.

Mr. HANCOCK. Thank you very much. You know, listening to this panel reminds you of the old statement, "There, but for the grace of God," I think we have all heard that.

Let me ask a question. In today's issue of the National Journal there was a letter written to Chairman Archer that was published in here—signed by the ranking member, Mr. Gibbons, and 14 Members of the minority party criticizing our hearings that we are holding now, currently holding on what is called the Contract With America.

In fact, they are quoted as saying none of the witnesses have been expert in the Contract's provisions. I would just like to ask this panel, in your judgment, should we, as the Ways and Means Committee, be talking to members from the academia and from the bureaucracy or should we be talking to people like you?

I have been on this committee for just 2 years now, and for the last 2 years almost all of the panels started with either bureaucrats or people that have Ph.D.s behind their name rather than actual people. What is your opinion? Are we handling this wrong or should we be going and talking to the experts?

Mr. DON PAUL. We are the experts.

Mrs. ROSEMARY PAUL. We are the experts.

Mr. DON PAUL. We know what it is all about. If I could just interject, there was nobody twisting our arms in this. We solicited this ourselves from the viatical company, and out of all fairness to them, you don't have to accept this immediately. If you do, you still have 30 days in which to make up your mind as to whether you want to keep the money or not, and if you don't want to keep it and have second thoughts, return it and it is all over. There is nobody out to get you on it. The settlement was very fair.

Ms. KEOWN. I appreciate being called an expert. I know more about death and dying than I ever wanted to know, but I appre-

ciate your listening to us, and I agree, unfortunately, we are the experts, and there, but for the grace of God, you might be one, too.

Mrs. JOHNSON. Thank you. Mr. Ford will question.

Mr. FORD. Thank you, Madam Chairman. Mr. Phinney, you support the tax-free treatment of all payments due to terminal illness with no time limitation in your testimony.

Would such a proposal have a negative impact on the current disability insurance market, and how would such treatment be reconciled with the basic premise that the recipient of the benefits will die soon or have exhausted all other resources and have no other financial resources available to him or her?

Mr. PHINNEY. I am sorry, would you restate the question?

Mr. FORD. Well, you talked about the tax treatment of all payments due to a terminal illness, with no time limitation. How would you treat—how would you reconcile the payment of this with a person dying, a person dying or collecting the benefits or paying taxes and you, with the government, having exhausted, I guess, all resources. At the same time there is no time limit or time schedule for a person who might have 1 year, 2 years, or 3 years and the government not knowing whether there are any other resources available to that person at the time of death or at the time of settlement with these claims.

Mr. PHINNEY. Well, I feel that once a person is diagnosed with a terminal illness, their entire life changes, and from there it is a downward spiral. It depends on the situation.

Some people have a longer period than others, but I think it would be unfair to create artificial measurements or standards by which to judge when one terminally ill person should receive nontaxable benefits as opposed to another just based on the length of their life expectancy, the remaining life expectancy. It is a time when people need these resources, they have paid——

Mr. FORD. How do you determine that life expectancy?

Mr. PHINNEY. By a doctor's diagnosis.

Mr. FORD. What happens in cases where it is not the case, what happens if the life expectancy is 2–4 years longer than anticipated by the physician?

Ms. KEOWN. You say, thank God.

Mr. FORD. I understand that, absolutely.

Ms. KEOWN. That is exactly what you do, but I think having received the accelerated death benefits, in our case, my husband has heart disease, and I think that his survival has been longer from having received this because of relieving the stress that is involved.

I feel it is a safe assumption that we all know that relieving stress does improve the quality of our life and most of the time the longevity, but I don't think that you can set a time or I certainly can't.

David has lived at least 2 years, I mean from day one they said he can't live through the weekend, and we sat with crisis, after crisis, after crisis on a daily and hourly basis, and he continues to live. I would hate to think that we had received this and then we would have to pay it back because it is not all there now. We need that to continue to buy his medication and to provide the care that has allowed him to live this long.

Mr. FORD. Have your experiences caused you to think any differently on our national health care policy in this country as to whether we should have a strong national health care plan with full protection with all medical expenses provided?

Ms. KEOWN. Mr. Ford, I prefer personally—we have a need for health care reform. I personally would rather work, have an opportunity to work to buy and to get what we pay for without being taxed to provide for that care so that we, as reasonable human beings, can make our own decisions regarding the welfare of our families.

The road that we have chosen and the road David has chosen to live out his life, I am not—I would never say that is how someone else should do it. All I can say is that is what is best for us, and all we want are options and the ability to make those decisions ours.

Mr. FORD. My time has expired, but could I get Mr. Phinney to just respond to that question, if you don't mind.

Mrs. JOHNSON. Perhaps we can come back to that. It is Mr. Ramstad's opportunity to inquire.

Mr. RAMSTAD. Thank you, Madam Chair. I would be happy to yield to the gentleman for the purpose of that response.

Mr. FORD. I really appreciate it. Mr. Phinney, could you respond to that question, please?

Mr. PHINNEY. Yes, I agree that when financial resources, more financial resources are made available by the nontaxability of viatications it allows people to have more funds available to avoid being on public assistance, being a burden on society, and also to be able to afford better health care. It is a fact that people who have private insurance policies, who have their own health insurance, live longer than those who are merely on Medicaid, and there is also a statistical positive correlation between financial solvency and longevity.

Mr. FORD. That is comparing the Medicaid of the health care benefits in the Medicaid program versus the private sector. We are speaking of a national health care plan that would be across the board, a plan that would be universal to all Americans, so it wouldn't be a difference in the provision of the policy.

Mr. RAMSTAD. Reclaiming what is left of my short time, if I may.

Mr. FORD. Thank you very much.

Mr. RAMSTAD. Just let me say to each of the panelists that I, too, admire the great dignity and courage that each of you personifies here today, and like my colleague from Missouri, I appreciate real-world witnesses, people with experiences like yours, much more than the bureaucrats from these gray buildings up and down the avenues.

Let me ask the question briefly. As a strong supporter of the provision relating to accelerated death benefits in our Contract With America, I think it is not only the humane thing to do, but it is the cost-effective thing to do. My question relates to that premise. If you didn't have accelerated death benefits, which, if any of you, would find yourself in a nursing home? Could you just elaborate on that or comment on that?

Mrs. ROSEMARY PAUL. My husband is handicapped, as well, so it took a lot of stress for him to take care of me, and he ended up

in the hospital right after Christmas because of the stress that my illness has provided. Luckily Viaticus was able to settle with us right at that time.

Just the knowledge for me to know that when my time is gone, I will not leave him with more medical bills and for him to worry, for me, that has taken a big burden off my shoulders, knowing that he is going to be able just to live and maintain our lifestyle that we have worked so hard for just with his disability pension. Because believe me, with the money that we have gotten from Viaticus, it will be gone by the time I am gone, but he will be left without any financial debt.

Mr. RAMSTAD. I certainly appreciate that response. Let me just ask if there are any of you who are in imminent danger of being placed in a nursing home if we don't pass the Contract's provision relating to accelerated death benefits, given the tremendous expenses that you are, obviously, facing?

Mr. DON PAUL. Sir, without the money that we got on the viatical settlement, our resources were gone. I would have had to—both Rosemary and I are on Social Security. With me not being able to take care of her, she would have had to go into a nursing home and probably at government expense.

Ms. KEOWN. My husband would not choose to go to a nursing home, and as long as there is a breath in my body, he will not go.

Mr. RAMSTAD. Well, we think you and your husband should enjoy the dignity of independent living and that is why we support the provision in this Contract. I thank you, again.

Ms. KEOWN. It is more cost effective. My labor is very inexpensive.

Mrs. JOHNSON. Thank you. Mr. Payne will inquire.

Mr. PAYNE. Thank you very much, Madam Chairman. I, too, want to thank all of the witnesses who have testified this morning, because I think this is very helpful to us to understand the impact on your lives and certainly the lives of many other people who aren't here, and it helps us as we look at how to make good public policy, and certainly it is policy that I support.

I don't have a question, but I wanted to follow up on something that Mr. Bunning mentioned. He mentioned that in his research only 5 percent of the policies now contain some sort of accelerated death benefit. It is my understanding that the Prudential Insurance Co. has pioneered this concept and now offers it without any increase in premium to their policyholders. I certainly hope that other insurance companies, after hearing the kinds of testimony we have heard today, would understand how beneficial this is to their policyholders and would pursue this same kind of accelerated death benefit. I thank you all again, and I yield back the balance of my time.

Mrs. JOHNSON. Thank you. Mr. Zimmer will inquire.

Mr. ZIMMER. Thank you, Madam Chairman. I would like to say that not only are you experts on the specific insurance issue on which you are testifying, but you are expert in something more important, how to confront dying and death with dignity, with courage, with faith, and with practicality.

I served on the board of my local hospice for a number of years, and I can tell you that I regret that for the first time in our hear-

ings TV cameras aren't present because the public really needs to know how to deal with the major problems you are facing personally, the insurance and tax issues aside, and you are all excellent models for people, for all of us who are going to be confronting these tremendous challenges later in our lives.

I would like to ask Mrs. Keown, who is the only member of the panel who has actually received a direct accelerated death benefit, you said that you had to go through—you couldn't go through a bidding process, and it would be difficult for you to work out a viaticated settlement.

Do you believe that we in the committee should somehow through the Tax Code favor accelerated death benefits in preference to viatication because of the ease of availability and the ease of accessibility to the insured?

Ms. KEOWN. Mr. Zimmer, I only have experience with accelerated death benefits. I think it is wonderful. I think it should—I think everybody should have it like us. Who thinks you are going to use it? But I think it should be given favorable consideration because I think if there is perhaps competition, that maybe a greater percentage of that would go to the policyholder under this situation. I am just not familiar enough to speak as an expert, but I think any benefits that a terminally ill person receives or their family most definitely needs not to be taxed.

We need every penny that we can get, and to fall back on public assistance as the very last resort, so anything that can be done would help us.

Mr. ZIMMER. Mr. Paul.

Mr. DON PAUL. Mr. Zimmer, that may be all and well for people that are purchasing their insurance. Our insurance was a group life insurance, and I think you would probably not be able to get restrictions on that.

Mr. ZIMMER. That is something I hope we can pursue with the subsequent panel, with representatives from the insurance industry. I would hope that they could make it available, but, obviously, in the current situation where not all the insurance companies have followed the Prudential's example, we have got to be mindful of that. I thank you for bringing that to my attention.

Yes, Mr. Phinney.

Mr. PHINNEY. For some individuals, their policies do not offer an accelerated benefit provision, and most of those are only available if a life expectancy is 6 months or less or 1 year or less.

The individuals who only have the 6-month accelerated death benefit available to them, if their life expectancy is 1 year or just over 1 year, they can only do a viatical settlement, not an accelerated death benefit, and that would throw them into an income taxation situation, so I just wanted to make that point.

Mr. ZIMMER. Well, we would hope to make the income tax situation as fair as possible by our actions.

Mrs. Rawoot.

Ms. RAWOOT. Yes, I would like to say as well that the ADB (accelerated death benefit) is also such a new mechanism that I would venture to say that the overwhelming majority of baby boomers, the baby-boomer generation with life insurance policies in place do

not have any ADB provision, and I was never approached by an agent to add it on.

This individual was approached actually by their Prudential agent. So I think it would be terribly unfair for legislation that was being written now to allow tax-free treatment for something that insurance companies, for all intents and purposes—that the public, rather, would only, for all intents and purposes, would only be able to take advantage of by future insurance contracts. But all those insurance contracts that are out there now for people of my generation, a generation that is finding itself increasingly faced with diagnoses of terminal illness with the increased, the relentless increase of cancer and AIDS, I think it would be a terrible tragedy to leave out all those insurance contracts where ADBs were just simply not available to the policyowners at the time they were purchased, and I really don't see the logical rationale for it whatsoever.

Mr. ZIMMER. Thank you very much. I want to thank everybody on the panel for giving us this very important testimony.

Mrs. JOHNSON. Thank you.

Mr. Collins will inquire.

Mr. COLLINS. Thank you, Madam Chairman. I really don't have any questions, but I do want to say that I appreciate each of you being here. Your information has been very valuable. We appreciate your taking the time, and I know it was somewhat of a stress to do this and to even talk about the situation, but thanks very much for your input.

Mrs. JOHNSON. Thank you.

Mr. Kleczka will inquire.

Mr. KLECZKA. Thank you, Madam Chair. I have no questions either of this panel except to show my appreciation for their coming down and relating some very heart-wrenching stories. Thank you very much.

Mrs. JOHNSON. Thank you.

Mr. Neal will inquire.

Mr. NEAL. No questions, Madam Chairman. I believe Representative Kennelly has offered legislation similar to this in the past. I have been a sponsor of it and applaud the panel for their forthright attitude today.

Mrs. JOHNSON. Mr. Ensign will inquire.

Mr. ENSIGN. Thank you, Madam Chair. I would like to thank you for coming and sharing the testimonies that you have shared today.

Mr. Phinney, I do have a question for you just to clarify this in my own mind. When you talk about being diagnosed as having a terminal illness, if you are diagnosed HIV positive, but you don't have AIDS, for instance, would that be something that should be included, or would you have to actually be to the AIDS stage when you are no longer allowed to work or carry on a normal work schedule?

Mr. PHINNEY. Well, I think the definitions, the definition of AIDS has changed recently. It used to be based on T-cell counts or CD–4 counts.

Mr. ENSIGN. Right, and it is evolving and who knows what it will be in the future.

Mr. PHINNEY. I don't know what the definitions are now, but I don't know what the cutoff point should be or if there should be

one, but I think that people with a terminal illness should be given the opportunity to enter into a viatical settlement that is nontaxable.

As to whether their life expectancy should be under 5 years, under 2 years, under 1 year, I really can't make that determination. I would think that perhaps whether they are actually disabled such that they cannot work, that might be another definition of whether or not they have met the—that might be another criteria to use for nontaxability, but I think anybody who viaticates because they have a terminal illness should be at some point allowed proceeds that are nontaxable.

Mr. ENSIGN. I would agree with that, and I would like to further add that as I see it, with the payments that you received, as far as a cost-to-benefit ratio, I know we are looking in real terms on the way you have received these benefits, but you are able to stay home longer. You are able to take care of your own families longer. That seems, to me, in the long run to also save our government money.

I mean, there doesn't seem to be a losing situation here. I see nothing but a positive situation. I thank you all for coming today.

Mrs. JOHNSON. Mr. Christensen will inquire.

Mr. CHRISTENSEN. Madam Chairman, I echo the sentiments of my colleagues and thank this panel for coming, and as my colleague from Missouri quite eloquently said, this is definitely the panel of experts. I thank you for your time here today.

Mrs. JOHNSON. Mr. Phinney, I would like to follow on with one question. I would guess that the diagnosis would play a big role in what kind of settlement offer you received.

In other words, if the diagnosis indicated that you might live 6–8 years, you might not have many offers, so isn't there some mechanism within the viatical settlement process that deals with the issue of time more effectively than we might by defining 12 months or 15 months or 24 months?

Mr. PHINNEY. I think I have an answer for it now. I think that the individual who is contemplating a viatication should be able to make the decision whether they are going to viaticate based on whether they need the money depending upon what their condition is, whether they need the money for alternative medical treatment, which is not covered by health insurance, if they have to travel to Paris to get special medical treatment or whatever, but an individual is not going to accept an offer that is ridiculous, I wouldn't think, if they have any degree of intelligence. So I think that there is a—that each individual really should have the decisionmaking power as to whether they want to enter into a viatication.

If they need to because they have a terminal illness and they have the financial need to do so and they want to accept an offer, they think it is fair, I really think it should be up to them to make that decision whether they enter into the viatication, and then if they do, I think it would make sense to have it nontaxable.

Mrs. JOHNSON. The viatical settlement, like an accelerated death benefit, continues until you die, correct?

Mr. PHINNEY. Normally, you get a lump sum payment and you assign the policy so you don't own it anymore, and you have got a lump sum amount.

Mrs. JOHNSON. I see. So it does differ from the accelerated death benefit in that regard. Mrs. Keown.

Ms. KEOWN. With the accelerated death benefit, we received a very large percentage, I think, of the total policy. We were most satisfied, and the ease with which it was handled really relieved not only the financial strain, but also the emotional strain of having to deal with it.

With David's condition and heart disease, in response to your time period, none of us know, but with some disease processes that I have become more familiar with that are terminal, they are a little bit easier to define because of the way the disease progresses.

The miracle is that David is still alive, but his will come probably in the snap of a finger because it is heart disease. He had to have lived 6 months or less, but again he has been here 2 years, and it is because of the care that he has received. I am patting myself on the back.

Mrs. JOHNSON. Mr. Paul.

Mr. DON PAUL. Madam Chairman, I hope we are not complicating this by going into a lot of redtape, which I think is happening right here right now. This is very simple. The company does not solicit your business. You solicit the business from them on a viatical settlement.

Like any other insurance company, they use actuarial figures to determine the percentage amount of the policy you are going to get based on your physical condition and based on all of your medical records to determine from there, and you also know just about how much life expectancy you have.

Mrs. JOHNSON. So you are saying there is no necessity for government to get involved in setting those criteria?

Mr. DON PAUL. I don't think so. I think we need to keep it simple. We don't need to complicate it with a lot of redtape because even with AIDS or anything else, they are not going to settle on a policy.

The viatical settlement is not going to settle on a policy if you have got 15, 20 years, and you are not going to have to accept what they offer you, so we could keep it very simple. They base it on actuarial figures as to how long you have to live, and you have the option to either accept it or reject it. It is just that simple.

Ms. RAWOOT. Just to second that, I would just add that this really seems to be one of those areas where the natural market forces at work would be the best regulator because the viatical company will offer a financial settlement only based on the hard data made available to it from the medical records and the medical doctors, and, obviously, no one can predict with certainty when anyone is going to pass away from a given illness, but—so they do, they assume a fair amount of risk, as well.

Mrs. JOHNSON. If there are no further questions from the committee, I do want to thank you for your courage day in and day out and for your willingness to share your experience with us. It has been very helpful.

Ms. Paul, did you have a comment?

Mrs. ROSEMARY PAUL. I just want to second something my husband mentioned, the life insurance company, they are going to pay the money to us after we are dead, OK? Why not give them a

chance to enjoy the money before we are dead, before we go? To us, it is more beneficial.

I am enjoying my life, and I am sorry if I don't leave anything to anyone else, but I am enjoying my life by being with them. Later on, after I am gone, I am not going to worry. Let them worry about it.

Mrs. JOHNSON. You have certainly made clear all the many ways in which accelerated death benefits and other solutions improve the quality of your lives and are a good deal for everyone. We thank you very much.

Mr. SHAW [presiding]. I see our old friend and former colleague, Dan Mica. Welcome. Glad to have you with us on this panel today.

Mr. Pardo, who is president of the National Viatical Association and president of Life Partners, Inc., of Waco, Tex.

By the way, Dan Mica is executive vice president of the Federal Affairs American Council of Life Insurance; Per Larson, Highland Mills, N.Y.; Alan B. Perper, president, Dignity Partners, San Francisco, Calif., on behalf of the Viatical Association of America; and John Banks, chief executive officer. Your written statement will be made a part of the record. You may summarize or proceed as you see fit. Dan, why don't you start.

STATEMENT OF HON. DANIEL A. MICA, EXECUTIVE VICE PRESIDENT, FEDERAL AFFAIRS, AMERICAN COUNCIL OF LIFE INSURANCE

Mr. MICA. Thank you, Mr. Chairman. Let me start out by saying I am accompanied by Stephen Kraus on my right, chief counsel, Pensions, at the ACLI (American Council of Life Insurance). Indeed, since my written statement is a part of the record, I will summarize.

We are very pleased to express our strong support for the provisions in the Senior Citizens' Equity Act that would treat accelerated death benefits as nontaxable death benefits. The moving testimony we all heard early this morning clearly demonstrates that accelerated death benefits can play an important and sometimes critical role in providing individuals with the timely financial support they need to deal with major health problems.

I am pleased to report today that over 215 life insurance companies offer accelerated death benefit protection to more than 18 million policyholders, and I might add that that is quite an increase from just a few years ago. Therefore, I think it is important that Congress act as quickly as possible on this issue so that the current uncertainty for our policyholders regarding the tax treatment of these benefits will be clarified.

Accelerated death benefits or "living benefits" allow policyholders to access the face amount of their policies prior to death in response to the growing need to ease the financial burdens and strains on Americans and their families, and you have all heard this. I will summarize some of this here. You have heard about it in detail this morning.

This cost-effective approach was a life insurance policy as the foundation to provide benefits under the following circumstances—terminal illness, long-term care, or permanent confinement to a nursing home, and I might also add that companies have acceler-

ated death benefits to treat a broad range of specific medical conditions such as strokes, life threatening cancers, and major organ transplants. There is also substantial public support for accelerated death benefits.

Almost three-quarters of those interviewed by the Roper Organization in a May 1993 poll sponsored by ACLI approved of the concept of accelerated death benefits. In addition, almost 70 percent of those holding individually purchased life insurance policies indicated interest in being able to accelerate the benefits of their policies.

Mr. SHAW. Mr. Mica, would you suspend just a second? There is an undercurrent of conversation in this room. If any of our guests would like to talk, I would appreciate your taking your conversation out into the hall. Individually you may not be making much noise, but when I see about 10 or 12 conversations going on in the room, it does make it difficult for us to hear. If you could proceed.

Mr. MICA. Thank you, Mr. Chairman.

Mr. Chairman, as an aside at this point, I just wanted to point out, we have conducted these polls. They indicate strong public support, but another measure—and this is something I had in my file from 5 years ago when these policies, these types of policies were first introduced, is the strong editorial support from all over the Nation—the Minneapolis Star and the Atlanta Journal and the Boston Globe, the USA Today—that these types of policies have and continue to receive.

I kept this file for years because this really is a product that the American public, the American community that takes an interest in this, the editorial and business community have all had strong support for. I might also say that a substantial majority of individual policies in our survey already in force, as well as new policies, now offer accelerated death benefits.

There has also been a notable increase in the number of group contracts which offer this benefit. While the actual number of policyholders receiving accelerated death benefits so far has been relatively small, the benefits, as we have heard today, are obviously very important for those who do need them. We are pleased that several bills have been introduced that deal favorably with the tax clarification of accelerated death benefits, and we would contemplate providing your committee with technical suggestions designed to ensure that the Contract With America legislation operates as we believe you intend it to operate.

The potential devastating cost of terminal or catastrophic illness is a critical issue that must be addressed. The life insurance business can help meet that challenge in an efficient and, I would say again, cost-effective manner. Congress, for its part, can help by providing appropriate tax clarification with respect to accelerated death benefits. Mr. Chairman, I thank you. That is a summary of my comments. I would be happy to take any questions.

[The prepared statement follows:]

STATEMENT OF HON. DANIEL A. MICA
EXECUTIVE VICE PRESIDENT, FEDERAL AFFAIRS
AMERICAN COUNCIL OF LIFE INSURANCE

Good morning Mr. Chairman and members of the Committee.

My name is Dan Mica and I am Executive Vice President - Federal Affairs of the American Council of Life Insurance. I am accompanied today by Stephen Kraus, Chief Counsel, Pensions at the ACLI.

I am pleased to testify today on behalf of the American Council of Life Insurance which represents 640 life insurance companies, holding nearly 90% of the life insurance in force in the United States. We are pleased to express our strong support for the provisions in the Senior Citizens Equity Act that would treat accelerated death benefits as non-taxable death benefits.

GENERAL COMMENTS

Life insurers have been increasingly active in adding accelerated death benefit provisions to their life insurance products. Today, over 215 companies offer this protection to more than 18 million policyholders. Therefore, it is important that the Congress act quickly on this issue, so that the current uncertainty for our policyholders regarding the tax treatment of these benefits will be clarified.

ACCELERATED DEATH BENEFITS

In the late 1980's and early 1990's, the life insurance industry developed an exciting and innovative way to ease the financial burden and strain imposed on Americans and their families in the case of terminal or chronic illness. Called accelerated death benefits, these features of life insurance policies allow their holders to receive the full value of their policies before death in certain circumstances.

The financial and emotional strain that a final or chronic illness can cause is irrefutable. The dramatic escalation in expenses associated with such illnesses is also common knowledge. Accelerating death benefits allows insurance companies to provide Americans in such situations with their death benefits before death, thereby hopefully easing the financial strain and preserving the policyholder's dignity to the greatest extent possible. Clarifying the tax treatment of accelerated death benefits encourages terminally ill and chronically ill individuals to use their own resources to pay for the expenses of final or chronic illnesses, instead of relying on government programs such as Medicaid. By accelerating death benefits, the insurer can help with little, if any, additional cost.

Accelerated death benefits currently offered by the life insurance industry include payments under the following circumstances:

- terminal illness -- a medical condition which results in a drastically limited life-span, usually twelve months or less
- long-term care -- personal care, health and social services needed by individuals who experience a chronic illness or disability
- permanent confinement to a nursing home -- an illness or physical condition which can reasonably be expected to result in an individual remaining in a nursing home for the rest of his or her life

There is substantial public support for accelerated death benefits. Almost three quarters of those interviewed by the Roper Organization in May 1993 for an ACLI-sponsored study approved of the concept of accelerated death benefits. In addition, almost 70% of those holding individually purchased life insurance polices indicated interest in being able to accelerate the benefits of their policies.

A substantial majority of individual policies in force, as well as new policies, now offer accelerated death benefits. There has also been a notable increase in the number of group contracts

which offer accelerated death benefits. While the actual number of policyholders receiving accelerated death benefits so far has been relatively small, the benefit is obviously important for those who do need the benefits as you have already heard earlier this morning. Clarification of the tax treatment of such benefits is also vitally important to these Americans, and their families.

CURRENT LEGISLATION

We are pleased that several bills have already been introduced that favorably deal with the issues outlined above. In this regard we strongly support H.R. 8 and H.R. 99, which was introduced by Congresswoman Kennelly. We will provide your Committee with technical suggestions designed to ensure that the Contract with America legislation operates as we believe you intend. We urge, however, that we work together to make the legislation as simple as possible in order to facilitate the provision of these important benefits.

The potential devastating cost of terminal or catastrophic illness is a critical issue that must be addressed. The life insurance business can help meet that challenge in an efficient and cost-effective manner. Congress, for its part, can help by providing favorable clarification of the tax law with respect to accelerated death benefits.

Thank you, Mr. Chairman, for the opportunity to present our views. We look forward to working with you and your colleagues to enact tax clarifying legislation as quickly as possible.

Mr. SHAW. Thank you. We will proceed now to Mr. Pardo, please.

STATEMENT OF BRIAN D. PARDO, PRESIDENT, NATIONAL VIATICAL ASSOCIATION, AND PRESIDENT, LIFE PARTNERS, INC., WACO, TEX.

Mr. PARDO. Mr. Chairman, members of the committee, my name is Brian Pardo. I am president of Life Partners, Inc., a Texas-based company that has purchased more viatical settlements than any other entity in the Nation. That amounts to more than 2,000 policies over the last 5 years.

I also have the pleasure of serving as the president of NVA (National Viatical Association), which is located here in Washington. Last year NVA members and other members of the industry purchased an estimated 300 million dollars' worth of policies, and we expect that this year that number would grow to $400 million and our view is that by the year 2000 that number could on, an annualized basis, be approximately $1 billion.

I would also like to point out briefly we have worked very closely with the National Association of People With AIDS. We have served as the national voice for people living with HIV in the United States, and have collaborated with them on our position regarding this matter.

Today, there are over 400,000 Americans diagnosed with full-blown AIDS in the United States, and this is the end stage of the disease. There are another million Americans plus that are HIV positive who will progress to the full-blown AIDS status unless there is a medical breakthrough which is seen as being very unlikely.

The cost of health care for people living with AIDS is staggering. The American Medical Association estimates that the treatment costs from the point of full-blown AIDS diagnosis to death is $69,000, and I emphasize this is only for the end stage portion of the disease, not the preliminary years which also require a great deal of medical care. This will amount, under the current scenario we have in the United States, to about $96 billion required in health care treatment and most of that, in our view, will be spent over the next 5 years.

Unfortunately, most PWAs (people with aids) and other people with terminal illness, as we have seen in the earlier panel, face a serious financial dilemma as well as a medical dilemma. HIV disease, in particular, is among the most costly of medical conditions, and currently the vast majority of people that are affected by HIV disease do end up on public assistance programs, Medicaid, and welfare.

The ability to make their own decisions regarding treatment, sustained health, and longevity remain the foremost concerns of people living with HIV disease, and in our view, in fact, all people dealing with terminal illness. Yet the high cost of medications and treatment remain the most pressing barrier to their remaining life with dignity.

Fortunately, a large number of terminally ill people in the United States have an asset that they generally do not realize is an asset, and that is their life insurance policy. It is estimated that 40 percent of all Americans have a life insurance policy, and we

feel that this percentage applies ratably or even perhaps in proportionally greater numbers among HIV positive Americans and other Americans with terminal illnesses.

Therefore, through the viatical process, a meaningful financial contribution amounting to billions of dollars annually can be applied from the private sector, using the resources of the insureds themselves and relieving financial pressure on public assistance programs.

In essence the viatical process provides a private sector solution to a looming public sector problem. The ability to sell one's life insurance policy for a lump sum payment of cash, which is known technically as a transfer for value, is a long-recognized right of policyholders, which allows them the unique opportunity to turn a nonliquid asset into cash now, and to provide dignity and financial security to millions of terminally ill Americans without expense to the taxpayers.

We estimate that more than 20 billion tax dollars can be saved over the next 5 years alone by maintaining a free viatical market process such as it exists today. Insurance companies-sponsored accelerated benefits programs, while on the right track, currently fall way short of providing a meaningful financial impact.

As we could see in the earlier panel, four out of five individuals viaticated policies rather than accelerated them. Of the 2,000 or more insurers in the United States today, only about 200 offer any form of accelerated benefits program. Those that do generally limit those programs to short life expectancies, qualifications on policies, and lower payouts than are commonly seen with viatical companies. Therefore, it is our view that the viatical process should be left to the free enterprise system, which is an environment in which the industry has grown and flourished, and I might add it has been substantially free of abuse or misconduct.

Providing a tax exemption on the sale of proceeds of life insurance policies by terminally ill Americans is without a doubt in the best interest of the sellers and the taxpayers alike. I would stringently argue that terminally ill sellers can better manage their own financial affairs rather than recycling tax dollars through the government for the ultimate same purpose. By providing for tax-exempt sales of policies, Congress can allow individual citizens to realize substantially greater net proceeds to help cover medical costs and subsistence needs.

In the past, bills have been proposed that would allow tax exemption only to an accelerated benefit program as proposed by the insurance companies. We feel this would only serve to discriminate against a class of taxpayers, those who would not qualify for those programs which make up the bulk of people afflicted with terminal illness, and it would also allow the insurance industry to compete unfairly with the viatical industry at the expense of the taxpayers.

Since there is very little fundamental difference in these two forms of realizing cash from a viatication or acceleration of the death benefit, they should be treated, in our view, the same for tax purposes. Therefore, it is our recommendation, which is endorsed by the National Association of People With AIDS as well, that this committee recommend tax exemption for all forms of viatical transactions for any person who is diagnosed terminally ill, regardless of illness or regardless of life expectancy. Thank you.

[The prepared statement follows:]

TESTIMONY OF BRIAN D. PARDO, PRESIDENT NATIONAL VIATICAL ASSOCIATION BEFORE THE COMMITTEE ON WAYS AND MEANS REGARDING TAXABILITY OF PROCEEDS FROM VIATICAL SETTLEMENTS AND ACCELERATED BENEFITS

January 19, 1995
10:00 AM

Mr. Chairman, Committee Members;

My name is Brian Pardo and I am the president of the National Viatical Association (NVA). The NVA was incorporated in 1993 to serve as a trade association for the viatical settlement industry. We have operated continuously since then in the best interests of our member companies and their clients. Our membership represents well over half of the total viatical transactions executed in the United States to date. The scope of our experience has provided us with a unique perspective of where this industry has been, and where it is going in the future. Conservatively, the NVA membership will collectively purchase more than $400 million in policies this year. Moreover, viatical transactions in general are growing at a tremendous rate in the United States.

VIATICAL SETTLEMENTS : A BRIEF DESCRIPTION

A viatical settlement is simply the sale of an existing life insurance policy by a terminally ill person in return for a percentage of the face value of the policy paid immediately.

The viatical settlement is an effective estate planning tool which permits a person dealing with a life threatening illness to ease the financial stress often associated with a terminal condition. In short, a viatical settlement allows a terminally ill person to enjoy the benefits of his or her life insurance policy while he or she is still alive and to transform a non-producing asset into immediate cash which can be used to improve the quality of his or her life.

Terminal illnesses, in addition to their detrimental health effects, exact a tremendous financial toll upon insureds and their loved ones. With the rapid increase in the number of, and the spread of, many terminal illnesses, especially AIDS and certain types of cancer, the use of this type of sale and assignment by insureds has become more widespread and has developed into the viatical settlement industry.

As these transactions are currently regarded, both viatical settlements and accelerated benefits are taxable. Actually, viatical settlements are taxable on both sides. The seller has been paying taxes on the basis of the difference between the amount which has already been paid into the policy in premiums and the amount which was received as payment for the policy. The purchaser pays taxes on the basis of the difference between the purchase price for the policy and the amount of the death benefit.

COMPARISON OF VIATICAL SETTLEMENTS AND ACCELERATED BENEFITS

Fundamentally, there is little or no difference between independent viatical settlements and accelerated benefits programs of insurance carriers... in both cases a terminally ill owner of a life insurance policy turns over the policy in return for a given sum of cash now. The specific amounts available and qualifications which must be met vary greatly, but the basic outcome is the same.

Practically speaking, however, there are many differences that are very meaningful to terminally ill policy holders.

1. Very few insurance companies offer any form of accelerated benefit program. According to an article in the May, 1994, issue of the Journal of the American Society of CLU & ChFC, (hereafter referred to as "May, 1994") only about 160 companies out of approximately 2000 companies in the United States offer any type of accelerated benefit. Further, most that do offer such programs do so primarily as an inducement in their marketing programs.

2. Viatical settlement companies purchase a much wider range of policies. Of the insurance carriers that offer accelerated benefits, most severely restrict the type of policies that qualify. For instance, 55% of the accelerated benefits programs listed in the Life Association News (February, 1993) survey applied **ONLY** to universal or Whole Life policies.

3. Insurance companies' accelerated benefits programs generally have very narrow life expectancy parameters. Most companies offer benefits only to policy holders with less than 12 months life expectancy (May, 1994), whereas viatical companies purchase policies from individuals with life expectancies of as much as four to five years.

4. Insurance companies' accelerated benefits programs also generally have additional restrictions which prevent the majority of policy holders from qualifying. Many cover only specified diseases. Curiously, none of those requiring the policy holder to suffer from one of a list of specified diseases include AIDS as a qualifying illness. Most also have a minimum size requirement for the base policy. Viatical settlement companies will purchase any size policy from any individual with any terminal illness.

5. Insurance companies generally offer less money to policy holders than viatical companies. The vast majority will not offer more than 75% of the face value of the policy. Additionally, most have maximum payout restrictions. Viatical companies do not limit payout.

Viatical companies generally bid for policies in a free market atmosphere, thereby assuring the policy holder of the highest possible payout. When the viatical industry was first getting started, no one knew what to expect when entering into a settlement and there were very few companies in operation. At that time offers tended to be rather low because there was so little competition and participants had so little experience in this market. As the industry has grown, the very nature of a competitive, free-market atmosphere has driven the offers up, resulting in viators receiving much more for their policies. It has also served to ensure that the companies in operation are continually refining their analyses of the market so that they can make offers that are as competitive as possible.

Insurance companies introduced accelerated benefits as a response to the appearance of viatical settlements on the scene. Payouts available under their programs have thus far consistently been lower and harder to get than payouts through viatical settlements.

I am not pointing out these differences to criticize the insurance industry. The NVA firmly believes the decision to viaticate a life insurance policy must be made on a prudent business basis. The insurance industry has taken steps to address the needs of policy holders in ways which they consider financially prudent.

On the other hand, the viatical industry is a competitive alternative to insurance companies' accelerated benefits programs. The winners in this competitive process are the policy holders, who are the citizens and taxpayers of America. Therefore, the NVA believes it is in the best interests of the public for this competitive stance to continue to exist in a **level playing field environment.**

IMPACT OF PAYOUTS ON HEALTH CARE COSTS

The payouts viators receive from viatical settlements and accelerated benefits provide them with the funds they need to finance their own living and medical expenses. According to the study conducted by the National Association of People with AIDS, *HIV in America: A Profile of the Challenges Facing Americans Living with HIV*, over half the respondents indicated

that their primary area of concern was their need for financial assistance. These settlements relieve them of much of the stress associated with living under such limited conditions.

That same study indicated that 62.3% of people with an AIDS diagnosis are covered by some form of public insurance, primarily Medicaid. The Journal of the American Medical Association estimates that the cost of caring for an individual from the point of AIDS diagnosis to death is $69,000. The latest CDC estimate of the number of people in America infected with HIV is 1 million. Over the course of the next five years, the cost to taxpayers for caring for individuals moving into the final stages of this disease alone will surpass twenty billion dollars.

The life insurance industry estimates that 40% of Americans own life insurance. If that estimate holds steady for this population, that would mean 40% of that cost could be lifted off the shoulders of taxpayers and met through viatical settlements. In this manner, viatical settlements provide a private sector solution to a public sector problem. In addition, viatical settlements also benefit the federal coffers because they are taxable to the purchaser. When the insurance company pays the death benefit to the purchaser, the difference between the price paid for the policy and the amount received from the insurance company is taxable.

Individuals who viaticate policies enable themselves to meet their own needs, medically and otherwise. They are empowered to control their own lives, exercise choice and live with dignity. Their lives are no longer dominated with concern over where they will get the money to pay for next month's medications. They are not forced to alter the manner of living to which they have become accustomed, accept public assistance, wait for hours to see a doctor who is not necessarily even familiar with their cases. These payouts allow them to continue **living now.**

DISCRIMINATORY TAX POLICY IS NOT IN THE PUBLIC INTEREST

While we realize neither the Internal Revenue Service nor the Committee members examining this issue have any intention of discriminating against a class of taxpayers, which would be the inadvertent result of approving any regulations which would establish unevenness in the treatment of one transaction relative to another.

The various tax exemption proposals I have seen previously have **only applied to benefits under insurance company programs** and have remained silent on other forms of viatical settlement options which policy holders may find more attractive.

Also, since accelerated benefit programs are being highly touted by the insurance industry as a **marketing tool**, providing a tax advantage solely to their programs would unwittingly aid the marketing programs of insurance carriers who offer such programs. The NVA does not feel that is the desire or intention of any member of this Committee.

The differences that do exist between viatical settlements and accelerated benefits are purely quantitative (how soon and how much), **not** qualitative. It would truly be tragic to establish a policy which would discriminate against terminally ill individuals who do not have an accelerated benefits rider available to them on their policies, those who do not qualify for the programs offered by their insurers, or those for whom a viatical settlement would offer a better purchase price.

As stated in this Committee's own advisory announcing this hearing, the purpose of this provision would be to make it possible for "terminally and chronically ill individuals... to use tax-free distributions from their life insurance policies to pay medical bills and living expenses." Considering that is exactly what viatical settlements do, it appears to be within the intentions of this Committee to include both types of payouts. I hope bringing the oversight of not specifically mentioning the inclusion of viaticals to the Committee's attention will be sufficient to get the situation corrected.

WHAT SHOULD BE DONE ?

The NVA believes there are two courses of action which would be fair and impartial to all concerned with the viatical process. Of those two options, one is much more adamantly endorsed than the other. I have conferred with Bill Freeman, Executive Director of the National Association of People with AIDS, and have been given the authority to include here that NAPWA, along with the NVA, highly recommends that this Committee choose option 1 to follow.

1. **APPROVE THE TAX EXEMPTION FOR ALL TYPES OF VIATICAL TRANSACTIONS.** Obviously, treating all viators equally is in the public interest. Should this Committee recommend adopting regulations making early payouts for terminally ill policy holders tax-exempt, the proposal should be broadened to include all people who viaticate a policy, whether it be through an accelerated benefits program or through the sale of the policy to a viatical company. The NVA and NAPWA would definitely support such a recommendation from this Committee.

In both cases the motivation to viaticate the policy and the end result are the same: the seller receives a current financial payout in exchange for the transfer of a future death benefit. By qualifying all such transactions, no single class of policy holders would be disadvantaged.

The classes of policy holders which would be disadvantaged if the current proposal were approved consist of all individuals who fall outside the parameters of insurance companies' accelerated benefits programs... and, I would represent to this Committee that that is the vast majority of those coping with terminal illness. **The NVA strongly urges the Committee to take this approach and make proceeds to all terminally ill sellers of policies tax exempt, whether they were acquired through a viatical settlement or an accelerated benefit.**

2. **IF OPTION 1 ABOVE IS UNACCEPTABLE, LEAVE THE CURRENT REGULATIONS INTACT.** The NVA understands that the *Contract with America* is designed to provide the majority of Americans some tax relief. While these transactions could easily become one point of relief (especially considering the fact that the purchasers of policies would still be paying taxes on their gains), the NVA does not consider current tax regulations to be unreasonably burdensome.

There is no question, a tax-exempt status would be preferable to viators. However, most viators are able to receive large, meaningful cash settlements as a result of the viatical process. These settlements are far in excess of premiums paid. Uninfluenced by any form of bias toward another segment of the market, I would expect the number of individual citizens benefiting from viatical settlements to continue to increase for many years to come.

Over the last six years the practice of selling policies for current value has grown from practically nothing to as much as $300 million per year today. Further, the growth rate of the process in general is staggering. Many industry participants feel the volume of viatical transactions could reach a billion dollars or more annually by the year 1998. This growth is occurring under current regulations and is unlikely to be impeded if a level playing field is maintained.

Therefore, the National Viatical Association strongly recommends **1) that the tax exemption be approved for all viatical transactions, regardless of type, thus treating all viators equally and fairly, or if that cannot be done, 2) leave the current regulations intact and refuse to create the imbalance which would result from bestowing preferential status for any one segment of the market.**

Thank you.

Mr. SHAW. Thank you.
Mr. Larson.

STATEMENT OF PER LARSON, HIGHLAND MILLS, N.Y.

Mr. LARSON. Mr. Chairman and members of the committee, since 1992 I have advised approximately 200 seriously ill people on how to use private benefits to help them fight their disease and maintain the quality of their remaining life. Rather than be forced onto public assistance, my clients want to be able to pay their bills and are more than happy to do so with the life insurance proceeds obtained through either accelerated or viatical settlement benefits. This is why I and Affording Care, a nonprofit I cofounded to provide financial education for the seriously ill, applaud this committee's efforts to exempt ADBs from taxation and urge the committee to consider tax-free status for viatical settlements.

My written testimony addresses many questions regarding viatical and accelerated benefits. Let my remarks today focus on the need for viatical settlements to be tax free. Because viaticals are available for all dread diseases, and because they will drastically decrease the incentive for terminally ill people to seek public assistance, I recommend them.

People seek financial advice from me as soon as they are aware that their lives are in danger. In my experience, this is usually when they have 2–4 years to live. This is a time when they are motivated to act, when their actions will have the most impact, and when the funds from viatication, for example, have the best chance of keeping them off public assistance, not later.

Why do the seriously ill have this need for increased financing? Well, it is because Social Security is low, it is because they were hit by illnesses too early or it is because their nonreimbursed expenses are too high. When the option of viaticating is discussed, inevitably my clients ask me bitterly why it is that proceeds from their life insurance are tax free the day they die, but taxable in the time they have left to live.

Perhaps I can give a poignant example supporting the necessity for tax-free treatment of viatical settlements. Imagine your parents sitting at their kitchen table. Your father has Alzheimer's or any other of the dreaded diseases. Because of current tax policy they are faced with a gruesome decision.

If they viaticate his $100,000 policy for, let's say, $80,000, to take care of him and the family, the government is due one-third of this. If they don't do that and choose to impoverish themselves to go on public assistance, the money passes tax free.

If the proceeds were tax free, as I recommend, there would be no such forced choice, and much less gaming the system. They could viaticate whatever they needed repeatedly when they needed it with no tax penalty. This is real, and this is a decision that could confront anyone who is seriously ill.

The current system encourages individuals to spend down and resort to public assistance rather than privately care for themselves. Doesn't it make sense to allow individuals tax-free access to this same money 36 months earlier so that they can avoid dependency, indignity, and a lower quality of care?

Viaticals extend the range and the number of individuals who can avoid public assistance because only a very small percentage of people with life insurance have ADB riders. Even though many individuals have group insurance through their employers, these funds are largely untapped due to the fact that many insurers and employers do not have accelerated benefit riders on their group policies, and they are very reluctant to adopt them.

Viatical settlements are available to all of these individuals and could help more of them avoid public assistance if they were tax free. The fact of the matter is that extending the limit for viatical settlements to 36 months and subjecting the process to State regulation will provide the individual with funds during the entire period of their illness when they can prevent problems better and not just have it at the end of their life.

Mr. Chairman, this is a win-win proposition for the government and a class of individuals in desperate need of consistent, fair tax treatment. In closing, I thank you for the opportunity to testify before this committee. I ask you to carefully consider the testimony provided to the committee today, and I welcome any questions that you or the committee members may have. Thank you.

[The prepared statement follows:]

Testimony
before
The House Ways and Means Committee
from
Per Larson
Financial Advisor and Advocate for the Seriously Ill

Mr. Chairman and Members of the Committee:

I help seriously ill people find and use the non-governmental resources available to them through accelerated and viatical benefits to help them fight their disease and maintain the quality of their remaining life. In so doing I help them stay off of government entitlement programs such as SSI and Medicaid. I have found that my clients are happy to be able to pay their bills with life insurance proceeds obtained through accelerated or viatical benefits instead of simply bequeathing their life insurance and being forced to have the government pick up their medical bills. This is why I urge the Committee to consider tax-free status for both accelerated and viatical benefits.

My testimony is going to focus on why viatical and accelerated benefits need to both be tax-free transactions; why it makes sense to apply this tax-free treatment to viatical settlements for terminally ill people with life expectancies of up to 36 months or for people with dread diseases; why any professionals dealing with people in this situation need to be made aware of these options; and why states should be regulating both of these tools as insurance products.

I help my clients prevent or solve financial problems that may be triggered by a disabling condition. This usually includes mobilizing private medical, disability and life insurance, employment benefits supplemented possibly by appropriate volunteer-run or state-run programs of assistance.

I do not help people get public entitlements. One of the reasons I began my practice is that I believe many middle-class Americans are often wrongly advised that their only option is to impoverish themselves in order to qualify for public entitlements.

My professional experiences have taught me that most people want to avoid public assistance programs if at all possible in order to have better quality of care; to give themselves and their families more independence; and to maintain their dignity.

In retrospect, it's hard to believe that until the end of the 1980s, financial professionals had not realized that many common practices and conventional wisdoms often don't apply when life is threatened. Many rules are reversed; the usual advice often no longer works. New techniques such as accelerated and viatical benefits needed to emerge in order to enable private citizens to obtain adequate resources to deal with the increasing cost of today's life-threatening illnesses.

I began my private practice in 1992. I have advised approximately 200 seriously ill people since that time. As far as I can determine, there are few people like me who regularly give this type of help as the mainstay of their work.

I co-founded an organization called Affording Care in that same year to offer financial education to those facing serious illness. We retrain professionals in the realities of how life-threatening illness, and its impact on personal finances.

I was one of the first who received training in this area from the people who went before me and pioneered this work. These pioneers are no longer able to do this work or training. They have themselves become disabled or have died. One of these pioneers includes a financial planner who advised the first policy holder to carry out a viatical settlement.

Early in my practice, I assisted in two-hour seminars for consumers on Personal Finance and Serious Illness for Body Positive, a not-for-profit organization, for two years. In September 1993, I spoke on estate planning during Affording Care's daylong workshop on Personal Finances & Serious Illness for the International Association of Financial Planning.

Because few financial professionals have chosen to practice in this area full time, I have chosen to train the non-financial professionals who serve those seriously ill, including social workers, psychotherapists and voluntary health organization staffs, in how to spot these problems before they occur or become severe. This includes people at the American Cancer Society, Memorial Sloan Kettering, New York Hospital, ARCS, Brooklyn AIDS Task Force, and Mothers with Children with AIDS.

I have written over 25 articles or columns in this area, including the guidelines for the hotline of the Gay Men's Health Crisis when they receive inquiries regarding viatical settlement. I've been quoted on these topics in financial journals such as Worth, National Underwriter & Financial Planning. In June of last year I was one of three panelists on "Premium Dollar Today", a half-hour television program, focused on "Accelerated Death Benefits."

My previous specialization was in health care benefits and particularly health care cost containment. I chaired several conferences for Business Week, including the first conference on corporate health cost management in 1980 and another on health data in 1985, both while I was Marketing & Planning Director of the Actuarial and Benefits Consulting Group of Coopers & Lybrand. In a joint venture backed by a major insurer between 1984-1986, I designed and created the Corporate Health Audit, an employee health planning system.

My MBA is supplemented by a postgraduate certification as an HMO director (sponsored by the Robert Wood Johnson Foundation), both of which I received from Wharton School.

Serious illness places special requirements on financial advice

People turn to a person like myself or to techniques such as these as soon as they are clear that their lives are in danger. In my experience, this can easily range up to a point where they have 2-4 years of life expectancy. Few are able to do much about their lives financially if life expectancy is below 12 months. Most of my clients would want to use viatication after they had reached a point of 36 months life expectancy. This is also the point where I believe the results of this are most effective. As a result, I believe this is a natural working limit for the tax-free status of such settlements.

I have found that much standard advice given healthy people, reinforced by messages of our popular culture, often turns out to be irrelevant or even damaging when applied to the situation of seriously ill people.

I have been forced to devise other ways to help people who inquire about financial strategies in the face of serious illness nationwide. I have determined that the entire process of offering financial advice in the financial planning profession needs to be altered to meet the needs of those facing life-threatening illness. For example: it is often inappropriate to produce multi-year plans; the seriously ill often are unable to endure traditional face-to-face meetings; there may be so many rapidly changing health factors in their situation that comprehensive planning becomes too costly and misleadingly out-of-date; they may benefit more from planning that is focused on specific concerns even though this is not recommended practice for healthy people.

Serious illness usually increases financial need dramatically

Many people whose lives are threatened with serious illness are in the prime of their lives. They often have incomplete or missing insurance coverage or employment benefits that could help them fight the disease and maintain the life they have struggled so hard to achieve.

Many of the dreaded diseases are new. Reimbursement for their treatment is frequently rejected on the grounds that they have not yet become standard practice. This is particularly true as cost-containment measures enter into force. Many people in this situation understandably turn to alternative forms of treatment such as acupuncture and chiropractic for which there is no reimbursement at all.

When we talk about costs and serious illness it is important to differentiate between reimbursed and extraordinary costs. We also need to include in the definition of extraordinary cost all types of costs triggered in some way by the illness. This can include many measures not normally considered to be medical yet which are undertaken in good faith by people who are seriously ill to literally fight for their lives.

Here are some examples: shift to a lower-stress job or a job with fewer hours, or to disability status; alterations to the home environment since people are home more; expenses to lift the spirit; expenses related to non-vocational interests that are now more important; improvements in diet; alternative treatments; support groups; attempts to realize long-postponed life dreams; actions to reconcile and interact more with family and friends; home services for impaired activities of daily living; medication setups and administration.

Major illness increasingly imposes extra financial burdens that are not reimbursed at all. It is not unusual for a seriously ill person to have several hundred medical visits in any one year; the travel costs for those visits is itself a significant budget item. Many people have to move because their disease requires ground floor access or because they are discriminated against. Even without moving, living facilities often need modification to help them with simple activities of daily living.

In many areas of the country it is difficult if not impossible to secure medical, disability or new life insurance coverage. In this case the major tool that can help them is viatical settlement of existing life coverage.

I find that in many cases it's necessary for people facing serious illness, particularly those with illnesses with a sporadic impact, to go out on disability earlier than usual with traditional chronic disease or accidents, in order not to worsen their health. With today's new diseases, expenses often mount to 40% more than income rather than the traditional 40% less that disability insurance usually pays.

In today's competitive job climate people must perform 100% of their job 100% of the time. While the Family Medical Leave Act and the Americans with Disabilities Act provide for leave from work, there are no provisions for increased employer financial contributions as part of these benefits. People need these funds and employers are not expected to provide them. The fact is that today's dreaded diseases force those in today's working environment people to go out on disability much earlier than was the case before. This means they have a much longer period of life that must be financed through means other than employment. By providing for tax free access to life insurance policies through viatical settlements and ADBs, individuals are able to privately supplement lost potential earnings.

Debt often accompanies disease, especially when past expenses were to be offset by future earnings. Without viatical settlement it is almost inevitable that individuals will default on their obligations since under most state laws disability income is exempt to some degree.

I have noticed that the sudden onset of life-threatening illness reminds people of life dreams unrealized, relationships untended and values unfulfilled. It is natural and proper, I believe, for them to need funds to provide meaning for their life in these ways.

Needs differ with different diseases

The needs of people who are seriously ill differ in several major aspects:

1. when extraordinary costs are incurred;
2. uncertainty about life expectancy;
3. degree of chronicity and manageability; and,
4. impact on competency.

When costs incurred and how much cost is incurred depends on the disease. Many people have no experience and training in these matters. Their need for information to help them make decisions about these costs is as important as the resulting need for resources. For example:

- People with Alzheimer disease tend to be hit with continuously increasing costs that can turn the end of life into a nightmare.
- People with cancer tend to be hit with major costs at the time of their diagnosis; treatment is often immediate. Then there is a lull after which it is concluded that the cancer is in remission or again needs treatment.
- People with AIDS, in contrast, have few costs up front upon diagnosis. Initially, they may need preventive measures. Then an infection may strike and they may need hospitalization. Then homecare needs become prominent. It is important to remember that reimbursed and extraordinary costs differ in major ways during this process.

No matter what the cost pattern, however, all of these situations would be markedly improved by both viatical and accelerated benefits.

The special needs of those faced with life-threatening illness

People with serious illness have diminished or unpredictable capacity.

People with illnesses considered terminal are overwhelmed.

People at risk of dying require clarity, consistency, predictability, and reliability as well as simplicity, normalcy and dignity.

Clients ask me bitterly why it is that proceeds from their life insurance are tax-free the day they die, yet taxable in the time they have left to live. Those who provided for the costs of disease and death through middle class benefits like life insurance or employment life insurance do not understand this incongruity.

As I said at the beginning, my clients come to me because they do not want to have to fall back onto SSI, Medicaid, welfare, food stamps and similar public programs. They want to remain self-sufficient as much as possible; they want to pay for the best care available; they want to provide for their families to the end.

Making viatical settlement and accelerated benefits tax-free would make it more likely for this to happen by making more funds available for these catastrophic expenses.

Instead of forcing people to rely on public programs and then pass on the full-value of their life insurance to their heirs tax free, viatical and accelerated benefits will permit the seriously ill to pay their bills while fighting their illness and maintaining their dignity and former way of living. This would make it less likely that government and hospital charity funds would need to pay for their care. The costs and profits of furnishing these funds constitutes a new industry that pays its taxes by meeting this need. I believe this is a net gain to society overall.

Most important, granting tax-free status to both viatical and accelerated benefits would be a clear signal to the American public that it is possible for them to prepare for and prevent the catastrophic costs that life-threatening disease now precipitates - and that they do not have to experience insult on top of their injury when they fall seriously ill.

Accelerated and viatical benefits should be treated equally

Tax-free treatment of viatical settlements will produce savings for the government by reducing government entitlements while at the same time maintaining the individual's quality of life or at least life-style.

Instead of forcing people to rely on public programs and then pass on the full-value of their life insurance to their heirs tax free, viatical and accelerated benefits will permit the seriously ill to pay their bills while fighting their illness and maintaining their dignity and former way of living. This would make it less likely that maintaining their dignity and former way of living. This would make it less likely that government and hospital charity funds would need to pay for their care. The costs and profits of furnishing these funds constitutes a new industry that pays its taxes by meeting this need. I believe this is a net gain to society overall.

Most important, granting tax-free status to both viatical and accelerated benefits would be a clear signal to the American public that it is possible for them to prepare for and prevent the catastrophic costs that life-threatening disease now precipitates - and that they do not have to experience insult on top of their injury when they fall seriously ill.

Accelerated and viatical benefits should be treated equally

Viatical settlements can establish life on a new financial footing for someone whose life is at risk. This can then prevent people from having to impoverish themselves in order to qualify for SSI, Medicaid, Food Stamps, etc. It is simply a matter of getting the financing to people who are seriously ill at the right time.

I believe some people with longer life expectancies are afraid to viaticate now because they will then be more likely to live with the tax consequences. Others, in fact, are tempted to impoverish themselves and then seek accelerated benefits when death is palpably near - a time when they may be more willing to ignore the tax consequences. This is bad for individuals and bad for society.

If tax treatment is unequal and viatical settlements are taxed, I believe there will be further misunderstanding. It is already difficult for people to comprehend all the ways serious illness changes their lives financially. It is very difficult for them to learn new ways of handling financial problems. I believe different tax treatment of viatical and accelerated benefits will generate further confusion.

I believe the societal benefit of viatical settlements is potentially greater because they can be effected with virtually any type of policy. As a result, many lower and middle class individuals that have group insurance through their employers could access funds currently unavailable to them. These funds are now unavailable due to the fact that many employers have not added accelerated benefit riders to group policies and are reluctant to do so. This is true even for disease support organizations staffed

largely by people who have that particular life-threatening illness. It takes a long time for benefit managers and union plans to adopt changes like this.

I also believe that one reason the life insurance industry, unions, and employers have not gone ahead with accelerated benefit actions and communications is largely because their tax status has remained in limbo.

Insurers have many different restrictions on acceleration. Some companies allow acceleration of 25, 50, 75, 100 or some other percent of the policy. Whatever the reason, the result is confusion. These are the craziest restrictions I have ever seen. Consumers do not understand why accelerated benefits exist on some policies but not on others - why they are offered after a certain date, above a certain amount, only on a certain type of policy, or on only part of a policy. One person I am currently helping has a $18,000 policy which falls short of the $25,000 threshold this policy requires to qualify for an accelerated benefit.

This may be one case where insurers should have been held to one single standard in exchange for their ability to unilaterally set limits on the amount granted and to determine whether any accelerated benefit is to be offered at all.

In my opinion, the bottom line is that accelerated benefits have very little impact on consumers. I have been able to successfully complete far fewer accelerations than viatical benefits.

The tax-exempt period for viatical settlements should be 36 months.

Viatical settlements should be tax-exempt for individuals who have a life expectancy of 36 months and/or who have a dreaded disease. The policy reasons for this exemption have been discussed throughout this testimony -- individuals who are dying have an immediate need for access to funds, funds that are unavailable to most of these individuals without draining their resources.

The impact of viatical settlements will be potentially greater than the impact of accelerated benefits. The reason is that viatical settlements can be obtained 2-4 years before death is expected (compared to 6-12 months for accelerated benefits.) Since accelerated benefits are possible only for people with less than 12 months of life expectancy, at that point they are much more likely to already be impoverished, on SSI, and on Medicaid.

It is important in this context to note the fundamental difference between viatical settlements and ADBs. An ADB is only available to an individual who has purchased such a feature from one insurer, almost universally long before that individual knows that he or she is dying. As I just stated, this feature is also only accessible to these individuals within 6-12 months of death. While as a consumer advocate, I would welcome the extension of this period to 36 months, I understand the pragmatic business concerns behind the 6-12 month limit. I do not actively seek such relief.

In contrast, viatical settlements are conducted by third party entities that purchase these policies and do not force any payment from an insurer other than the proceeds on the same timetable already contracted for between the insurer and the insured. This process does not involve any increase in actuarial risk assessment or capital requirements by the insurer.

The fact of the matter is that extending the limit for viatical settlements to 36 months and subjecting the process to state regulation will provide the individual with funds during the entire period of his or her illness, not just at the end of it. At the same time, this is accomplished without forcing any increased obligations on the insurer.

Furthermore, by increasing the time accessible window and delineating dreaded diseases, market access to these policies increases for buyers and sellers. An incentive system is created that increases the bids for these policies. At the same time, this system prevents those without legitimate illnesses from taking advantage of this new system. Viatical settlement companies will not profit by purchasing policies from individuals who in all likelihood would not meet the 36 month threshold or have not been certified to have a dreaded disease.

Accelerated Benefits are Administratively Complicated.

While I always seek to learn whether accelerated benefits are an option, this is often difficult to find out. Because these benefits are frequently an addition to policies already in force, the agent often doesn't know about them. Because they're new, customer service clerks sometimes say they don't exist. Because they're rarely requested, inquiries to claims should go to a supervisor. Because they're introduced slowly, it may be worthwhile checking with public relations or the President's office to see if they're about to be approved. (State approval can itself take 6-12 months.)

People with group coverage - which is to say many working people - are not informed or ill-informed about this additional benefit. If they are well-informed it is usually at a time when they are healthy - and there is a tendency for most people in good health to avoid thinking about disease and death.

Many people I see have thrown away the notifications they received about accelerated benefits because they looked like product solicitations, often coming as a flyer with a bill. Some people with serious illness simply do not even have the time, patience, attention, interest or ability at various times to thoroughly process their mail. Insurers and benefits managers need to be aware that these important notices are not being effectively communicated. Response measures should be simplified. People should be able to respond to an "800" telephone number that is promptly answered by someone patient and knowledgeable. Mail response is sometimes simply not possible.

It might be pointed out that such inconsistencies and complications are often encountered in administrative dealings. The point to remember however is that these seemingly small problems become insurmountable barriers to obtaining funds to those who are hampered by life-threatening illness.

Many of the same procedural problems exist in completing a viatical settlement. However, market mechanisms are in place in this industry that should correct them over time. In the case of accelerated benefits these matters are decided between regulators and insurers with no input from the market or consumers.

I have written elsewhere on the need for state regulation of the viatical industry along the lines of what has been enacted in California and New York. I shall include in my recommendations broad outlines of what the Committee should expect to develop in the industry over the next 1-2 years. I believe that providing a tax-exemption for viatical settlements will serve to bring in new sources of funding which will in turn promote the increasing regulation and professionalization of this industry.

The tax status of accelerated and living benefits is confusing

The tax situation is complicated. Because of the lack of IRS regulations and because accelerated benefits are structured in these two very different ways, insurers can give little tax guidance - only vague recommendations that consumers seek tax counsel.

Yet there are no training courses for tax counsel. No pamphlets or procedures are furnished by any agency or insurance company for tax advisors. Furthermore, many tax advisors are trained primarily for simplified cases. Major articles have been

published stating that the revenues received are taxable as capital gains; others have stated revenues are taxable as income.

Virtually no information exists for consumers as to what principles and practice govern the tax liabilities for those at risk for their lives.

- The IRS originally proposed regulations making accelerated benefits tax free. The IRS then appears to have suspended its efforts when many bills were introduced in Congress in early 1994.

- While it is true that the IRS can pursue heirs for taxes past due, there is little case experience and only one private letter ruling. This lack is remarkable because many viatical settlements have occurred during this same period.

In the meantime, both California and New York have made accelerated benefits and viatical settlements free of state and local tax. Trained professionals are making arguments in widely different directions. Faced with these differing interpretations and differing state regulations, many consumers ignore the tax and by so doing become tax scofflaws. We need definitive guidance from the government.

For many people a living benefit is the largest one-time sum they have ever handled. Most consumers have been used to passive measures such as withholding on W-2s to ensure they have met their tax obligations. Few of these consumers are used to hiring the professional and expensive tax advice they probably need in this situation. In all likelihood, most tax advisors will tell them that tax-treatment is clearcut in principle but complicated in practice. In many cases, estimated taxes are required. In special cases involving large sums, a situation most consumers are not used to dealing with, the deadline dates for having to pay such estimated taxes are extended. In many cases while estimated taxes are based on last year's taxes, if the estimated tax is much greater than the previous year, a further estimated tax is required. We are hitting terminally-ill consumers with some of the most complicated, little-used sections of the tax code at a time when they have difficulty opening and replying to their mail.

I go into this detail here because I have learned how important it is when serious illness strikes to have clarity and consistency. And I have learned that the lack of clarity and consistency in tax policy on accelerated benefits and viatical settlements is very unsettling indeed to those with life-threatening disease.

Recommendations

Viatical and accelerated benefits should be tax-free

These benefits should be made tax-free for those who have either a diagnosis of a "dreaded disease" that is generally considered to be terminal, an estimated life expectancy of less than three years, or who are confined permanently to a long-term care facility.

If not, then regulations should be issued by the IRS on both accelerated and viatical benefits. We need a revenue ruling.

The tax-exempt period for viatical settlements should be 36 months.

Viatical settlements should be tax-exempt for individuals who have a life expectancy of 36 months and/or who have a dreaded disease. The policy reasons for this exemption have been discussed throughout this testimony -- individuals who are dying have an immediate need for access to funds, funds that are unavailable to most of these individuals without draining their resources.

Regulation should be encouraged at the state level

While the following recommendations are not within the scope of the Committee's focus on taxes, as an advisor and advocate for the seriously ill, I wish to enter into the record recommendations which I feel are needed at the state level for the protection of consumers.

Within the context of state regulations:

- **Viatical and accelerated benefits should be strictly regulated.**
- **Protections similar to those enacted in New York (under Article 78) should be encouraged.**
- **All viatical settlement firms and sales brokers should be licensed and regulated.**
- **Advertising and written communications should be factual and educational.**
- **Sellers should receive uniform, complete financial information.**
- **Sellers should be encouraged to examine their overall financial options.**
- **Brokers should fully disclose their role and compensation as commissioned sales agents.**
- **Brokers should be strictly regulated as sales agents of the viatical settlement firms.**
- **Insurers should respond within reasonable time to authorized requests for policy information.**
- **Assignment restrictions should be eliminated to the extent permissible by law.**
- **Sellers with government entitlements should receive specialized counseling by their advisors, brokers or the funding source.**
- **Sellers should not be coerced into selling to satisfy debts or as a requirement for government entitlements.**

Mr. SHAW. Thank you, Mr. Larson.

Mr. Perper.

STATEMENT OF ALAN B. PERPER, PRESIDENT, DIGNITY PARTNERS, SAN FRANCISCO, CALIF., ON BEHALF OF THE VIATICAL ASSOCIATION OF AMERICA

Mr. PERPER. Mr. Chairman, members of the committee, my name is Alan Perper, and I am the president of Dignity Partners. Our company has been involved in the viatical settlement industry for more than 3 years and is one of the largest and oldest companies in the industry.

Our company cofounded the Viatical Association of America, which is an industry trade association representing 60 proregulatory companies. The association is comprised of a group of high quality companies and individuals.

Mr. Banks' company, for example, is owned by CNA Insurance Co., one of the largest insurance companies in the United States. My two partners went to West Point and have been involved in the financial services business since the mid-1980s. I have graduate degrees from Chicago and Duke and practiced corporate law with Jones Day for a number of years.

Further, our industry is an evolving regulated industry. It is not today the same industry it was even 2 years ago. Fourteen states have adopted or are considering the adoption of viatical licensing legislation. Dignity Partners is currently licensed by the departments of insurance in California and Kansas and has applied for a license in New York.

My point is that despite what you may have read in the newspapers and seen on television, for the most part, the participants in this industry are responsible businesspeople. I know I speak on behalf of all the high quality companies that comprise our association in saying that we are proud of the way in which we are bringing a needed service to our clients in a professional and responsible manner.

Today, we have heard testimony from Teresa and others about desiring to live their remaining lives with dignity, not desiring to turn to the welfare programs. Welfare programs are under a tremendous amount of stress today, and the terminally ill add to this stress.

A terminal illness plays a devastating role on one's financial resources. Often people are unable to work, some lose their health coverage or must supplement payments for costly medications and the care of their disease. A report prepared in 1992 by the National Association of People With AIDS showed that approximately 60 percent of the people survive on monthly incomes of less than $1,000.

In addition, many of our clients have been shunned from their families. They have nowhere else to turn, but to the welfare program. A few weeks ago we received a thank you note from a client saying thank you for the bottle of wine and Christmas card. They were the only gifts I received this Christmas.

In short, we believe that the addition of viatical settlements to H.R. 8 and its passage will greatly reduce the need for our clients to resort to entitlement programs.

Finally, I would like to close by stating that such legislation would not be without precedent. In 1990 California adopted legislation making viatical settlements tax free. Similarly, the State of New York followed suit, and I suspect that as more States consider viatical legislation and the model NAIC Act recently adopted, they will amend their tax provisions as well. Thus, the passage of Federal legislation addressing this issue will enhance the efforts now under way among the States. Thank you.

Mr. SHAW. Thank you, Mr. Perper.

Mr. Banks.

STATEMENT OF JOHN BANKS, CHIEF EXECUTIVE OFFICER, VIATICUS, INC., CHICAGO, ILL.

Mr. BANKS. Good morning, Mr. Chairman and members of this committee. My name is John Banks, and I genuinely appreciate the opportunity to talk with you today about the tax-free treatment of certain insurance benefits to terminally ill individuals.

I am chief executive officer of Viaticus, which is a wholly owned subsidiary of CNA Financial Corp., which is the parent of the CNA Insurance Companies. By virtue of my role with the company, I believe I am well positioned to bring a broad perspective to today's issue. I think perhaps a more important qualification is that my wife of 21 years died 4 years ago after fighting breast cancer for many, many years.

It was exhausting, and I can tell you that the challenges of dealing with terminal illness are many and severe. I can also tell you that if people must face these challenges in the midst of extreme financial crisis that problems can become impossible to bear.

I think you have heard that today from the earlier panelists. I am here today for one fundamental reason, and that is to encourage legislation that creates an effective system to put the most resources possible in the hands of terminally ill people, each of whom desperately need our assistance.

Specifically, I want to strongly support the enactment of the accelerated death benefit provisions of H.R. 8, the Senior Citizens' Equity Act, but to suggest that it be modified also to include the tax-free treatment of proceeds from viatical settlements, which are another primary means that many terminal ill individuals are currently using to access critical financial resources.

I should note that three of the four brave panelists from whom you heard earlier received their financial assistance through a viatical settlement. The viatical settlement is already a State-regulated insurance activity which involves the sale of a life insurance policy from a person with a life threatening illness to a third party, a viatical settlement company.

As you have already heard, New York and California already treat viatical settlements as tax-free transactions under their State income tax laws. As you know by now, a viatical settlement can be undertaken by anyone who has been diagnosed as having a life threatening illness such as cancer, heart disease, AIDS, amyotrophic lateral sclerosis, commonly known as Lou Gehrig's disease like Rosemary Paul or of particular relevance to senior citizens, Alzheimer's disease.

A viatical settlement can involve almost any type of insurance policy, including term, whole, universal and group life. From our experience with people facing a wide array of terminal conditions, what they want more than anything, and I know my wife felt this way, is to bring a sense of normalcy and control back into their lives.

Our clients have told us on a number of occasions that finding new financial resources which allows this to happen is a God send. Having listened to the others on today's panel ranging from people themselves suffering from terminal illnesses to other industry representatives, financial planners, I am sure it is clear to you that there are several technical means through which financial resources can be delivered to the terminally ill, based on some translation of their life insurance policy.

Regardless of any differences that exist within this group as to the technical issues surrounding this point, what I hope will emerge as paramount is that, No. 1, the viatical settlement, as another specific vehicle through which terminally ill individuals have the option to access the financial value of their life insurance policy, should be mentioned specifically along with the accelerated death benefit as an element of the Senior Citizens' Equity Act; and, No. 2, from a larger perspective, that all reasonable means through which terminally ill individuals can now access the value of their policies, whether it be through an accelerated death benefit or a viatical settlement, should be formally made a tax-free benefit through the enactment of the same act.

It is estimated that approximately two-thirds of the Nation's families would quickly face financial distress if one of the primary wage earners in the family was unable to work because of serious illness. In addition to causing the many hardships outlined by our earlier panelists, this lack of income also very often results in the lapse of a life insurance policy due to the lack of funds for premium payments. Such outcomes are neither good for individuals nor for our society, which must ultimately bear the financial and collective spiritual costs of such human tragedies.

By making the changes all of us here today are suggesting, the act would ensure fair and equitable treatment of all individuals and their families unfortunate enough to have to endure terminal illness. More importantly, it would expand the number of individuals who could access the single remaining financial resource they may have to bring dignity and hope to their final days.

In summary, as you already heard here today, ADBs and viatical settlements are tax free in New York and California. You also heard that we feel that therefore there is a precedent for making these benefits Federal tax free. Due to the fact that a very broad spectrum of the U.S. population may at one point benefit from such a tax status, we feel the Federal tax laws should also be changed to provide Federal tax relief of viatical settlements. It truly has been an honor and a privilege to be here this morning. Thank you.

[The joint statement of Mr. Perper and Mr. Banks follows:]

JOINT STATEMENT OF
JOHN BANKS
CHIEF EXECUTIVE OFFICER
VIATICUS, INC
(Unit of CNA Financial Corp.)
and
ALAN PERPER
PRESIDENT
DIGNITY PARTNERS

BEFORE THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Committee:

This is a joint statement by Mr. John Banks and Mr. Alan Perper. Mr. Banks is the Chief Executive Officer of Viaticus, Inc., a wholly owned subsidiary of CNA Financial Corp. ("CNA"). CNA is the parent company of CNA Insurance Companies, a multi-line insurer, who pioneered nearly 30 years ago the long-term care policy for the elderly which is still considered to be the industry standard.

Mr. Perper is President of Dignity Partners, one of the oldest and largest viatical companies. The views expressed herein also represent the views of the Viatical Association of America ("VAA"). VAA represents over 60 industry participants.

We very much appreciate the opportunity to appear before you today to discuss the tax-free treatment of certain accelerated death benefits ("ADBs"). In the insurance industry, ADBs include third-party viatical settlements and certain accelerated insurance payments made directly by insurers to their policyholders under a life insurance policy.

We are here today to strongly support the enactment of the accelerated death benefit provisions of H.R. 8, the "Senior Citizens Equity Act" ("the Act"), with necessary modifications to allow for the tax-free treatment of viatical settlements, the primary form of accelerated death benefits.

We believe we speak on behalf of the entire group of individuals who make up this emerging sector of the insurance industry in saying that what we most want is the creation of an effective system to put the most resources possible in the hands of terminally and chronically ill people who desperately need assistance.

I. Viatical Settlements

A viatical settlement is a state regulated insurance activity which involves the bona fide contractual sale, exchange or assignment of a life insurance policy covering a person with a life-threatening illness, to a third party. The third party is typically known as a viatical settlement company. New York and California already treat viatical settlements as tax-free transactions under their state income tax laws.

Although viatical settlements are considered by many as the primary form of accelerated death benefits and are tax-free in certain states, they are currently not covered under the ADB provisions of H.R. 8. Unlike the ADB provisions in H.R. 8 (which only apply to select policies

with an ADB feature), viatical settlements are available for virtually all insurance policies of virtually any size, from almost any carrier, and on both individual and group policies.

A viatical settlement can involve a senior citizen who has been diagnosed as having a life-threatening illness, such as cancer, heart disease, Alzheimer's Disease, or ALS ("Lou Gehrig's Disease"). Viatical settlements can also apply to persons with leukemia, AIDS and other dread diseases. Most of these individuals are chronically or terminally ill. Many of these individuals and their families are in great financial need at the most critical time of their life, due to their illness.

From our experience, people in this condition want more than anything to bring a sense of normalcy and control back into their lives. Our clients have told us on a number of occasions that finding new financial resources which allows this to happen is a Godsend.

A viatical settlement is generally available as long as ownership in the policy can be transferred. In a viatical settlement, an individual sells, exchanges or assigns a portion or all of the face amount of a transferrable insurance policy to a viatical settlement company for a cash payment. The cash payment is an amount derived from the face value of the policy and is regulated in many states by state insurance law which mandates a fair and reasonable payment.

A viatical settlement can involve almost any type of life insurance policy, including term, whole, universal and group life. Moreover, a person in need can access a viatical settlement with a number of viatical settlement companies, creating a free market approach to achieve an extremely humanitarian goal. Unlike the ADB provision currently in H.R. 8, an individual using a viatical settlement is not restricted to dealing only with his or her own insurance company.

Also, unlike a policy with a strict ADB feature which can include caps and limitations, a viatical settlement can be extremely flexible in its timing and terms. Individuals using viatical settlements are often able to immediately access a much greater sum of money than that which would be available under typical ADB provisions.

Viatical settlements are subject to regulation in many states throughout the country. A Model statute and Model regulations were adopted by the National Association of Insurance Commissioners ("NAIC") in 1993 and 1994. Many states are already adopting regulations based on these NAIC Models.

We have worked and will continue to work with the NAIC Commissioners and various state regulators to help craft regulations that will bring this entire industry into the mainstream of American insurance products. The industry is being regulated and we welcome the security and consumer confidence such regulation brings.

Viatical settlements were virtually non-existent five years ago. However, the industry has grown recently in response to a proven and existing market demand for additional financial options which may be available at times of need. It is expected that in 1995, policies with a face value of $300 million will be viaticated, providing invaluable financial resources to persons at the most critical time of their life.

II. Modification Consistent with Principles of "Contract with America"

Modification of the ADB provisions of H.R. 8 to include viatical settlements is consistent with the underlying principles of the "Contract with America."

In essence, we are proposing that a terminally ill or chronically ill person, who otherwise meets the requirements of the Act, should be permitted to obtain the same tax benefits from his or her life insurance policy that would otherwise pass to his beneficiaries -- tax-free access to their life insurance policies.

Our proposal is timely and consistent with the five basic principles underlying the "Contract With America:" (1) individual liberty, (2) economic opportunity, (3) limited government, (4) personal responsibility and (5) security at home and abroad. Our proposal

embodies the first four of these principles and is not in any way inconsistent with the fifth. It is also consistent with the rationale of the Senior Citizens Equity Act, which we believe was formulated because of the well founded belief that our tax laws impose harsh penalties on our senior citizens.

INDIVIDUAL LIBERTY -- Our proposal would embrace individual liberty by allowing one to obtain something which is rightfully theirs without having to worry about the Federal government taking a share just because the individual chose to access these funds when they need them during their lifetime instead of passing them on to their beneficiaries after their death.

ECONOMIC OPPORTUNITY -- Our proposal would provide economic opportunity to those individuals who desire to provide themselves with a guaranteed and predictable source of funds if they find themselves in financial need due to a terminal illness. Rather than being forced to deal with only one entity -- an insurer offering and providing an ADB rider -- an individual could work with a variety of potential viatical companies and thus obtain the true market price. This modification would increase competition in the industry and thus maximize each individual's return.

LIMITED GOVERNMENT -- Our proposal is consistent with the principle of limited government because it would essentially get the government out of the way of the individual if and when the individual finds it necessary or desirable to utilize something for which he or she has paid. Since the government has already agreed that it is not entitled to these funds when they are passed through to the beneficiary, why should the government interfere with an individual's right to obtain these same funds when they are needed most -- when he or she is still alive with a terminal illness?

PERSONAL RESPONSIBILITY -- Our proposal is consistent with the principle of personal responsibility. Our proposal would enable a person to invest in a policy that would not only provide for their loved ones after their death, but could also be utilized as a resource to provide funds to pay for his or her medical expenses during a period in which they are suffering from a terminal illness. Our proposal would make it possible for individuals stricken with dread diseases to pay for their own medical and living expenses and to avoid becoming destitute and relying on government welfare programs and Medicaid during the last months of their lives.

III. Senior Citizens Equity Act, H.R. 8

H.R. 8 as currently drafted provides a benefit for only a small, select number of taxpayers who need financial resources available through accelerated death benefits paid by insurers to their own policyholders. The bill would allow an exclusion from gross income for amounts paid or advanced to an individual under a life insurance contract only if the insured under the contract is either: (1) terminally ill (the individual must be certified to have an illness or condition expected to result in death within 12 months) or (2) chronically ill and confined to a "qualified facility." Inherent in the provision is the requirement that the insured must have an insurance policy which contains this form of ADB feature.

The presently drafted statute is very narrow and restrictive, and does not cover: (1) individuals who do not have an ADB provision in their policy; (2) individuals who are diagnosed as terminally ill but are expected to live longer than 12 months; (3) individuals who are chronically ill but are confined to something other than a "qualified facility" (or are living at home and not now confined); and (4) individuals with "dread diseases."

Moreover, the current language of the proposed statute does not allow individuals to take advantage of market competition and free enterprise. It only applies to individuals who are fortunate enough to have an ADB provision in their policy, and further confines the individual to deal only with the insurance company with which they have the requisite policy.

The vast majority of life insurance policies do not have an ADB feature. A recent research paper by the Life Office Management Association ("LOMA") states that "[t]here is an enormous gap between the number of people who are covered by living benefits under a life insurance policy [e.g., a typical ADB feature] and those covered by all sorts of life insurance".

It has been estimated that approximately 3 million of the 366 million life insurance policies in force (or only about 1%) have ADB features.

The narrowness of the presently drafted statute is inconsistent with "model" state rules and discriminates against terminally, chronically and seriously ill individuals at the most critical time of their life.

Moreover, it creates an artificial tax preference for insurance policies with a strict ADB feature. Without a level playing field, an individual may be forced to choose a less favorable ADB feature because of the tax preference, when a more favorable viatical settlement is available. Depending on the terms of an ADB feature, an individual may also be in the unfortunate position of dying while waiting for the maturation of an ADB feature that never occurs. Such an individual may have instead taken advantage of a viatical settlement but for the adverse tax consequences.

To underscore the inequity by example, if a company has a six month ADB rider and a policyholder is expected to have a life expectancy of twelve months, the policyholder will fall outside the policy's ADB eligibility requirements. Such an individual cannot under the terms of the policy apply to the company for early benefits, eventhough under the current version of H.R. 8, the payments, if available, would be tax-free. Although a wide variety of viatical settlement companies would be willing to purchase the company's policy, the policyholder's receipt of the sales proceeds would be taxable under the current version of H.R. 8.

In contrast, other competing companies may provide a similar policyholder with a twelve month ADB rider. In these cases, the policyholder not only can take advantage of an available ADB feature, but does so tax-free. We see no discernable reason for this inconsistent tax treatment. This inequitable result should not be allowed under the tax code.

IV. Discussion

We believe it is essential to expand the tax-free coverage of ADBs to cover all ADBs including viatical settlements for a number of very important reasons which are summarized below.

Financial Resources at a Time of Greatest Need

It is estimated that approximately two-thirds of working Americans would quickly face financial distress if one of the primary wage earners in the family was unable to work because of serious illness. This lack of income often results in the lapse of a life insurance policy due to the lack of funds for premium payments.

This notion has been confirmed both by market research and by the anecdotal comments we have repeatedly heard from viators, case managers, insurance professionals and a wide range of other individuals familiar with the situations faced by the terminally ill.

Life threatening illnesses are particularly financially devastating for the elderly, many of whom live on a fixed income. A recent survey published in the December 21, 1994, edition of the AMA Journal ("JAMA"), showed that fully 25% of patients aged 65 and older with terminal illness lose all of their savings and income.

In many cases, the ill individual and his or her family are forced to rely on Medicaid, food stamps, welfare or dwindling hospital charitable funds. Many times this results in greatly limiting their choices of medical care and treatment.

The viatical settlement option allows these distressed individuals to maximize the use of existing personal financial assets and private insurance to cover critical costs, rather than turning to government services and programs. In many cases, individuals can allocate the viatical settlement proceeds to maintain the premiums for private health insurance, Medi-Gap insurance and nursing home insurance which they already have purchased, as well as to assist with burdensome co-payments.

Individuals can use the proceeds from a viatical settlement: (1) to pay for much needed medical expenses; (2) to pay for care givers, nursing home care and home nurses; (3) to pay off mounting debt incurred during the illness; and (4) to pay for food and nutritional supplements. This humanitarian service also allows individuals to continue to pay rent and mortgage payments, thus giving the individuals the freedom and dignity to remain in their own home rather than a government run institution.

Broad Spectrum of the Elderly and Terminally Ill Can be Helped

The benefits of the viatical settlement option accrue to a wide spectrum of American people, including the poor, middle class, dual income married families, and senior citizens. Many of these individuals have little or no income earning potential at this critical time of need.

Under a viatical settlement, speedy access to unrestricted private funds is provided to those with cancer, heart disease, Alzheimer's Disease, stroke, pulmonary conditions, AIDS, chronic kidney disease, chronic liver failure, ALS ("Lou Gehrig's Disease"), leukemia, those in need of costly organ transplants, and many other life threatening conditions.

Already Tax-Free in Certain States and Cities

New York and California have already taken the initiative to exempt viatical settlement payments from income tax. New York City has also excluded viatical settlement payments from the city income tax.

New York and California are also the states with the largest viatical settlement activity. These states have taken a pro-active role in promoting the viatical settlement concept in a responsible and reasonable manner. Despite their relatively high state income tax rates, budget constraints and financing needs, these states have decided to forego a tax on viatical settlements for the benefit of their residents. We expect many other states and cities to follow suit in the months to come. Clearly there is precedent for including viatical settlements under the rubric of all living benefits, and ensuring that it receives tax-free status at the Federal level.

Regulated by the States

Leaders of the viatical settlement industry have worked with the NAIC and with numerous State insurance legislators and regulators to develop a reasonable and fair regulatory framework for this new industry. This effort culminated last year in the successful adoption of the NAIC Model Act and Model Regulations for viatical settlements. The primary purpose of these Model rules is to provide fair treatment for viators (e.g., the seller of an insurance policy to a viatical settlement company) and adequate industry oversight by State insurance departments.

State regulation addresses major issues such as adequate disclosure to viators, reasonableness of payments, confidentiality, minimum capital requirements, sanctions against companies engaging in deceptive practices or advertising, applicability of Unfair Trade Practices Acts, rights of rescission by the consumer, broker oversight, and viatical settlement company/broker licensing and examination.

Along with the Viatical Association of America and others involved in viatical settlements, we welcome state regulation of this emerging industry. Constructive work continues to take place on a daily basis between the industry and the NAIC.

Reduced Use of Medicaid

Many distressed families turn to Medicaid to pay for the enormous burden of medical care associated with a chronic or terminal illness. Even worse, because Medicaid is a means-based entitlement, it requires individuals to spend down and make worthless almost all assets before becoming eligible for Medicaid payments.

An individual so situated would almost always be forced by economic necessity to surrender or lapse his/her life insurance policy for little or no value in order to receive benefits

under Medicaid; thus, rendering a lifetime of prior premium payments immediately worthless. The emotional trauma is great as lifelong plans are destroyed.

With a viatical settlement, the distressed individual would be much less likely to rely on Medicaid or any other government service or program.

Strong Public Policy Justification

Viatical settlements offer a beneficial private sector alternative for distressed individuals at the most critical time of need. If a financially encumbered individual facing a life-threatening illness were aware of the viatical settlement option, he or she might choose to transfer his/her policy to a viatical settlement company for a significant immediate payment of money. This option would preserve the insurance asset, allow for the immediate transfer of funds, and allow U.S. taxpayers a constructive alternative to access their own assets to meet medical and other necessary living needs.

Under existing law, the pre-death benefits received under a viatical settlement are generally fully taxable. This is particularly ironic in light of the fact that if the insurance proceeds are paid to designated beneficiaries on the death of the insured they would be tax-free under the current Federal income tax laws.

Stated otherwise, current Federal tax law encourages ill individuals to look to government programs as their primary source of funding for medical care. Tax-free viatical settlements offer a dignified, private sector solution.

Fairness, equity, and reasonableness demand that this form of free market alternative to government programs and intervention be given tax-free treatment similar to that provided for other more limited forms of ADBs under the current draft of H.R. 8.

V. Overview of Necessary Modifications

In order to achieve fairness and equity for all intended beneficiaries of the ADB proposal currently contained in H.R. 8, the following modifications to the proposed statute need to be made by the Committee.

Section 306 of the current draft of H.R. 8 needs to allow for the tax-free treatment of all accelerated death benefit payments, specifically including "viatical settlement payments." This change would allow for fair and equal tax treatment of pre-death benefit payments as between payments made directly by insurance companies and those made by third parties (e.g., viatical settlement companies.)

Section 306 should be modified to add the term "viatical settlement payment" to the type of accelerated death benefit payments which are given tax-free treatment. To accomplish this, the implementing language should be changed to state that "any amounts paid or advanced to an individual (from an insurance company, viatical settlement company, other third party or otherwise) as a result of a sale, exchange, assignment or other transfer of a life insurance contract on the life of an insured -- (A) who is a terminally ill individual, (B) who is a chronically ill individual, or (C) who is an individual who has a dread disease, shall be treated as an amount paid by reason of the death of the insured."

The current definition of "terminally ill individual" should be modified to mean "an individual who has been certified by a physician as having an illness or physical condition which can reasonably be expected to result in death in 36 months or less, or in a drastically limited life span." This language is generally consistent with the language currently contained in the NAIC "Viatical Settlement Model Act" and the NAIC "Accelerated Benefits Model Regulations."

The current language describing a "qualified facility," which is part of the "chronically ill individual" definition, should be slightly modified to allow more flexibility for ill individuals living at home during their illness.

The individuals qualifying for tax-free treatment should include individuals with a "dread disease." The definition of "dread disease" means "a medical condition which has required or requires extraordinary medical intervention without which the insured would die, or a medical condition which would, in the absence of extensive or extraordinary medical treatment, result in a drastically limited life span."

Section 306 should also clarify that tax-free treatment is also available to owners of insurance policies who are not "the insured." Also, regulation of the viatical settlement industry, like that of other insurance products, should be specifically left to the States, which is generally consistent with current Federal law.

VI. Positive Revenue Estimate

Consistent with the desire of this Committee for deficit reduction and the need to strictly scrutinize the revenue impact of all tax proposals, Viaticus, Inc. has commissioned a revenue estimate of our proposal for tax-free treatment of viatical settlements from Milliman & Robertson, Inc. ("M&R"), a leading health and tax insurance actuarial firm.

In a static model, this expert report shows that "if the tax status were changed and there was no resulting growth in viatical settlements [a highly unlikely event]," Federal revenues from viatical settlements would increase by over $390 million between 1995 and 1999.[1] The M&R report also shows that in a dynamic growth scenario, the revenue increase would be substantially more.

Much of the revenue comes from savings in Medicaid and SSI which is also under the jurisdiction of this Committee. To the extent an individual can use private money from a life insurance policy which he or she may own, it is less likely that the ill individual will rely on Medicaid or other government spending programs and services.

The M&R report demonstrates that Federal spending would be reduced and Federal revenues would increase from the following sources:

(1) Savings from Medicaid -- with funds available from private viatical settlements, afflicted individuals will either delay or not use Medicaid, thereby reducing Medicaid spending;

(2) Revenues from Medical providers -- the use of viatical settlements would increase the taxable profits of medical providers that receive full payment for services that would otherwise be paid by Medicaid at a discounted rate.

(3) Revenues from Wages -- if funds were available from viatical settlements to hire a caregiver, taxable wages of working relatives of the viators would not be reduced in cases where such relatives cease employment to act as a non-paid caregiver; additional revenue would come from the increased taxable revenue of paid caregivers; and

(4) Revenues from Viatical Companies -- the use of viatical settlements will increase the amount of tax revenue generated by viatical settlement companies.

---

[1] Under a static scenario, Federal revenues would increase from a change to tax-free treatment of viatical settlements by the following amounts:

	(In Millions)				
	1995	1996	1997	1998	1999
Revenue Change	+65.9	+71.5	+77.7	+84.2	+91.3

Five-year total (1995 to 1999) equals $390.6 million.

VII. Conclusion

The accelerated death benefit provisions of the current version of H.R. 8, the Senior Citizen's Equity Act, should be modified to allow for the tax-free treatment of viatical settlements, a primary form of accelerated death benefits. By taking this step, the Act would ensure fair and equitable treatment of all individuals unfortunate enough to have to endure a terminal illness. More importantly, it would expand the number of individuals who could tap the single remaining financial resource they may have to bring dignity and hope to their final days.

It has been an honor and privilege to be here this morning. We stand ready to work with you, Mr. Gibbons, the members of this Committee, and your staffs to ensure fair and equitable use of these pre-death benefits for individuals in great financial need at the most critical time of their life. We will be pleased to answer any questions you may wish to ask.

Mr. SHAW. Thank you, Mr. Banks.

I would like to thank each of our panelists. We have a vote on the floor. I hope the panelists can remain with us for a few minutes while we recess to go vote. We will recess now until 12:30.

[Recess.]

Mr. BUNNING [presiding]. I would like to reconvene the hearing if the panel would please come back and take their seats. It is my understanding that everyone has completed their testimony.

I would like to start out briefly by asking Mr. Mica, you quoted some different numbers than I have seen as far as accelerated death benefits. The last numbers that I had seen and the last numbers that I had been able to research was that only 5 percent of the insurance policies in the United States had accelerated death benefits. Are you telling me something different today?

Mr. MICA. Congressman, let me put it this way. We did a survey, and we have found an increased number. From 1994 the number went from—let me give you that number here. In March 31, 1994, we had more than 18 million policyholders who had accelerated death benefits available to them, and in 1991, which was data that has been frequently quoted up until recently, it was 1.3 million. I would be happy also to submit either for the record or to you our latest study, and this is a very current study, so it may be more current than the information you have. I don't know.

Mr. BUNNING. I would really appreciate that because that is important in our consideration of what we do in consideration of H.R. 8 and what we include or do not include and how many years are included. I would like to know specifically what type of accelerated death benefits are being offered, whether it is restricted to 1 year or just generally speaking how the industry is handling accelerated death benefits.

Mr. MICA. The breakdown by year, 6 months, no limit and so on is all broken down in this study.

Mr. BUNNING. That is fine, if you will submit that for the record.

Mr. MICA. It is the most current information, and it does cover that. I think the standard, if I might say, appears to be more and more 1 year, some with 6 months, and in answer to the question you offered to the panel earlier and what you are referring to now, it is my belief, and I think it is the belief of the leaders of our industry, that if Congress enacts favorable tax clarification, that accelerated death benefits will become almost, I won't say instantly, but very quickly, universally available.

Mr. BUNNING. Standard, in every policy?

Mr. MICA. All of the trends are in here. It has been added as riders to existing policies and an intrinsic part of new policies in the last few years in phenomenal numbers that we quote here, and so we see a bright future for this. The committee and Congress act as we expect them to.

Mr. BUNNING. I would like to address this to Mr. Banks or Mr. Pardo. I would like to know if the National Association of Insurance Commissioners has adopted a model regulation for viaticated settlements and for the viatication companies? Do those regulations contain minimum payout requirements and also require a viaticated settlement company to be licensed by each State in

which it operates? Would your company have any problems complying with the NAIC's model request or regulations?

Mr. BANKS. Maybe I can answer that. For Viaticus, we worked closely with the NAIC in helping develop that regulation, and we comply with all aspects of it now. If I could just refer back to these other statistics, if the number was 18 million insurance policies are covered now; is that right? I think there are 400 million insurance policies in force, so that would be about 4.5 percent.

The other thing is that we would hope that the ADB would become universal and it would put more money in people's pockets and it would be tax free. It still is going to be limited to 12 months, and we would like to think that viaticals would also be able to be given tax free because they reach far more people than the ADB does.

Mr. BUNNING. Mr. Banks, is your company currently regulated by State regulators where you operate?

Mr. BANKS. Regulation is being put in force by States right now. California and New York are the leaders in that. I think there are 14 States currently considering regulation. I spend quite a bit of my time traveling from State to State meeting with regulators to encourage them to enact this regulation.

When you are dealing with ill people who—and this might be their one major asset they have left, we feel that strict regulation of the industry, including pricing guidelines is absolutely crucial.

Mr. BUNNING. Well, since you mentioned California and New York, where I understand now that the settlements are tax free from State tax, what has your experience been in those two States? Do you see an increase, a quick increase in how many people would choose to——

Mr. BANKS. I think it is too soon to answer that, and I don't know whether the ADBs are offered more extensively in California.

Mr. PERPER. If I may add, I believe that California in 1990 amended its Tax Code at the same time that it enacted the viatical licensing legislation so that the two were tied, so it is kind of hard to see the distinction with a rise in accessing the viatical settlement to the tax-free treatment.

Mr. PARDO. Mr. Chairman, I would have to say that the National Viatical Association sees some significant problems with the NAIC model act. We have no problem with the disclosure elements of the act, and that is universal among the industry anyway. The fact of the matter is that my company, which has been in business for more than 5 years, has seen that in California only 11 companies in the United States since the inception of their law have been licensed at all.

It has been a very slow, very, very slowly progressing process in our view that has set it back. We don't see a need to regulate people in the disposition of their own private property, and we feel it violates certain private property issues.

As the former panel up here spoke of, they are quite capable of making their own decisions. We do agree with the disclosure elements and fair play, but the industry has operated for about 5 years without any real misconduct or problems whatsoever.

I would like to point out one thing, though, in the difference between viatical settlements and accelerated benefits, and that is to

my knowledge no accelerated benefit program of an insurance company lists AIDS as a disease which qualifies under an accelerated benefit program.

Mr. BUNNING. The big problem I am having is that you are testifying that you would like us to change the Tax Code, and not be regulated, and not have any regulations or any type of restrictions. I think if we are going to make it a tax-free benefit, even though the person, if they did not do—didn't viaticate a policy, would eventually have a tax-free settlement at death.

Mr. PARDO. That person wouldn't.

Mr. BUNNING. But someone would and therefore the Federal Government wouldn't receive any tax benefits from that or any income from that.

Mr. PARDO. Yes, but I don't see the nexus connection between complete regulation. Keep in mind we are dealing with——

Mr. BUNNING. I didn't say complete. I just said some guidelines where we have some type of understanding exactly what is going on.

Mr. PARDO. There are two elements essentially. One is that the viatical process operates essentially within a regulated framework. Insurance is regulated in every State in the United States already, and these transactions cannot occur without insurance companies, title departments, recognizing and agreeing and, so to speak, acting as the recorder of the transaction, so there is an element there already of regulation and regulation framework in which it works.

Mr. BUNNING. Let me ask Mr. Banks one more question, then I will yield. How many people come to your company through a third party, in other words, through a broker like some of the prior testimony indicated?

Mr. BANKS. Very few.

Mr. BUNNING. Very few. They come to you by themselves, without an intervenor?

Mr. BANKS. Right. Mostly we hear from care givers, and just to address the pricing issue of ADBs versus viaticals, when we hear from people who have the short sort of time spans or diagnosis that the ADBs are looking at; namely, 6 months, our pricing is as competitive or better than ADBs.

We had someone come to us last year who had an 8-month diagnosis, and they were paid in excess of 90 percent of their policy, and I would be happy to document that.

Mr. BUNNING. Thank you.

Mrs. Johnson.

Mrs. JOHNSON. Earlier panels have raised the issue of the 12-month limit, and that raises the issue of whether these contracts should be available just for terminally ill patients or also for chronically ill patients. Do you have any comment on that?

Mr. PARDO. I don't think that it would be possible, Mrs. Johnson, to viaticate a policy of somebody who is not terminally ill, so I think that is more or less self-regulating. Either through an accelerated death benefit or through the viatical process, essentially that process is going to remain the same.

Mrs. JOHNSON. If someone is chronically ill and wants the right to buy out their policy and someone is willing to buy it out, are you

saying there would be no market to buy it out if it wasn't clear that the buy-out date was going to be somewhere near on the horizon?

Mr. PARDO. What is at play here and the underlying process essentially is merely an extension of the concept of insurance itself, and that is the time value of money and an actuarial estimate of life expectancy. So what is happening here is that that life expectancy is being shortened prematurely, and therefore that gives additional present value to that contract. I know this is a very technical way of looking at it.

Mrs. JOHNSON. I follow what you are saying. You are just saying that unless it is pretty clear what the time involved is, then there is no advantage.

Mr. PARDO. Yes. Otherwise, the ratio the insurance companies are charging currently is the present value of it, and there is no spread, you might say, in there available to the individual.

What we are finding is that most individuals who become terminally ill don't know they can sell their insurance policy and capture a large percentage of its face value in advance.

Mrs. JOHNSON. But do you have any objection in the viatical contract area to eliminate the 12-month designation?

Mr. PARDO. Yes. I think it should be eliminated because I think if somebody is terminally ill, as the panel before us testified, it is their decision based on their condition, based on their financial circumstances, and also we see that when somebody sells their policy, many times, many of the times they live longer because they are stress free, but sometimes people who think they are going to live longer live shorter, and so you don't really know. You are terminally ill.

Mrs. JOHNSON. It is better to leave that decision about at what point this is a doable deal up to the individual and the companies involved?

Mr. PARDO. Yes.

Mr. PERPER. If I may add, I believe you have a compliance issue because often the terminally ill person does not want to know what his life expectancy is, and since the onus on paying the tax would be on the terminally ill person, he wouldn't know whether his proceeds were tax exempt by virtue of having a life expectancy of less than 12 months or more than 12 months.

Mr. BANKS. If I could just add to that as well, in the example I gave earlier of giving 90 percent on a $100,000 policy, as the Tax Code is presently written, the government would then take a further $30,000 from the person viaticating, so the person ends up with $60,000.

Mrs. JOHNSON. Correct. Thank you. Thank you, Mr. Chairman.

Mr. BUNNING. Mrs. Kennelly.

Mrs. KENNELLY. Thank you, Mr. Chairman. I would just like to point out for the record that a viatical company isn't regulated like an insurance company. It is very different. Also, I would like to urge some caution here.

When I first introduced this legislation, I thought there was nothing more reasonable than if you were terminally ill, the doctor certifies you only have 1 year to live, that you should be able to move on and get the profits from your insurance company and not

have to have the public pay for things that you could pay if you had the option. I have to inject a note of reality here.

It took us a long time, almost 5 years, to get to 1 year terminally ill certified by a doctor. Now, if we open it up to chronically ill, 1 year, 2 years, 3 years, I guarantee this legislation will not be seen in the first 100 days and nobody wants to see it more than I do. I inject this note of reality because when I first began there was a company, not an insurance company, but a company called the Grim Reaper cruising hospital wards, finding people.

Mr. Pardo, you say there have been no troubles. I am afraid there have been troubles. Some companies were taking 45 percent, and some individuals were being taken advantage of. We had SEC complaints for misrepresentation and illegal sale of securities. All these things were happening, and that was the reason we couldn't move forward with this very common-sense type of legislation. So I just would caution right now that we shouldn't just open it up, go further faster and end up losing 1 year.

We saw some wonderful testimony this morning. Obviously, these people found what they needed. But I think we should be awfully careful about some of the things we have learned over the last few years. We should just say this is all wonderful. I would like to ask Mr. Banks, your company is a subsidiary of CNA—

Why did you decide to be a subsidiary rather than a part of CNA? Why did CNA decide to make it a subsidiary? Can I ask the question without appearing that I am negative on this, that they didn't want to have the State of Illinois regulate. There is a history here.

Mr. BANKS. We are a wholly owned company of CNA Financial, which is an investment arm of CNA that also owns CNA Life Insurance Companies. I imagine that CNA Financial can buy any kind of company they wish, including cinemas or gas stations. I think the important thing to realize here is that the NAIC has been aware of viatical settlement companies since 1989, and as well as pushing to have ADBs extended with the insurance companies, they have also incorporated the fact that viatical settlement companies are a reality, and have enacted model acts and regulation to control them. We really welcome that. We really feel that the industry needs that.

[The NAIC Model Act and regulations are being retained in the committee files.]

Mrs. KENNELLY. Thank you.

Mr. Mica, would you comment on my thought that maybe we better move on, and you have been very good about working with us with the 1 year certified by the doctor, and then possibly go into this whole new field that we are in?

Mr. MICA. Well, first, let me say, obviously, we have indeed been working with your office and with a number of members of this committee for at least 5 years that I am aware of. Indeed, you raise some questions that have been nagging this entire committee all the time I have been involved in the issue. Obviously, our association, the Life Insurance Association, would love to have approved the tax clarification discussed by the committee here today.

With regard to viaticals, we do not have official policy as to whether or not they should move at the same time or separately.

We have said, as you may recall, that we don't think there should be favored treatment for viaticals versus life insurance companies, but, obviously, we would be very pleased to have action as soon as possible.

Mrs. KENNELLY. That is my caution to the committee, that we move as the Contract so says and get something done and then maybe we will expand this further in the future. Maybe I am wrong. Maybe we can do it all at once, but I do caution the committee from getting mired down in trying to rewrite and go further and then end up with nothing.

Mr. BUNNING. Mr. Ensign will inquire. No questions?

Mr. Christensen.

Mr. CHRISTENSEN. Just a couple questions. I am a new member on this committee, and prior to coming to this committee I was a life insurance salesman and worked with Connecticut Mutual Life Insurance Co., one of Mrs. Kennelly's constituents, and always lost the sale to someone who was selling an accelerated death benefit policy also, so I have to tell you that I am glad to see that there are a number of companies that are now selling these kind of policies. Not always lost, but a few times.

I guess I would encourage this industry to really—there are 400 companies or so out there that don't have ADB benefits right now. My one question that Mr. Banks sparked was the fact that maybe viaticals pay more than insurance companies, and that wasn't my understanding of it in the past.

I thought maybe Mr. Mica could clarify that. I just thought it would be good to hear if there is a difference in payment and also wanted to ask Mr. Pardo a question about whether or not if all companies some day sell ADB benefits, wouldn't that almost put a squeeze on the viatical association and eliminate your industry?

Mr. MICA. Well, first, Mr. Christensen, with regard to your first question, we pay full value on policies. That is the standard in our industry. Now, I guess I couldn't say that you might find someone who didn't pay full value out there, but as far as we know, that is the standard, and the full value means this; that whatever the face value is, there is an actuarial adjustment for the fact that the benefit is paid earlier, a small administrative fee, and the full value is paid. In terms of financial services, full value means that you are getting every dollar.

I don't know how the viaticals pay, but that has never been a question. I have heard, a little bit to my surprise here, that they pay more. That has not been my experience. I don't want to get into a debate with the gentlemen at the table, but our experience has been, and it is highly regulated, as you know, by every one of the 50 States, that the only way they will approve such a rider or a policy is that it must pay full value.

Mr. CHRISTENSEN. Mr. Pardo.

Mr. PARDO. Mr. Christensen, with regard to the pay issue, I can tell you unequivocally that at this point in time viatical companies on the average pay much, much more, and that is why the vast majority of accelerated benefits of any sort are done through the viatical process.

I would say that today less than 10 percent of all policies viaticated in the United States occur through an insurance com-

pany accelerated benefit program simply because they restrict the time, they restrict the amount, and they also restrict by policy, usually only whole life policies.

Mr. MICA. Are we talking volume?

Mr. CHRISTENSEN. I am not criticizing the—you say much, much more. Maybe I could get a clarification on that.

Mr. PARDO. Yes, in cases of over 12 months, most of the people who are viaticating policies, well, say half of them at least have group policies. Most group policies can't be accelerated at all. Policies less than 12 months and particularly less than 6 months, I would say that the accelerated benefits programs of the insurance industry generally are higher in that area.

Mr. CHRISTENSEN. I want this clarification for the record because probably Mr. Mica wouldn't say anything like this, but I understand that CNA owns your company, and I understand that CNA is also one of the American Council for Life Insurance companies, and so I understand that you have to be careful here, and I don't have to because I don't sell life insurance anymore. Is that true, Mr. Mica?

Mr. MICA. Is CNA a member? Yes. But let me tell you what my understanding is from our staff professionals.

We pay 95-plus percent on these policies. When they are saying much, much more, I am not sure how it can be much, much more unless you are talking volume. In other words, per policy we may pay 95, 97, 98 percent, 99 percent, but there may be more settlements. I don't understand that.

Mr. CHRISTENSEN. The viaticals are doing a whole lot more, but the amount paid is nearly the same, if not the same.

Mr. PERPER. If I may draw the distinction, while the ADBs are often 90 or 95 percent, it is on a portion of the policy. It might be on a $100,000 policy, they will offer 90 percent on $50,000 and the other $50,000 remains as the traditional death benefit.

For a viatical company, such as Dignity Partners, we on average pay 70 percent, and we often do that on the remaining portion of the ADB after someone has accelerated the other half, so that is the difference.

Mr. CHRISTENSEN. My time has expired. Maybe if someone else wants to follow up on this, Mr. Chairman, but thank you.

Mr. BUNNING. Mr. Kleczka will inquire.

Mr. KLECZKA. I do want to follow up on it because I am not very knowledgeable about this whole viatical settlement business. In fact, this is the first I heard of it, not being in the insurance business. I thought I heard the payout on the settlements on average is 70 percent?

Mr. PARDO. No, what I think he is saying is that is the average payout for a viatical settlement. It is not a matter that the accelerated benefits programs pay more or less or viaticals pay more or less. The matter is, how many people can be affected by the program?

Mr. KLECZKA. I am not trying to compare the accelerated benefit with you. I am trying to ascertain what your business is all about here. Maybe you can walk me through an example.

Let's say I am terminally ill, the medical experts indicate I have 2 years to live, and I have a policy, and we will use the same exam-

ple for two types of policies. I have a $100,000 whole life, and I go to you for a settlement. In that situation with those bare facts, what type of settlement would I get on my $100,000 whole life policy?

Mr. PARDO. In that situation you would not qualify at all for an accelerated benefit program. That is point No. 1.

Mr. KLECZKA. No, I am talking about—that's not——

Mr. PARDO. Point No. 2 is that you would probably——

Mr. KLECZKA. If my policy had provisions for it, I would.

Mr. PARDO. You would receive between 65 and 70 percent if you decided to sell your policy, say, with a 2-year outlook. I would say that would be a fairly consistent average.

Mr. NEAL. Would the gentleman yield?

Mr. KLECZKA. Sure.

Mr. NEAL. Just to follow up on that, what about the inside cash buildup on the policy, how would that be impacted?

Mr. PARDO. That would be added, but usually that is used up already. Another factor here to consider is that people that sell their policies, many times if they don't, will lose them for lack of being able to pay for the premiums long before they ever get to the point where they could qualify for an accelerated benefit.

Mr. KLECZKA. Let's go back to my example, using my example. The $100,000 whole life, I would get 65 to 70 percent of the face value?

Mr. PARDO. Yes, that is right.

Mr. KLECZKA. One lump?

Mr. PARDO. Yes, lump sum payment.

Mr. KLECZKA. If I die the next day instead of 2 weeks.

Mr. PARDO. It is still the same. You sold the policy. You got the money.

Mr. KLECZKA. OK. If I live for 2 years instead of 2 weeks?

Mr. PARDO. Yes, or if you live for 4 years. You see, it is an estimate, but we find that people generally live longer once they have viaticated.

Mr. KLECZKA. But it doesn't cost you any more? Your profit is the same?

Mr. PARDO. Not really, because the profit of the investor in a viatical transaction is the time value calculation. It is not just the spread between the amount of the policy and the face value. It is the amount of time that that is held, so if the individual lives for 2 years, for example, he might receive a 12- or 14-percent return, but if he lives for 4 years, he might only receive a 6-percent return.

Mr. KLECZKA. What type of return would I get using my example, with a term policy through my employer?

Mr. PARDO. What would the return be?

Mr. KLECZKA. Yes.

Mr. PARDO. It would depend on how long the individual actually did live.

Mr. KLECZKA. OK. That is totally based on longevity at that point?

Mr. PARDO. That is right, because that is the holding period.

Mr. KLECZKA. Like a ballpark, is it 50 percent or less or more?

Mr. BANKS. The important thing to remember here is that there are State regs in place that have pricing guidelines and disclosure

within them, and that even if we give 80 percent, the Federal Government is going to come in as the law now stands and take another 30 percent, and that is what we would like to see changed so that we get more money in the consumer's pocket.

Mr. KLECZKA. But the whole tax issue does not affect your bottom line at all?

Mr. PARDO. Oh, yes it does.

Mr. BANKS. How they tax——

Mr. PARDO. Excuse me a second.

Mr. BUNNING. One at a time, please. Mr. Banks.

Mr. BANKS. No, the tax issue doesn't affect our bottom line at all. All it impacts is how much money goes into the consumer's pocket.

Mr. KLECZKA. I appreciate that interest on your part. OK. Jon, do you want time to finish up on yours?

Mr. CHRISTENSEN. Would the gentleman yield?

Mr. BUNNING. Go right ahead, Mr. Kleczka. It is your time. I am going to yield to Jon. I think he had some followup.

Mr. CHRISTENSEN. A question for Mr. Mica. On the inside cash buildup within a policy, was what Mr. Pardo was saying correct on that or not within the payout system?

Mr. MICA. If I understood him, he was correct. You could borrow that cash buildup up front, and it would be considered a loan on the policy.

If I may continue to answer the question that was asked by Mr. Kleczka, the gentleman is right the way he has calculated that they pay more if in the example that you used, if you have a $100,000 policy and they pay 70 percent, you get $70,000, and what he was referring to is that some life insurance companies, many do not let you accelerate the entire amount. Therefore, they may say you have a $100,000 policy. We have found that through our experience that the widow or widower or the costs after you are gone still need to be covered, so we restrict 25 percent or whatever. There are different percentages, so you cannot accelerate the entire policy and hold some in reserve for when you pass on, so then when you do that you only get a percentage of the $75,000, but it would be, by our experience, far in excess of 95 percent, so we are talking kind of apples and oranges here, but there is a rationale to that.

Mr. KLECZKA. Thank you very much.

Mr. BUNNING. Mr. Neal will inquire.

Mr. NEAL. Thank you. As a followup to that, would you advise—the individual people that work for you—advise the individual on how best to apply the inside cash buildup?

Mr. PARDO. We would advise the individuals to look at all options. I think this is standard in the industry both with insurance companies and viatical companies to look at all options, including accelerated benefits, use of cash buildup, and also a viatical option to yield to them the greatest amount of net cash at any particular time in the course of their disease that they are applying for this benefit.

Mr. BANKS. The State regs do address that. They call for excruciating disclosure, and we really support that.

Mr. NEAL. My followup to that is, it would seem to me that despite the fact that you present a good product here today of good

reputation, that there are opportunities for enormous abuse if the regulatory framework breaks down. I mean, somebody who is in desperate need of cash may well be tempted for a significantly fewer dollar settlement than you are offering to provide the mob or somebody else with that avenue of opportunity as well.

Mr. BANKS. The State regs do address that with minimum payout ratios.

Mr. PERPER. In California not all viatical settlements or accelerated death benefits are tax free. On the viatical settlement side, it is only limited, the tax-free treatment, that is, is only limited to proceeds received pursuant to a viatical settlement contract entered into pursuant to the insurance code, so that is an important distinction.

Mr. NEAL. I believe that during the Carter years at one point the prime interest rate hit about 15 percent. I think the mob was even embarrassed by the rates the banks were charging in those days, and it does present a relatively complex issue.

Mr. PARDO. For 5 years, Mr. Neal, this process has gone along without abuse or significant misconduct or any incident of that sort, and also it is a competitive process. Most viators, as you could tell by the earlier panel, are aware of the fact, due to support groups and various means of communication dealing with their particular kind of problem, that there are numerous companies out there, 50 or 60, as you have already heard, that are willing to buy and, in fact, compete to buy these policies, and so the process is essentially a bidding process. They are able to use the free market system very much to their advantage.

Mr. NEAL. But do you think there is legitimacy to the example I cited, that that individual who is desperate for cash——

Mr. PARDO. Not in today's atmosphere I do not. I think that it was possible 4 or 5 or 6 years ago when the process first began, very quickly more sophisticated financial sources and support groups such as the National Association of People With AIDS, and industry associations and others got into the act, and the knowledge that an individual could viaticate their policy among the people that are affected in that way is very broad, and so I think it is very unlikely in this climate.

Mr. NEAL. Mr. Mica, do you want to comment?

Mr. MICA. No. I would only say that we are, the life insurance industry is heavily regulated in all 50 States right now, and there has been a long record of dealing with the States, particularly on this issue, and as I indicated earlier, essentially every one of the 50 States insists on full value in order to approve the policy.

Mr. NEAL. Thank you.

Mr. BUNNING. I would like to ask Mr. Mica one other question. If the provisions of H.R. 8 are passed, can you give us an estimate on how many insurance companies would make the accelerated death benefit a standard option or do you have any idea?

Mr. MICA. We do. We have discussed this. We don't have—you cannot predict the future on something like this, but based on our past data, there has been a sixteenfold increase from 1991 to 1994.

Mr. BUNNING. Even though it is taxable?

Mr. MICA. Even though it is taxable. The main reason given to us for companies who are not doing it is the taxation of this benefit

has not been clarified at this time. We have every reason to believe this would become virtually universal on all future group and individual policies, and, in fact, there is strong indication that even now companies, because the public is so interested in this, are stepping further in the water while they are waiting for you.

Mr. BUNNING. I want to thank the panel.

Go ahead, Mrs. Johnson.

Mrs. JOHNSON. Do any of the insurance policies allow AIDS settlements?

Mr. MICA. Yes, I am glad you asked that. When they talk about—they don't specify AIDS, but they specify terminal illness. As soon as that comes within the timeframe that is specified in the policy, 6 months or 1 year, and that can be certified, the policy covers it.

Mrs. JOHNSON. Apparently, at one time insurance policies, though, tended to be disease-specific or exclude specific diseases. Is that no longer the case in general?

Mr. MICA. Well, not for accelerated death benefits. I might just tell you by way of history, although this product was introduced heavily and primarily in 1989 in the United States, it was specifically introduced in Canada to assist with some AIDS patients. That was the genesis.

Mrs. JOHNSON. But early on didn't many of the insurance policies exclude AIDS patients or exclude certain diseases?

Mr. MICA. For accelerated death benefits? Not that I know of, no.

Mrs. JOHNSON. Because that is the statement in the testimony here by Mr. Pardo. Would you comment on that?

Mr. PARDO. I believe I can substantiate that. AIDS is not specifically listed to this day as a defined illness in the accelerated death benefits of the insurance industry, to this day.

Mr. MICA. Again, let me just say, it says terminal illness. The policies indicate terminal illness. When AIDS or any other illness is determined to be terminal within the period specified, in most policies it is 6 months or 1 year, you become eligible for the death benefit, and indeed there are numbers of claims that have been made on that basis.

Mr. LARSON. Mr. Chairman——

Mr. PARDO. I just want to add that in most cases illnesses, terminal illnesses are listed by line item within those riders, and so they are this, this, this, and this, this is what qualifies for that. AIDS is not included in that.

Mrs. JOHNSON. So in other words the terminal illnesses are defined.

Mr. PARDO. I think that is correct.

Mrs. JOHNSON. I think we need to get this point very clear before us. If you could help us with that after the hearing, I think it is important for us to show how the private insurance industry has evolved and therefore what the role——

Mr. BANKS. I think if I could point out that viaticals——

Mr. BUNNING. Mr. Larson.

Mr. LARSON. Thank you, Mr. Chairman. Because I work with the terminally ill directly, and very specifically conduct competitive bidding with viatical settlement companies and effect accelerated

death benefits, I would just like to add a note of caution to what Mr. Mica said.

I would like to put the emphasis back on the fact that this is supposed to be a Contract With America and not a contract with insurance companies, because I experience with my clients continually a deep frustration at the lack of accelerated death benefits available today, especially on group life insurance.

My experience indicates that the primary problem with this lies with the insurance companies as much as it does with State regulators. For example, I cite a 14-month regulatory process to approve an ADB, which I experienced recently with a client in New York and primarily with employers.

Now, what I would like to do is just urge the committee to look at this as a continuum, all diseases, all people with terminally ill diseases. They are the ones who are concerned here, not one provision versus another. Especially because of this problem with group life insurance, I think the best thing that will encourage accelerated death benefits will be, in fact, to grant tax-free treatment to viatical settlements which will put pressure on insurance companies and employers to offer ADBs and provide Americans with a complete spectrum of funds available if terminal illness strikes.

Mr. BUNNING. Mr. Banks, go ahead.

Mr. BANKS. Yes, I was just going to point out what Per mentioned, that viaticals do cover everyone, and it really is a real advantage in that they are presently covered by NAIC regulations at the State level.

Mr. BUNNING. Mrs. Johnson, do you have anything else?

Mrs. JOHNSON. To that issue of whether they are currently covered by the NAIC regulations at the State level, is that only true in the States that have adopted the NAIC regulations?

Mr. BANKS. Yes, that is correct. NAIC regulations have just been approved.

Mrs. JOHNSON. Only two States have adopted them and several more are in the process?

Mr. BANKS. The two States that adopted them actually developed their own regulations. The model regulation that was just approved by the NAIC was done so, I think, within the last month or so, and 14 States are looking at it already, so we would anticipate it becoming national.

Mrs. JOHNSON. Generally accepted over a period of a year or two?

Mr. BANKS. Again, the goal here is to remember that what we are trying to do is no matter what the pricing is, as long as it is well-regulated, which we support, the goal is to not have to share one-third of it with the Federal Government. This is—we can't tie this into some national health plan because this money also goes to keeping food on the table, making car payments, obviating a policy lapse; this is desperate.

Mr. KLECZKA. Will the gentlelady yield for a moment.

Mrs. JOHNSON. I would be glad to.

Mr. KLECZKA. I want you to respond, Mr. Banks, that you think it is ill advice to share one third of it with the Federal Government, although you have no problems of sharing one-third of it with your corporation.

Mr. BANKS. What was that again? It depends a little bit. If it is a 6-month policy, 10 percent of it is coming to our company to cover costs and profit. We do have to make a profit. In that scenario 33 percent is going to the government.

Mr. KLECZKA. Well, based on the example I was told before, the average on, say, a whole life is 65, 70 percent. That seems to me to be about 35 percent or one-third.

Mr. BUNNING. Thank you, panel, for your appearance here and thank you for your testimony.

The next panel, if they would come forward, Robert Shreve, Stephen Entin, Marilyn Moon, and John Goodman.

If we could take our conversations either out of the committee room so we can proceed, I would appreciate that. Mr. Shreve, if you would begin your testimony.

STATEMENT OF ROBERT SHREVE, CHAIRMAN OF THE BOARD, AMERICAN ASSOCIATION OF RETIRED PERSONS

Mr. SHREVE. Good afternoon, my name is Robert Shreve. I am chairman of the board of directors of AARP (American Association of Retired Persons). Mr. Chairman, the association thanks you for the opportunity to present its views regarding a phased-in repeal of the 1993 increase in the percentage of Social Security benefits subject to Federal taxation.

The association opposed the Social Security tax increase enacted in OBRA 1993 primarily for two reasons. First, the disproportionate tax burden that fell on middle-income older persons. Let me stress that people with taxable incomes of $34,000 or $44,000 a year are not wealthy.

Second, we were opposed because of the diversion of Social Security money for non-Social Security purposes. Given that older, middle-income taxpayers are the only nonwealthy group of taxpayers to experience large tax increases under OBRA 1993, it is easy to see why many older Americans do not perceive that tax as fair, and they support its repeal.

Nonetheless, the increased tax has become law, and the revenue raised is credited to the Hospital Insurance Trust Fund or Medicare part A. Now, we are faced with a dilemma, how to provide tax relief, but do so in a manner that does not increase the Federal deficit or leave the Hospital Insurance Trust Fund with a nearly $15 billion gap over 5 years.

Providing tax relief to older Americans is a legitimate goal. The increased tax was especially burdensome on middle-income older people. In fact, even though the thresholds were increased from those originally proposed by the administration, still approximately 1 million of the 5½ million affected beneficiaries are in the 15-percent tax bracket.

While many debate the precise meaning of middle income, surely those people in the 15-percent marginal tax bracket are not wealthy, yet they and other older taxpayers near the thresholds have been targeted for additional tax on their Social Security because they have been deemed wealthy.

Since middle-income taxpayers count on Social Security as a major, if not the largest source of income, the increased tax hits them hardest. This group has little ability to make up the lost in-

come. Additional work is often not a viable option. This group is already feeling the squeeze from skyrocketing medical costs and declining income, particularly interest rates.

Add to that income and property tax increases, and the normal costs of maintaining a household, and the loss of several hundred to a thousand dollars is significant. Indeed, an older person with $10,000 of Social Security and $35,000 in other income faced a tax increase of just under $1,000 in 1994, which is 3½ times the size of the 1994 COLA, which was 2.7 percent.

These losses are permanent and will accelerate what for most is already a time of declining income levels. This group also will feel the effect of higher Medicare premiums and other tax increases borne by all taxpayers under OBRA 1993.

AARP wants to work with this committee, as we have done in many instances in the past, to find a fiscally responsible way of providing tax relief that is fully paid for, that maintains the integrity of the Hospital Insurance Trust Fund, and that achieves those goals without placing additional burdens on Medicare beneficiaries.

We urge this committee to find a solution to pay for this and other provisions of the Contract With America that does not single out Medicare. The program has been reduced over $200 billion over the last decade, including $56 billion in cuts in OBRA 1993. Large Medicare reductions translate into real, substantial out-of-pocket costs for 36 million disabled and aged beneficiaries. These fiscally shortsighted cuts lead to a shifting of costs not only to individuals, but also to employers. In effect, the cost shift is a tax on business. Thank you, Mr. Chairman.

[The prepared statement and attachments follow:]

STATEMENT OF ROBERT SHREVE
CHAIRMAN OF THE BOARD
AMERICAN ASSOCIATION OF RETIRED PERSONS

The American Association of Retired Persons (AARP) appreciates the opportunity to present its views regarding the provision in the Senior Citizens Equity Act to repeal the 1993 increase in the percentage of Social Security subject to federal taxation from 50 to 85 percent. AARP opposed this tax increase in the Omnibus Budget Reconciliation Act of 1993 (OBRA 93) because of the disproportionate impact it imposed on middle-income beneficiaries and the diversion of Social Security dollars from Social Security purposes. The Association commends the chairman for holding today's hearing and hopes it will lead to some tax relief for affected older Americans, while also providing the financing so as not to increase the deficit or jeopardize the Medicare HI trust fund.

I. BACKGROUND

Prior to 1983, Social Security benefits were not taxed. The Social Security Amendments of 1983 provided for taxation of some benefits for the first time effective in 1984. This change was an important component of a carefully crafted compromise in which current workers and employers (through increased payroll taxes) and retirees all contributed to maintaining Social Security's long-term solvency. Since the taxation of benefits provision was enacted to help restore Social Security's long-term solvency, the revenue has been credited to the Old Age, Survivors and Disability Insurance (OASDI) trust funds.

The 1983 Social Security legislation specified that single taxpayers with modified adjusted gross incomes (MAGI) over $25,000 (including tax exempt interest and half of their Social Security benefits), and joint filers with incomes in excess of $32,000, were to be taxed on the lesser of half of their benefits or half the amount of income above these thresholds. The maximum percentage of benefits subject to federal taxation was set at fifty percent of benefits because employees pay half of the Social Security (FICA) taxes and the employer pays the other half.

The 1983 thresholds deliberately were not indexed in order to provide the Social Security trust funds with increasing revenue in the future when the number of beneficiaries would rise dramatically and the ratio of workers to retirees would decline. Initially, about eight percent of

beneficiaries were taxed on up to 50 percent of their Social Security. Today, almost one in four beneficiaries are affected, and by the turn of the century, almost one in three beneficiaries will pay tax on their Social Security benefits.

In its FY 94 budget, the Administration proposed raising the percentage of benefits subject to taxation from a maximum of 50 percent to a maximum of 85 percent for beneficiaries whose incomes exceeded the 1983 thresholds ($25,000 for individuals and $32,000 for couples). From the beginning, the Association expressed its opposition to this provision. Social Security currently takes in substantially more revenue annually than is needed to pay benefits and does not contribute to the deficit elsewhere in the budget. Thus, dedicated Social Security money should not be diverted to a deficit it did not cause. The Association was also concerned about the impact of the change on middle-income beneficiaries who would face a large tax increase not faced by other taxpayers with similar incomes.

The Administration's proposal was modified during the budget and reconciliation processes. As the proposal moved through Congress, AARP continued to emphasize its concerns and worked to raise the proposed thresholds for increased taxation. After the House adopted the Administration's proposed thresholds, the Senate recommended income levels of $32,000 for individuals and $40,000 for couples. (It narrowly rejected an amendment to raise the thresholds even further). Ultimately, the conference committee agreement further increased the thresholds for taxing 85 percent of benefits from the originally proposed $25,000 to $34,000 for individuals and from $32,000 to $44,000 for couples. The Association did not support the 1993 budget reconciliation legislation -- the first time we had not supported a deficit reduction bill in a decade -- and expressed its disappointment at the disproportionate tax hike on middle income seniors.

Unlike the revenue from taxing 50 percent of benefits, which is credited to the Social Security (OASDI) trust funds, the revenue from taxing the additional 35 percent of benefits is directed to the Hospital Insurance (HI) trust fund (Medicare Part A). While it was suggested that this was directed to HI in response to its solvency problem, it was apparently more in response to the need

to avoid a point of order in the Senate that barred consideration of any legislation affecting Title II of the Social Security Act in any reconciliation bill or resolution.

II. THE EFFECT OF TAXING 85 PERCENT OF BENEFITS

A. The Tax Impact

The tax increase affects about 5.5 million persons including about 1 million people in the 15 percent tax bracket in the 1994 tax year. The impact of the added taxation falls hardest on middle income beneficiaries. For example, an individual with $10,000 in Social Security benefits and $35,000 in other income experienced a tax increase of $980, or an over 15 percent tax increase.

For older middle income beneficiaries the impact is particularly onerous because the lost income is significant and difficult (if not impossible) to replace. Work may not be a realistic option, and shifting assets into potentially more profitable investments carries greater risk. Beneficiaries have limited flexibility to adjust their income because so much of it is fixed. Indeed, Social Security is generally their largest income source, averaging around 25 percent of gross income. Pensions, which generally are not fully indexed for inflation, are about 22 percent of income. Wages (of a beneficiary or a spouse) represent around 18 percent of income, and taxable interest is around 19 percent.

Those beneficiaries in the middle income group who derive a greater share of their income from Social Security will be hit hardest because a greater percentage of their overall income will be subject to new taxation. After federal and state taxes, local property taxes, higher out-of-pocket costs for health care and the normal costs of maintaining a household are accounted for, another several hundred to a thousand dollars in new tax liability represents a significant burden.

The tax increase is particularly onerous to those just above certain thresholds. Table A illustrates how the taxation in essence creates "cliffs". For example, if you compare single filers with $10,000 in Social Security benefits and $35,000 in other income to those with the same amount of

Social Security and $50,000 in other income, the tax increase is the same even though their total income is substantially different.

Other tax consequences result from the increased tax on Social Security. For older taxpayers living in the many states that directly tax Social Security or piggyback on the federal income tax system, state tax liability rises. Also, by including a greater percentage of Social Security in adjusted gross income (AGI), other deductions based on AGI (such as the medical deduction) will be reduced. The compounding effect results in an even greater tax bite.

B. The Tax Burden

In addition to the actual dollar increase, the increased taxation of Social Security raises marginal tax rates to excessive levels, particularly for older workers. It is actually possible -- taking into account income taxes, payroll taxes, and the Social Security earnings limit -- to lose money by earning extra income. The high marginal tax rates that are created by the interaction of the taxation of benefits provision and the earnings limit discourage additional earnings and act as a hurdle to those desiring additional employment income.

Some may argue that because of the existing partial exclusion of Social Security benefits from taxation, the tax burden of older Americans is too low. AARP believes that this is not the case. A reduced tax burden at retirement (of which an important component is the partial exclusion of Social Security) is wholly appropriate to maintain income adequacy as income declines. (See Charts 1 & 2) The average 62 year old retiree has a life expectancy of about 20 more years. Without wages, even a middle income retiree will have an uphill fight to remain middle income because incomes can erode significantly over time, and this tax increase accelerates that trend. Indeed, the Social Security cost-of-living adjustment (COLA), which helps older persons keep up with inflation, is effectively nullified for these middle income taxpayers by the increased taxation of Social Security. The increased taxation of Social Security means that some middle income older persons could pay in taxes an amount that far exceeds the value of the annual COLAs. For example, in 1994, an individual with $10,000 of Social Security and $35,000 in other income

received an annual COLA of $270 but faced a tax increase of $980. These middle-income older persons are not likely to see their incomes grow in the future and will experience an erosion of assets and buying power over time.

Although a reduced overall tax burden at retirement has been a long-time feature of the tax code, recent changes in the tax code have led to increased taxation of middle income older Americans. The Tax Reform Act of 1986 eliminated the extra exemption for persons over the age of 65 (replacing it with a smaller increased standard deduction for non-itemizers), and also cut back on one of the most important deductions for older persons, the medical deduction (raising the threshold from 5 percent of AGI to 7 1/2 percent of AGI). In addition, the Social Security Amendments of 1983 not only taxed Social Security, but also required that tax-exempt interest income be included in calculating the amount of Social Security benefits subject to tax. This provision, which may push beneficiaries over the tax thresholds, essentially requires (albeit indirectly) these taxpayers to pay tax on their tax exempt income. Given these recent changes, and the need for older persons to maintain an adequate income stream over their remaining lifetimes, the current tax burden at retirement is not "too low".

C. The Disproportionate Burden of Deficit Reduction

Throughout consideration of the OBRA 93 Social Security tax increase, AARP repeatedly pointed out to Congress and the Administration that elderly taxpayers, particularly those currently in the 15 percent tax bracket, would face a tax increase not borne by younger taxpayers with comparable income. In fact, under OBRA 93 middle income older taxpayers were asked to bear a much greater tax burden than non-elderly taxpayers with considerably more income.

In addition to the Social Security tax increase, OBRA 93 reduced the Medicare program by $56 billion, and increased other taxes that are also paid by older Americans. In short, older Americans were asked to make a disproportionately large contribution to deficit reduction in OBRA 93.

III. THE RATE FOR TAXING SOCIAL SECURITY BENEFITS

When the National Commission on Social Security Reform (the Greenspan Commission) originally analyzed proposals to tax Social Security benefits in the early 1980s, considerable attention was devoted to the appropriate percentage of benefits that should be subject to taxation. The level was set at up to 50 percent because the employee paid one half of the OASDI payroll tax with after-tax contributions. Beneficiaries understand this rationale even if they do not always agree with it.

The Greenspan Commission reviewed proposals to tax 85 percent of benefits. The higher taxation level was advanced because it would bring the tax treatment of Social Security benefits into closer conformity with the taxation principles that apply to private pensions. However, Social Security is fundamentally different from a private pension. Social Security is an almost universal social insurance program established by the government to provide income protection to workers and their families if the wage earner retires, becomes disabled or dies. The program has complete portability and a progressive benefit formula. In contrast, private pensions cover less than half of the workforce, lack portability, and benefits generally favor those with higher incomes. Given these distinctions it is not necessary for Social Security to have parallel tax treatment to private pensions.

Some analyses suggest that the 85 percent level may be too high. The Congressional Budget Office (CBO) has pointed out that the 85 percent level reflects the nominal value of payroll tax contributions and fails to adjust them for inflation. CBO suggests that a 60 percent rate would take inflation into account. An analysis by Social Security's former chief actuary, Robert Myers, notes that the 85 percent rate represents double taxation. He recommends an initial 80 percent rate (for nominal, not inflation adjusted dollars), followed by a declining percentage until it reaches 72 percent in the next century.

The 85 percent level is thus still subject to debate as the appropriate level for full taxation of benefits. Even so, parallel treatment with pension income is not necessarily desirable. In any

event, raising the percentage of benefits taxed represents a benefit reduction for 5.5 million current beneficiaries and many more approaching retirement. It heightens the anxiety of today's workers about the availability and value of their Social Security retirement benefits. While the "value" of Social Security for current workers is often understated because disability and survivor benefits are omitted from most analyses, workers' concerns about the impact of these proposals upon their retirement income security are understandable.

IV. ASSOCIATION POSITION

A. Cost of Repeal

AARP opposed the increase in the level for taxing Social Security from 50 to 85 percent. In addition, the Association believes that any revenue from taxation should have been used, as it had been in 1983, only to improve Social Security's long-term solvency.

Despite our concerns, the taxation of up to 85 percent of benefits became law, and the revenue raised was credited to the Medicare Hospital Insurance (HI) trust fund. The diversion of the revenue raised from taxing the additional 35 percent of benefits to the Medicare Part A trust fund, while enacted largely as a way to avoid a budget procedural point of order, currently improves the long-term balance of that trust fund.

Revenue from current law will infuse about $24 billion over 5 years into the HI trust fund -- money that will shore up the trust fund's declining financial health. A phased-out repeal would produce a $14.9 billion shortfall over 5 years. The HI trust fund is currently projected to be insolvent in 2002. If the provision is repealed without an offset, the HI trust fund would face a shortfall of needed revenue, and

insolvency would be moved up for the HI trust fund. Although the Budget Enforcement Act already requires that revenue reductions be paid for, it is also critical that any offsetting revenues maintain or improve the current condition of the HI trust fund.

B. Impact on the Medicare Program

AARP urges the Committee -- in its consideration of how to pay for the provisions in the Senior Citizens Equity Act as well as other provisions of the Contract with America -- not to single out the Medicare program. Medicare has been reduced substantially over the last several years -- by nearly $200 billion since 1980. Moreover, the program and its beneficiaries are only now beginning to feel the impact of the $56 billion in Medicare reductions recently made as part of OBRA 93. Medicare cannot continue to sustain cuts of this magnitude.

While some contend that cuts in Medicare spending would simply be reductions in the program's rate of growth, large reductions would translate into substantial out-of-pocket cost increases for the 36 million disabled and aged beneficiaries who depend on Medicare as their primary source of health insurance. Older Americans already have the highest out-of-pocket expenditures for health care of any age group (National Medical Expenditure Survey). Health care expenses currently account for 23 percent of the average older person's household income as compared with 8 percent for the non-elderly. Additional reductions would create a barrier to care for many beneficiaries or would limit their choices of health plans, providers and coverage.

Deep cuts in Medicare are also fiscally short-sighted. Cutting Medicare means that costs will simply be shifted to businesses and individuals -- driving up the costs of private health insurance. For businesses, this added expense means that employers will scale back coverage for their workers, require workers to pay more, or eliminate health insurance coverage for their workers all together.

The Association therefore supports tax relief for those affected by the Social Security tax increase, particularly for middle income taxpayers. However, the tax relief must be fully paid for. In addition, since the tax revenue now is directed to the Medicare Part A trust fund, the trust fund must be kept whole. Finally, any financing should not place further burdens on Medicare beneficiaries or the Medicare program. To do so would in effect be to replace a tax increase on one group of beneficiaries with another tax on a larger, more vulnerable group of beneficiaries.

V. ACCELERATED DEATH BENEFITS UNDER LIFE INSURANCE CONTRACTS

The Association has a deep, long-standing interest in the issue of long-term care. We appreciate the fact that the Contract with America recognizes the very serious nature of our nation's long-term care crisis and includes provisions that attempt to ease the substantial financial burden families face when the need for long-term care arises. While Social Security helps to provide some peace of mind for millions of retirees, it does not address their needs when a long-term disability strikes; not uncommon for the fastest growing segment of our population, persons over 75 years of age. One such proposal would allow tax-free accelerated death benefits under life insurance contracts.

In general, AARP supports granting tax favored treatment to a life insurance terminal illness benefit. In our view, prepayment of life insurance benefits could provide valuable financial assistance to terminally ill individuals. In limited circumstances, a morbidity benefit also should receive tax favored treatment. In both cases, adequate safeguards for consumers must be a condition for obtaining favorable tax treatment. Our primary concern is that certain beneficiaries -- spouses in particular--should be protected by requiring their consent to acceleration of the benefits. Such spousal consent could be similar to the requirement in the pension laws that spouses sign a written consent form in order to waive their right to benefits. The Association also urges that an individual considering purchasing or exercising a right to accelerated benefits receive disclosure and counseling from the insurer on a number of subjects, in particular on the implications for eligibility for low-income program benefits, such as those available under Medicaid.

VI. CONCLUSION

The Association supports tax relief for accelerated death benefits with appropriate consumer safeguards and for those affected by the Social Security tax increase, particularly for those middle income taxpayers who were hardest hit. AARP believes, however, that this tax relief must be paid for responsibly. Phasing out the Social Security tax, while likely to be confusing, will be less costly than an immediate repeal. We stand ready to work with this Committee to find a responsible solution that reduces the tax burden of those affected by the OBRA 93 provision, that is fully paid for, that maintains the integrity of the HI trust fund, and that achieves these goals without placing additional burdens on Medicare beneficiaries.

CHART A

ADDITIONAL FEDERAL INCOME TAX LIABILITY IN 1994 UNDER P.L. 103-66

Annual Social Security Benefit					
$5,000		$10,000	$15,000	$20,000	$25,000
Other income	Additional tax liability				
Single					
$20,000	--	--	--	c	c
25,000	--	--	--	c	c
30,000	--	98.00	343.00	c	c
35,000	490.00	980.00	1,183.00	c	c
40,000	490.00	980.00	1,470.00	c	c
50,000	490.00	980.00	1,483.50	c	c
75,000	542.50	1,085.00	1,627.50	c	c
100,000	542.50	1,085.00	1,627.50	c	c
Joint					
$20,000	--	--	--	--	--
25,000	--	--	--	--	--
30,000	--	--	--	--	--
35,000	--	--	--	52.50	183.75
40,000	--	127.50	221.25	360.50	768.00
50,000	490.00	980.00	1,470.00	1,960.00	2,450.00
75,000	490.00	980.00	1,470.00	1,960.00	2,450.00
100,000	490.00	1,085.00	1,627.50	2,170.00	2,712.50

a. AGI excluding social security, and assuming no tax-free interest is received.
b. Individuals are assumed to be age 65 or older and use the standard deduction.
c. Virtually no single individual currently received this level of benefits. Very few receive $15,000 in yearly benefits.

Source: Congressional Research Service, December 27, 1994

CHART 1

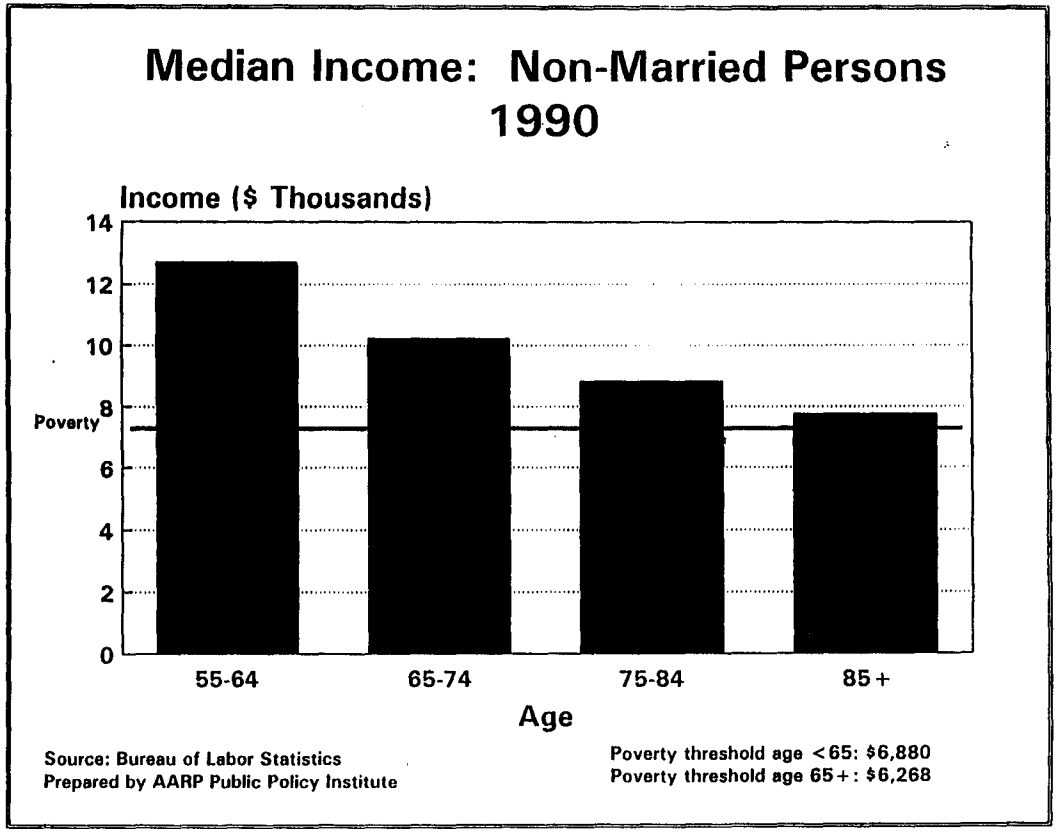
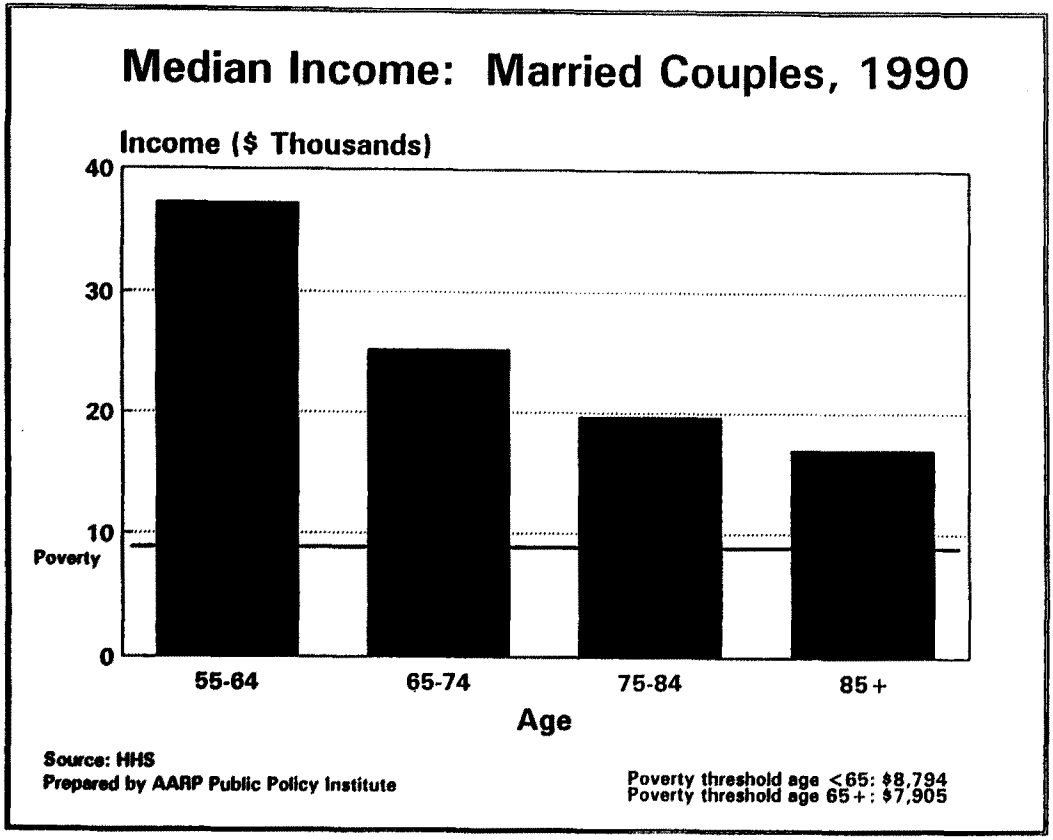

Median Income: Non-Married Persons
1990
Income ($ Thousands)
14
12
10
8
Poverty
6
4
2
0
55-64
65-74
75-84
85+
Age
Source: Bureau of Labor Statistics
Prepared by AARP Public Policy Institute
Poverty threshold age <65: $6,880
Poverty threshold age 65+: $6,268

CHART 2


Median Income: Married Couples, 1990
Income ($ Thousands)
40
30
20
10
Poverty
0
55-64
65-74
75-84
85+
Age
Source: HHS
Prepared by AARP Public Policy Institute
Poverty threshold age <65: $8,794
Poverty threshold age 65+: $7,905

Mr. BUNNING. Mr. Entin.

STATEMENT OF STEPHEN J. ENTIN, RESIDENT SCHOLAR, INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

Mr. ENTIN. Thank you, Mr. Chairman, and members of the committee. My name is Steve Entin. I work at the Institute for Research on the Economics of Taxation. Thank you for hearing me out on the subject of taxation of benefits.

The major provision of the Senior Citizens' Equity Act in the Contract With America would roll back the increase in the taxation of Social Security benefits enacted in the 1993 Budget Act (OBRA 1993).

Repealing the OBRA 1993 increase from 50 percent to 85 percent in the amount of Social Security benefits subject to tax would be a good step, but in my opinion, it does not go far enough.

A more sweeping reform of the taxation of benefits, as well as the Social Security earnings test which you covered in a hearing on January 9, is needed to reduce unconscionable disincentives created by the current system. What I want to focus on today is the disincentive effects of these provisions.

Since the 1983 Social Security amendments, which I must say were enacted in great haste and confusion, Social Security benefits are added to taxable income when the beneficiary's income exceeds certain thresholds. It is the threshold concept which causes the trouble.

Single beneficiaries with incomes above $25,000 and married beneficiaries with incomes above $32,000 must add 50 cents in benefits to their taxable incomes for each dollar over the threshold until half their benefits are taxed. OBRA 1993 increased the amount of benefits to be included in taxable income to 85 cents per dollar of income over $34,000 for single beneficiaries and over $44,000 for couples until 85 percent of benefits are included.

Now, here is the key point. The taxation of benefits is triggered by earning other retirement income that pushes total income over the threshold. Consequently, it is the other retirement income, including interest, even tax-exempt interest, dividends, pensions, and wages that is really bearing the tax, and at super-normal rates.

Over these thresholds, earning an extra dollar of retirement income can add $1.50 to taxable income, and up to $1.85 since OBRA 1993. For example, for someone in the 28-percent bracket, if you earn one extra dollar of interest there is a tax of 42 cents, if you are in the 50-percent tier, or a tax of 52 cents if you are in the 85-percent tier, on that added dollar of interest.

On wages, with the payroll tax added in, the marginal tax rate reaches 56 or 65 percent. If the taxpayer's wages are also subject to the Social Security earnings test, the tax rate can reach 103 percent to 109 percent, not even counting State income taxes. You even get 14 cents in tax imposed on $1 of tax-exempt interest if you are in the 28-percent bracket and you have to add 50 cents of benefits to taxable income because of the an added dollar of tax-exempt interest. If you are in the 85-percent tier, the tax is 24 cents.

Now, the Contract With America would eliminate the 85-percent provision in OBRA 1993, but it would leave up to 50 percent of benefits subject to tax. Just rolling back these punitive tax rates,

for example, from 52 percent to 42 percent, is not enough. A total overhaul of benefit taxation and the earnings test is needed.

The tax poisoning of private retirement saving that might push you over the threshold sends a terrible message to savers at all ages. It says "Congress does not want you to save for retirement." The super-normal tax rates on wages tells older workers, "We don't want your brains, skills, or experience in the work force." In time, because the thresholds for benefit taxation are not adjusted for inflation, more and more taxpayers will be pushed over the thresholds as incomes rise with inflation.

At 3 percent inflation, by 2010 when the baby boom is beginning to retire, the thresholds for married and single taxpayers will have fallen to roughly $19,000 and $15,000 in today's money. The tax spikes also poison pension and IRA withdrawals, penalizing the incentive to save.

Congress should remove both the 50-percent and 85-percent phase-ins by decoupling the taxation of benefits from other income. It is the only way to eliminate the resulting tax spikes. Instead of current methods, you might take some exempt amount, let's say $6,000 for a single beneficiary, $9,000 for a one-worker couple, and $12,000 for a two-worker couple, and require that benefits above those amounts simply be added to taxable income. That would create an income threshold below which you would not be taxing people on their benefits, which is the whole idea behind the thresholds in current law, but it would not have the side effect of driving marginal tax rates through the roof.

If you wanted to increase revenues, you could have lower thresholds. If you wanted to have fewer people subject to the taxation of benefits, you could have higher thresholds. That kind of approach or the other approach I put into the testimony would give you some flexibility in this matter. Thank you very much.

[The prepared statement and attachment follow:]

HEARING ON THE SENIOR CITIZENS' EQUITY ACT: REFORMING TAXATION OF SOCIAL SECURITY BENEFITS

Statement of Stephen J. Entin, Resident Scholar
Institute for Research on the Economics of Taxation

before the

Committee on Ways and Means

January 19, 1995

Repealing the OBRA93 increase, from 50 percent to 85 percent, in the amount of social security benefits subject to tax is a good step. Nonetheless, a more sweeping reform of the taxation of benefits, as well as the social security earnings test, is called for to reduce unconscionable disincentives created by the current system.

Before OBRA93, the tax treatment of up to 50 percent of social security benefits (tier 1) imposed marginal income tax rates of up to 42% on earnings of private saving for persons in the statutory 28% federal income tax bracket, a powerful disincentive to work and save. OBRA93 raised the rate as high as 51.8% by phasing in up to 85 percent of benefits into taxable income (tier 2). Beneficiaries who earn modest amounts of wages, not subject to the social security earnings test, can now face combined marginal federal income and payroll taxes as high as 65% (up from 56% before OBRA93), making working and saving for retirement or disability even less attractive. These rates would be several percentage points higher after adding typical state income tax rates.

Beneficiaries subject to the social security earnings limitation and taxation of up to 50 percent of benefits can face marginal tax rates of roughly 68% to 103% percent on additional wages (and about 72% to 109% when state income taxes are added). Beneficiaries subject to the earnings limitation and taxation of up to 85 percent of benefits can face tax rates of 71% to 109% on additional wages (and about 75% to 115% when typical state income taxes are added).

Clearly, strong action is needed to reduce these prohibitive tax rates. Repealing the OBRA93 increase in the amount of social security benefits subject to tax would only reduce the tax spikes described above from outrageous to merely horrible. A real correction requires completely restructuring the taxation of social security benefits and easing or repealing the earnings test.

How the tax works.

The so-called tax on social security retirement and disability benefits is really a tax on other, private income — interest, dividends, pensions, and wages — received by individuals collecting social security benefits. The taxation of benefits is triggered as other retirement income exceeds a set of thresholds, not by any change in one's social security benefits, which are set by a formula beyond an individual's control. Consequently, it is the other retirement income that bears the additional tax, not the benefits. The result is a tax on other income at super-statutory rates, resulting in a sharp disincentive for private retirement saving or continued work. The tax poisoning of private retirement saving sends a terrible message to savers of all ages: "Congress does not want you to save for retirement." The super-normal tax rates on wages sends a terrible message to older workers: "We don't want your brains, skills, or experience in the work force."

Under current law, benefits start to be taxed when modified adjusted gross income (MAGI) — the sum of a beneficiary's ordinary AGI (wages, interest, pensions, dividends, etc.), tax exempt bond income, and half of social security benefits — exceeds $32,000 for a married couple filing jointly and $25,000 for a single taxpayer (tier 1). For each dollar by which MAGI

exceeds the exempt amounts, $0.50 of the taxpayer's social security benefits becomes taxable income, up to half of benefits.

As benefits become taxable, earning another dollar of taxable interest, dividends, pensions, or wages increases taxable income by $1.50, effectively raising the marginal tax rate on the added dollar of income to 1.5 times the statutory rate, e.g., from 15% to 22.5% or from 28% to 42%. An added dollar of tax exempt interest raises taxable income by $0.50, subjecting the otherwise untaxed interest to de facto marginal tax rates of 7.5% for taxpayers in the 15% bracket, and 14% for taxpayers in the 28% bracket. Once half of benefits have become taxable, additional earnings again face normal marginal tax rates. (The 31% rate is not affected. Half of benefits become taxable before a taxpayer's income exceeds the 28% tax bracket.)

OBRA93 increased the amount of social security retirement and disability benefits subject to income tax to 85 percent for married couples with MAGI above $44,000 and for single beneficiaries with income above $34,000 (tier 2). Affected beneficiaries have to add $0.85 of benefits to taxable income for each dollar of MAGI over these thresholds until 85 percent of benefits become taxable. This increases the marginal tax rate spike to 1.85 times normal rates. The 15% marginal income tax rate becomes 27.8%, and the 28% marginal income tax rate jumps to 51.8%.

When wages are involved, one must factor in the payroll tax. The self-employed and employers get to deduct half of the 15.3% payroll tax. In the case of the self-employed, the deduction reduces adjusted gross income by $0.0765 for each dollar of wage income subject to the payroll tax, slightly reducing the marginal income tax spike created by the phase-in of benefits into taxable income. The combined marginal income tax and payroll tax rates range from 37% to 66% before state income taxes (see table). (Similar result obtain in the case of employee/beneficiaries if one factors in the combined employee/employer payroll tax after allowing for the deduction of the employer's half.)

Interaction with income taxation of social security benefits.

Even higher tax rates occur when a beneficiary is subject to the social security earnings limit on wage and salary income (in 1995, $8,160 for beneficiaries ages 62-64, and $11,280 for those ages 65-69) as well as the phase-in of benefit taxation. Beneficiaries lose $1 in benefits for every $2 by which wages exceed the limit for people ages 62-64 or $1 for every $3 by which wages exceed the limit for people ages 65-69, producing effective tax rates of 50% and 33-1/3%, respectively, on the wages. These implicit tax rates due to the earnings test are not strictly additive to the income tax effects of benefit taxation, because the benefit reductions slightly reduce the income tax spike.[1] Nonetheless, together with the payroll tax on the added earnings, the federal marginal tax rate on beneficiaries' wages can reach confiscatory levels of 68% to 103% in tier one and 71% to 109% in tier two before state income taxes, and roughly 70% to 115% over the two tiers when typical state income tax rates are added (see table). Benefits lost to the earnings test may be recovered later in life if excess earnings cease, but only if the retiree lives long enough. The tax disincentive is surely daunting, and was made more so by OBRA93.

Not just an upper income penalty.

The tax spikes due to the taxation of benefits currently fall on the top 20 percent or less of social security beneficiaries. Ultimately, however, over 60 percent of beneficiaries will pay some tax on their benefits, because the income thresholds for benefit taxation are not adjusted for inflation. At three percent inflation, by 2010, when the baby boom is beginning to retire, the thresholds for married and single taxpayers will have fallen to roughly $19,000 and $15,000 in today's dollars. Children now in kindergarten will face thresholds of roughly $5,900 to $4,600 in 2050 in today's dollars, and will avoid tax on their benefits only by being too poor to owe any income tax at all.

Impact on saving incentives.

The tax spikes in current law are a trap for unwary users of pension plans and IRAs. Normally, people face higher tax rates during their working years, and lower rates after retirement. By using pensions or deductible IRAs, they can shift taxable income from a high tax rate period to a low tax rate period. However, if their retirement income falls within the phase-in range of their social security benefits, they may face a higher tax rate after retirement than when they were working. If the savers are young, the tax deferred inside build-up in the retirement plans is enough to compensate, but past a certain age, they would be better off not using such accounts. Such savers would be better off with a "back-ended" IRA, as proposed in the Contract with America, in which no deduction is allowed for contributions, but withdrawals are tax exempt. But beware: the taxation of social security benefits would poison even a back-ended IRA, just as it imposes a tax on other tax exempt income at 50% or 85% of the taxpayer's statutory tax rate, unless the IRA withdrawals were explicitly excluded from the calculation of modified adjusted gross income used to determine the amount of social security benefits subject to tax. If a back-ended IRA is enacted, that exclusion must be part of the provision, or the incentive to save provided by the back-ended IRA will be cut sharply.

Better ways to tax benefits.

Congress should do more than repeal the OBRA93 increase in the amount of social security benefits subject to tax. Congress should remove both the 50 percent and 85 percent phase-ins by decoupling the taxation of social security benefits from the amount of a taxpayer's other income. That is the only way to eliminate the resulting spike in marginal tax rates on interest, dividends, pensions, wages, and other privately provided retirement income. I offer two methods of decoupling for consideration.

Method 1: Benefits above some exempt amounts, up to half of total benefits, would simply be added to ordinary taxable income. The exempt amounts, say, $6,000 for a single retiree, $9,000 for a couple using the 50 percent spousal benefit, and up to $12,000 for a two-worker couple each receiving his or her own benefits, could be adjusted to produce the same, higher, or lower revenue than current law, as desired. (Including no more than half of total benefits is suggested because, in the future, it will roughly correspond to the half of the payroll tax paid by the employee, for which no income tax deduction was allowed, and which was, therefore, already taxed.)

Method 2: An alternative approach would be to tax social security benefits in the same manner as pension income used to be taxed. Individuals would pay no tax on social security benefits until their benefits exceed their lifetime employee payroll tax "contributions". Any benefits in excess of lifetime contributions would simply be added to taxable income. (Employer taxes, which were deductible when paid, would not be exempt.)

The thresholds in current law are designed to exempt, at least temporarily, low and middle income people from paying tax on benefits. Alternative method one, above, is designed to shelter roughly the same group of low and middle income beneficiaries without the tax spike created by the current method. This method effectively shelters lower income retirees because there is a strong relationship between having high social security benefits and having high levels of other retirement income. People have high social security benefits because they had high earnings during their working lives. Such persons also tend to have high private pension benefits, high levels of accumulated savings and earnings from savings, and a greater ability to continue to earn high levels of wages when semi-retired. It is conceivable that some people who had high levels of income during their working lives saved little or none of it, and so have little private retirement income, but they are the exception, and their situation should not drive tax policy into creating enormous disincentives against normal saving behavior.

Alternative method two would tax more people and more benefits than method one, and, initially, more than under current law. However, both alternatives would subject fewer benefits to taxation over time than current law, as more and more people exceed current law's unindexed thresholds.

Conclusion.

Reform of social security benefit taxation (and the earnings test) is urgent. The current tax treatment imposes mindless disincentives to work and save. The OBRA93 changes exaggerated the flaws. The Committee should do more than repeal the 1983 changes; it should completely overhaul the method of taxing benefits. The social security earnings limitation should also be raised or, better yet, eliminated entirely. (On January, 9, 1995, the Subcommittee on Social Security held a very informative hearing on raising the limit to $30,000.)

Current tax treatment of social security benefits fails every test of sensible policy. If the objective is fairness, or similarity to the tax treatment of private pensions, it cannot be achieved with tax rates approaching or exceeding 100%. If the objective is to turn Social Security into a means-tested welfare program, there are surely more efficient ways to do it.

Effective Federal* Marginal Tax Rates for Social Security Recipients				
Statutory income tax rate	Marginal tax rates as social security benefits become taxable, in tier 1 (50% phase-in range) or tier 2 (85% phase-in range)			
	Income from savings, pensions		Wage income below earnings test threshold	
	Tier 1 (150% of statutory income tax rate)	Tier 2 (185% of statutory income tax rate)	Tier 1 (adjusted income plus payroll tax rate**)	Tier 2 (adjusted income plus payroll tax rate**)
15%	22.5%	27.8%	37.2%	42.1%
28%	42%	51.8%	56.2%	65.3%
	Wages subject to the social security earnings test, payroll and income taxes**			
	Ages 65-69		Ages 62-64	
	Tier 1	Tier 2	Tier 1	Tier 2
15%	68.1%	71.2%	85.4%	88.9%
28%	84.9%	90.7%	102.7%	109.3%

* Add 4 to 6 percentage points for typical state income tax rates.
**Assumes self-employed payroll tax, allowing for income-tax deductibility of "employer's" half of payroll tax and effect of deduction on modified adjusted gross income used to determine amount of social security benefits subject to income taxation. Figures would be very similar for employee beneficiaries after adding the employee and employer payroll tax after deduction of employer's half at employer's tax rate.

Endnotes

1. When an employee/beneficiary is subject to both the Social Security earnings test and the phase-in of benefit taxation at the 50 percent rate, the interaction of the two provisions produces an effective increase of either 37.5 percent (for beneficiaries ages 62-64) or 41.67 percent (for beneficiaries ages 65-69) in the marginal tax rate on wage and salary income, rather than one-half. The added dollar of wages costs the beneficiary $0.50 in benefits if age 62-64, $0.3333 if age 65-69. Since half of Social Security benefits are counted in determining whether a taxpayer's income exceeds the threshold for taxation of benefits, that measure of income falls by half of these benefit losses, or by $0.25 or $0.1667. Thus, the net result of an added $1 in wages is an additional $0.75 or $0.8333 in the income measure used to determine benefit taxation, and an increase of half that amount -- $0.375 or $0.4167 -- in taxable benefits. Thus, the consequence of the added dollar of wages is to raise taxable income by $1.375 or $1.4167. This effectively raises the 15 percent tax rate to 20.625 percent or 21.25 percent, and the 28 percent tax rate to 38.5 percent or 39.67 percent, for those in the 62-64 and 65-69 age groups, respectively. For people subject to taxation of up to 85 percent of benefits, the corresponding increases in taxable income are $1.6375 or $1.7085, raising the 28 percent marginal income tax rate to 45.85 percent or 47.84 percent, for those in the 62-64 and 65-69 age groups, respectively. Adding in the 50% or 33-1/3% implicit tax rates due to the earnings test, plus payroll tax (adjusted for the employer's deduction) and state income taxes, marginal tax rates under these conditions can reach 75 percent to 115 percent.

The calculation is a bit trickier for the self-employed. The added dollar of wages raises adjusted gross income by $0.9235 (=$1-$0.0765). Subtracting half of the lost Social Security benefits ($0.25 or $0.1667) results in a net increase of modified adjusted gross income of $0.6735 (ages 62-64) or $0.5902 (ages 65-69); an addition to taxable income of 50% or 85% of those amounts, and implicit marginal income tax rates that are 1.337, 1.572, 1.295, or 1.502 times the statutory levels. One must then add the payroll and state and local income tax rates, arriving at similar results as in the employee/beneficiary example.

Mr. BUNNING. Ms. Moon, please.

STATEMENT OF MARILYN MOON, SENIOR FELLOW, URBAN INSTITUTE

Ms. MOON. Thank you. I appreciate the opportunity to be here to testify, but I must start out by apologizing. My formal statement has an error in it of a simple calculation done late at night on a holiday weekend, and I apologize. I would be happy to correct that for the record.

I would like to focus my oral remarks on my conclusion that it is undesirable for those who support Social Security and Medicare, our two important social insurance programs, to make changes that will benefit only a minority of elderly persons in the short run and potentially cause more harm in the long run.

I believe that it is irresponsible to consider this change in taxation in a vacuum, that the consequences of its rollback would be more harmful to the elderly, and that it is only wishful thinking, for example, to assume that Medicare would be spared any further changes after this rollback.

In my remaining testimony, I would like to focus just on two of the points that I raise in the written part. First, the issue of economic incentives that Mr. Entin raised is not the only principle to use in considering these changes. Although I don't agree with his analysis on the efficiency side, I want to focus on issues of fairness. Second, it is essential to understand the likely impact on the Medicare program of eliminating the revenues from Social Security taxation in an environment in which we are facing a financing crisis in Medicare in the near future.

First, let me talk about fairness of the actual tax itself. In judging the advisability of taxation of Social Security, there are two principle issues of fairness. One is the question of equal treatment of equals, where it is appropriate to look at how we treat younger families versus how we treat older families in the United States.

Since older Americans have long benefited from the exclusion of Social Security benefits from their incomes for purposes of calculating taxes, they do not pay as much as younger families in taxes. For example, if you consider two couples with $80,000 of income in 1995, one of which is over 65 and the other under 65, after accounting for payroll and income taxes, the Federal tax burden would be nearly twice as high on young working families as it would be on elderly families. Therefore, the expansion of the taxation of Social Security actually improves the principle of horizontal equity.

I think rather than thinking about this taxation as adding additional burdens, we need to think about the fact that we have provided this tax benefit in the beginning for these individuals, and we are now reducing that tax benefit to some extent.

A second equity principle is the issue of progressivity, of whether those who have a higher ability to pay, as measured by their incomes, pay a greater share of their incomes in taxes. Again, I conclude that taxation of Social Security benefits is a reasonable way to make Social Security benefits more progressive over time because it takes into account other income sources that individuals have.

It is very difficult to make that formula much more progressive than it is now, I believe, without recognizing the role that other income plays on individuals. Taxation of Social Security benefits essentially does that, and I believe, therefore, it is a reasonable tool to have in the arsenal of good social policy options for older Americans.

Now, let me also discuss the impact on Medicare of the likely repeal of this taxation. Even if the rollback of this legislation would find other ways of financing that revenue change under the budget rules, the important question is what will happen to Medicare because these dollars now flow into the Hospital Insurance Trust Fund. Medicare is going to face a number of problems in the future, and if you look at the arsenal of possible changes that could be used to cut Medicare, none of them are nearly as attractive as this particular way of helping to finance the Medicare benefit package.

For example, an income-related premium tries in a more cumbersome way than taxation of Social Security benefits to replace lost revenues. Such a premium would add considerable additional administrative burdens, making it undesirable from that perspective. Other changes such as a higher coinsurance on home health, which is a favorite of many people who propose changes in Medicare, would be particularly harmful to older Americans; that is, persons over age 85 who are heavy users of home health services.

This would mean, for example, an increase of about $700 in additional copayments to an average user of home health services, and an even greater amount for an extraordinary user of home health services. So on balance, while I don't think it is pleasant to talk about taxation of anything, the Social Security taxation provision being discussed here today is not an unfair approach in an environment in which the resulting revenues are being used to help older persons by dedicating them to the Hospital Insurance Trust Fund. Thank you.

[The prepared statement follows:]

TAXATION OF SOCIAL SECURITY BENEFITS

Statement by Marilyn Moon[1]
before the
Committee on Ways and Means
U.S. House of Representatives
January 19, 1995

I appreciate the opportunity to testify today on the issue of the taxation of Social Security benefits. The Contract with America proposes to roll back changes in the taxation of Social Security benefits that were made in 1993. My testimony today offers four issues that ought to be examined in considering such a proposal:

- The challenges that will face the financing of Social Security over the next 50 years;
- The history and rationale for the taxation of Social Security benefits;
- The impact of the taxation of Social Security on beneficiaries and Medicare; and
- The impact of the new burdens that would need to be added to replace revenue lost to Medicare.

My interest in this issue stems from my work on aging issues for most of my career as an economic researcher and policy analyst. I am currently a senior fellow at the Urban Institute, a nonprofit, nonpartisan research organization here in Washington, where I work mainly on health issues and measures of economic status for the elderly.

The Challenges Facing Social Security and Medicare in the Future

As I am sure you are well aware, both Social Security and Medicare will face unprecedented challenges as the Baby Boom generation approaches retirement age. And, for Medicare, the problems are projected to come even sooner because of the additional burdens of rapidly rising health care costs. Current projections by the actuaries suggest that the trust fund for Part A of Medicare will be depleted by the year 2001. This problem needs to be seriously addressed within the next two or three years.

Solvency for Social Security will also become a major issue but not as soon, meaning that adjustments to the Social Security program can be put off for a longer period. But here too the earlier we begin to tackle the problem, the less pain will likely be inflicted on anyone. Moreover, Social Security and Medicare are linked, so that problems in one part of our social insurance system will inevitably affect the other parts.

Any proposal that affects Social Security or Medicare needs to be viewed in the context of this looming financing crisis. Making tough decisions to protect the future of Social Security and Medicare will be difficult, so it makes little sense to propose changes that exacerbate these challenges. Consequently, changes that raise spending on these programs or that reduce revenues that flow into them are irresponsible unless fully offset by other changes that bolster the financial health of these two programs.

The History and Rationale for Social Security Taxation

Taxation of Social Security benefits was introduced in 1983 as part of a broader set of amendments to restore actuarial balance to the program. Other changes lowered future

---

[1]Senior Fellow, The Urban Institute, Washington, D.C. This statement presents the views of the author and does not necessarily represent the views of the Urban Institute, its trustees or sponsors.

benefits, raised the retirement age for future generations of retirees, and increased contributions into the system--thus spreading the burdens of the change among Americans of all ages. Taxation of benefits is one of the few progressive changes that can be made to generate savings for the program from current beneficiaries. That is, by establishing an income threshold before taxation of Social Security begins (at $25,000 for single persons and $32,000 for couples), those with the lowest incomes were protected. And even then no more than 50 percent of all Social Security benefits were ever subjected to taxation. Even the highest income beneficiaries were still allowed to keep at least half of Social Security benefits from counting as income for purposes of taxation.

In judging the advisability of taxation of Social Security, a number of principles of taxation can be examined. One major principle is the equal treatment of equals--that is, people with the same incomes should pay the same level of taxes. Since older Americans have long benefitted from the exclusion of this very important part of their incomes from taxation, they do not pay as much as younger families in taxes.[2] The expansion of the taxation of Social Security thus actually improves this tax principle of horizontal equity.

Another principle relates to the issue of progressivity--of whether those who have higher ability to pay (usually measured by their incomes) pay a greater share of their incomes in taxes. Again, taxation of Social Security meets this principle of fairness. Moreover, it is a more progressive way to reduce benefits than changing the Social Security benefit formula, for example, because it takes into account all sources of income in determining who should be liable for higher taxes. In that sense, it is a better gauge of ability to pay than if adjustments were simply made on the basis of Social Security benefits alone. And it is certainly more progressive than across-the-board cuts in cost of living adjustments which constitute one of the other major proposals for Social Security savings.

Taxation of benefits is also fully consistent with the philosophy of Social Security to supplement retirement income for Americans, and to supplement it more generously for those with lower incomes. Finally, the original legislation on Social Security was silent about whether or not it would count as income for purposes of taxation. An IRS ruling--and not legislative intent--is what gave us the exclusion of this source of income from taxation.

Since 1983, proposals to further modify Social Security to assure its availability for future generations have often included extension of the taxation of benefits. When searching for ways to spread the burdens of these changes across present and future generations of beneficiaries, this has been viewed by many as one of the fairest ways for current beneficiaries to contribute to the solution. Thus, if the 1993 Social Security change had not been instituted as part of deficit reduction legislation, such a provision would very likely be included in any Social Security reform plan in the future.

Further, the additional taxation enacted in 1993 had another important element: these new revenues were dedicated to the Medicare Hospital Insurance trust fund to help improve its financial health. Thus, every dollar that higher income beneficiaries pay goes to help pay benefits to Medicare beneficiaries. Effectively, this is a way to make the Medicare program more progressive as well without generating new administrative structures to do so.

Elimination of the 1993 legislation that expands taxation of Social Security will deprive the Medicare trust fund of needed revenues and help to accelerate its fiscal crisis. Thus, any assessment of the value of rescinding this legislation must also consider the impact on the Medicare program because of this direct linkage between the two programs.

---

[2]And coupled with other tax benefits they receive, the elderly, on average, paid 16.3 percent of their incomes in federal taxes as compared to 24.7 percent for families headed by someone under age 65 in 1991, for example.

The Impact of Taxation on Beneficiaries and Medicare

The taxation provision that the Contract with America proposes to rescind would only affect beneficiaries with incomes above $34,000 (singles) or $44,000 (couples), or about 13 percent of all elderly beneficiaries. Since many beneficiaries have relatively low incomes, more than seven out of every eight elderly beneficiaries are unaffected by this provision.

For those who are affected, the share of Social Security that counts as income gradually rises from 50 percent to 85 percent above that threshold. Thus, even the highest income beneficiaries are allowed to shelter 15 percent of their benefits from taxation--still giving them an advantage over younger families with similar levels of income.

Consider the example of a couple with an income of $80,000 per year, including $12,000 of Social Security benefits. Before the imposition of the tax change of 1993, this couple would have paid income taxes on one-half of their Social Security benefits, so that their adjusted gross income (AGI--that is, income before deductions and exemptions) would have been $74,000. After the new law, they would have to pay taxes on $10,200 of their benefits, bringing their AGI to $78,200. If they were in the 28 percent tax bracket, this would increase their taxes by $1,176. As compared to a younger family with the same income and deductions, however, they still would pay $504 less in income taxes.

And families with lower incomes, closer to the thresholds would pay less in additional taxes. For example, a single person with an income of $40,000 including $8000 in Social Security would have to report $4700 of that as income for tax purposes, bringing her AGI to $36,700. She would pay $196 more in federal income taxes (again assuming that she is in the 28 percent income tax bracket).

As noted above, the revenues raised from this provision go directly to the Medicare Hospital Insurance (Part A) trust fund. The Department of the Treasury estimates that this provision will add $15 billion to the Medicare trust fund over the next 5 years, and $48.5 billion between 1995 and 2005. While the $15 billion represents only about 13 percent of what Medicare Part A will spend this year, it does help to extend the life of the trust fund. And since other changes will still be needed to keep Medicare solvent, even this relatively small contribution is critical.

Alternatives for Replacing the Lost Revenue

Budget rules require that revenue lost by eliminating the 1993 expansion of taxation of Social Security benefits would have to be replaced by some other set of changes in spending or revenues. Moreover, even if other means were found to replace the revenue that did not affect Social Security or Medicare, it would still be necessary to make an equivalent amount of higher revenues or lower spending in Medicare to protect the trust fund. How might that be done? Medicare changes for Part A offer only a limited range of options, some of which will need to be tapped in the next few years even without losses from this income tax contribution. Part A covers hospital services, skilled nursing care and home health services, and so it is in these areas that reductions would need to be found.

One set of changes might be to reduce payments to health care providers for Medicare. This would mean, for example, cutting payments to hospitals, nursing homes, and/or home health agencies. Since hospital services make up the bulk of Part A spending, many of the cuts would have to take place there. Hospitals, however, are already objecting strongly to the levels of payment they receive under Medicare, arguing that they often do not even cover the costs of such care. To the extent that they are able, hospitals will attempt to shift any shortfall in payments onto other payers of care, such as private insurance patients. And if there are major shortfalls that cannot be shifted, hospitals and other health care providers may be force to close their doors or stop treating Medicare patients. Both of these effects create problems for our health care system. Since the early 1980s, Medicare has relied heavily on this type of savings. At some point, once the gap between costs and what Medicare will pay

widens enough, this option will cease to be a viable source of new savings, however.

A number of proposals for cutting Medicare thus look elsewhere to changes that would affect beneficiaries directly. These include a new Part A premium or higher cost sharing for the services received.

Medicare has never charged a premium for the Hospital Insurance portion of the program, so this would mean a major change in the philosophy of the program. Moreover, if applied to all beneficiaries, we would trade a progressive benefit for one that put heavier relative burdens on those beneficiaries with modest incomes. It is difficult to argue fairness when asking a widow making $10,000 per year to pay a new premium in lieu of an elderly couple with $80,000 of income paying more income taxes.

Some of the proposals for a higher hospital deductible or a new premium would be income-related (such as that proposed by Congressman Kasich last year). Those with higher incomes would pay more. While this would be fairer than a flat increase and would make higher premiums or deductibles possible since lower income beneficiaries would not have to bear the full burden, this would require either setting up a whole new administrative structure or using the IRS. Ironically, this would be equivalent to taxing Social Security benefits--but with more complicated adjustments. Thus, it makes little sense to trade taxation of Social Security for a similar, but more convoluted tax on Medicare.

Finally, one of the more likely options for helping the Part A trust fund would be to institute a new coinsurance payment for home health services. The coinsurance on this service was eliminated in 1972 and a number of health care proposals and deficit reduction plans have called for reinstituting the coinsurance. Indeed, the Congressional Budget Office has estimated that a 20 percent coinsurance could raise about $20 billion over 5 years. However, this option has particularly undesirable effects on low and moderate income beneficiaries. Because the very old are most likely to use this benefit--and to use it extensively--they would bear the greatest burden from this change. The average user of home health services would face a new coinsurance charge of over $700 per year under this proposal. And because the incomes of these older, frail Medicare beneficiaries tend to be quite low, this would be a particularly regressive change. For example, beneficiaries aged 85 and over would pay coinsurance rates about five times higher than those aged 65 to 69.

Conclusion

While it may be tempting to roll back the tax increase enacted in 1993 that subjected more of Social Security to taxation, there are strong reasons to resist that temptation. This expanded taxation of benefits is consistent with the types of sacrifices that Americans need to be asked to make in the future to ensure that Social Security will be able to fulfill its promises over time. Although the decisions will not be easy ones, needed changes in Social Security and Medicare should not be postponed. Moreover, repeal of this provision would send exactly the wrong signal to Americans about making tough but fair decisions regarding government spending.

The 1993 expansion of the taxation of Social Security represents a progressive change that not only helps in reducing the federal deficit but also in funding the Hospital Insurance portion of the Medicare program. Without this provision, changes in Medicare that would be required in the next few years would be less likely to protect the most vulnerable beneficiaries. Rescinding that provision would be a step backward, not forward in putting these two critical programs of the federal government on a firmer footing.

Mr. BUNNING. Dr. Goodman, please.

STATEMENT OF JOHN C. GOODMAN, PH.D., PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL CENTER FOR POLICY ANALYSIS, DALLAS, TEX.

Mr. GOODMAN. Thank you, Mr. Chairman. My name is John Goodman. I am president of the NCPA (National Center for Policy Analysis). Now, Marilyn Moon just told us that for tax purposes we should treat Social Security benefits the way we treat any other type of income, and if that is what we were doing, then I wouldn't be here today, but that is precisely what we aren't doing.

Although we call this tax a Social Security benefit tax, it is not really a tax on Social Security benefits. If you don't have any other income, you don't pay any tax at all. You only pay the tax to the extent that you have other income.

Now, as we have already learned, the way this tax works is that when you earn $1 of income, you pay taxes, theoretically, on 85 cents of Social Security benefits. What that means is you earn $1, you pay taxes on $1.85, and as Mr. Entin says, what that means is you increase your marginal tax rate by 85 percentage points.

Now, what this means is that we aren't treating people with equal incomes equally. This chart compares a young person with an elderly person earning exactly the same income. They are both in the 28-percent Federal income tax bracket, but because of this very pernicious Social Security benefit tax, the elderly person is in the 52-percent tax bracket paying almost twice the marginal tax rate of a young person.

Now, on what does this tax fall? If it is not falling on Social Security, what does it fall on? It falls on mainly investment income, capital income. Although the elderly represent only 12 percent of the population, they are holding 40 percent of all the capital assets, so this tax falls on dividend income, interest, capital gains, withdrawals from IRAs, and pensions, and although we were told just a few moments ago it affects only a small percent of the elderly population, that is not true.

This is also a tax on young people. Because of this tax, the vast majority of the working population suddenly discovers that its IRA is less valuable, its pension plan is less valuable. A 20-year-old worker today earning, say, an average wage of anywhere from $23,000 to $26,000, this worker might put money in an IRA or his employer may put money in a pension fund thinking they are taking advantage of the principle of tax-deferred savings, but in fact that worker's IRA is worth half as much as it would have been precisely because of this Social Security benefit tax.

Now, if I could have the next chart. For those elderly people who depend on wage income as well as investment income, in their retirement years this tax is even worse. As Mr. Entin just told us, when you combine the Social Security earnings penalty with the Social Security benefit tax and the Federal income tax and the Social Security FICA tax, you get enormously high marginal tax rates.

My numbers are a little different from Mr. Entin's numbers because we have only put in half the FICA tax in these calculations. If you put in the full FICA tax, you get even higher numbers. For

the elderly, between 62 and 65, they have to give up $1 of benefits for every $2 of earnings. That is a 50-percent tax added to all these other taxes.

Between 65 and 70 years of age, they are giving up $1 of benefits for every $3 of earnings. That is a 33-percent tax, add them all together, take account of all the interactions, and you get tremendously high marginal tax rates, which really penalize and discourage the elderly from bringing their valuable skills to the labor market.

Finally, if I could have the third chart, many people have never stopped to look at the formula that people have to use in order to calculate how much tax they owe, but it is a very, very complicated formula. It turns out it gets in very subtle ways to income that people don't even realize is being taxed.

I have already mentioned that withdrawals from pensions and IRAs are taxed at a 52-percent rate; capital gains, the highest rate is 28 percent for everybody else in the population. It hits 52 percent for some of the elderly; tax-exempt income.

Most people think when they buy tax-exempt bonds that they are not paying taxes on this income, but if they are elderly, that gets included in the calculation of their tax, and the marginal tax rate on that income can be as high as 24 percent. Social Security COLA increases, if you are young and disabled, you don't pay tax on that kind of income, but if you are elderly, that is also included in the calculation of this tax, and the tax rate can be 12 percent.

Now, these are very, very pernicious marginal tax rates. They fall on capital. They do harm to the economy. What do we get in return? Well, in 1989, the NCPA, my organization, made a forecast of what we would gain and what we would lose by increasing the Social Security benefits tax from 50 percent to 85 percent of benefits.

We discovered the revenue gain would be small, only about $4 billion a year in the short run, but in the long run the revenue loss would be much larger, about $14 billion, certainly by the end of the decade, and the reason for the revenue loss is that when you tax capital income this heavily, you really discourage investment. You really reduce the Nation's capital stock, and the country pays a price for doing that. Thank you very much.

[The prepared statement and attachment follow:]

Rolling Back Taxes on Social Security Benefits

By John C. Goodman

When the portion of Social Security benefits that is subject to taxation was increased from 50 percent to 85 percent in 1993, the Clinton administration called it an "entitlement spending reduction." In fact, it was a tax increase on investment income and wages of elderly Americans. This increase in the amount of benefits subject to tax has increased marginal tax rates faced by the middle-income elderly to a record high, resulting in less capital and labor, a slower rate of economic growth and a lower income for all Americans.[1]

The portion of a person's Social Security benefits that is taxable is determined by a complex formula. The elderly pay income taxes on 50 percent of their Social Security benefits if their total income (calculated by including all tax exempt income and one-half of their benefits) is between $25,000 and $34,000 for an individual or between $32,000 and $44,000 for a couple. If their total income (measured the same way) exceeds $34,000 for an individual or $44,000 for a couple, they pay taxes on 85 percent of their Social Security benefits.

Here is an example of how the formula works: Suppose an elderly couple receives $12,000 in Social Security benefits and $26,000 in other income. Their total income is $32,000 as measured by the formula — $26,000 plus one-half of the benefits ($6,000). Thus, the income tax would apply only to the $26,000 in non-Social Security income. If this couple earn $1 more, however, the income tax applies to that $1 *plus* 50 cents of Social Security benefits. If they earn $12,000 of additional income, an additional $6,000 (one-half of their Social Security benefits) is taxed. This puts the couple at $44,000 as measured by the formula. If they earn $1 more at that point, the income tax applies to that $1 plus *85* cents of Social Security benefits. And so on until 85 percent of their total Social Security benefits are included in taxable income.

The Social Security benefit tax usually is described as a tax on *benefits*, but in fact, it is a tax on other *income*. No tax is paid unless a taxpayer's income reaches a certain level. Beyond that point, the tax rises as income rises. Since 85 cents of benefits is taxed for each additional $1 of income, when elderly taxpayers earn $1 they pay taxes on $1.85. The effective tax rate on income is 85 percent higher than otherwise.

The High Tax Rate on Savings. About 60 percent of the income of elderly taxpayers comes from investments (including pensions).[2] For most younger people, the tax rates on investment income are 15 percent and 28 percent. Yet, because of the Social Security benefit tax, the rates for the elderly on income from savings can be up to 85 percent greater than the rates for the younger people.[3] As Table I shows:

- Elderly taxpayers in the 15 percent income tax bracket pay an effective rate of 27.8 percent (15% x 1.85).
- Elderly taxpayers in the 28 percent tax bracket pay an effective rate of 51.8 percent (28% x 1.85).

The Higher Tax Rate on Workers. Many elderly people continue to work — their marginal tax rates are higher still. When the Social Security (FICA) tax (7.65 percent) is added to the income tax rates of 15 and 28 percent, marginal tax rates for younger workers are 23 and 36 percent.[4] For the elderly between 65 and 70 who earn more than $11,280 in wages per wage earner, there is an additional penalty. They lose $1 of Social Security benefits for each additional $3 of earnings. For those under age 65, the

---

[1] This subject is discussed in detail in Aldona Robbins, Gary Robbins and John Goodman, "Should 85 Percent of Social Security Benefits Be Taxed?" National Center for Policy Analysis, NCPA Policy Backgrounder No. 126, June 10, 1993.

[2] See Aldona Robbins and Gary Robbins, "Elderly Taxpayers and the Capital Gains Debate," National Center for Policy Analysis, NCPA Policy Report No. 153, July 1990.

[3] Assumes taxpayer is below the maximum Social Security benefit tax.

[4] We have counted only the employee's share of the FICA tax because that is directly deducted from the paychecks of workers. Most economists, however, would agree that workers pay the employer's share (also 7.65 percent) as well in the form of reduced wages. Our calculations of marginal tax rates, therefore, are conservative.

TABLE I

How the Social Security Benefit Tax Affects Marginal Tax Rates on Income from Savings

Income Tax Bracket	Social Security Benefit Tax	Total Tax
15%	12.8%	27.8%
28%	23.8%	51.8%

TABLE II

Marginal Tax Rates on the Wages of Elderly Workers[1]

Ages 65-70

Tax	15% Bracket	28% Bracket
Income Tax	15.00%	28.00%
FICA Tax	7.65%	7.65%
Social Security Earnings Penalty	33.33%	33.33%
Social Security Benefit Tax[2]	10.63%	19.83%
Total Federal Tax	66.61%	88.81%

Ages 62-64

Tax	15% Bracket	28% Bracket
Income Tax	15.00%	28.00%
FICA Tax	7.65%	7.65%
Social Security Earnings Penalty	50.00%	50.00%
Social Security Benefit Tax[2]	9.56%	17.85%
Total Federal Tax	82.21%	103.50%

[1] Workers are assumed to be below the caps on the FICA tax, the Social Security benefit tax and the Social Security earnings penalty (which becomes zero once all benefits are lost).

[2] The Social Security benefit tax rate is lower than the rate shown in Table I because of the loss of benefits due to the earnings penalty.

penalty is even more severe: if they earn more than $8,160 in wages, they lose $1 of benefits for each additional $2 of earnings. Add these penalties to the FICA tax, the income tax and the Social Security benefit tax, and as Table II shows:

- Workers between 65 and 70 years of age face a marginal tax rate as high as 88.81 percent.
- For workers ages 62 through 64, the marginal rate can be as high as 103.5 percent.
- This means that workers pay as much as $1.04 in taxes when they earn an additional $1.00 of income.

For some workers the rates can be even higher. For example:

- If workers face a state and local income tax rate of 5 percent, the highest marginal tax rate on wages climbs to 112.5 percent.
- For workers who are also self-employed — and thus are paying a 15.3 percent FICA (Social Security payroll) tax — the marginal rate climbs to 120.4 percent.
- To cite an extreme example, there are circumstances under which elderly workers who are self-employed and living in Montana can face a 130 percent marginal tax rate.[5]

The Long Reach of the Benefit Tax. Because of the way income tax returns are organized, many elderly taxpayers do not realize that the Social Security benefit tax actually taxes income. Many also are unaware of how far-reaching it is. The Social Security benefit tax reaches capital gains income, tax-exempt income and Social Security COLA increases. And because many states accept the federal definition of taxable income, it increases some state and local income tax rates by 50 percent.[6]

- Capital gains income is subject to the 52 percent top rate for persons receiving Social Security benefits versus 28 percent for others.
- Tax-exempt income can be taxed at a rate of 24 percent versus a zero rate for younger taxpayers.
- Social Security cost-of-living adjustments (COLA) increases are taxed at a rate as high as 12 percent.
- And state and local income taxes can be increased as much as 9 percentage points.

A Tax on Middle-Income Families. These high marginal tax rates affect the incentives of middle-income families, not of the wealthy elderly. Once a taxpayer reaches an income level at which fully 85 percent of Social Security benefits are taxed (about $30,000 of other income for an individual and about $42,000 for a couple), additional income is taxed at ordinary tax rates.[7] The wealthy elderly, who face a marginal tax rate of 31 percent, 36 percent or even 39.2 percent, are made worse off by the Social Security benefit tax. But the tax does not affect their economic decisions. The middle-income elderly, on the other hand, are affected directly. High marginal tax rates affect their decisions to work additional hours, invest in or sell assets and realize other types of income.

---

[5] Based on a 14 percent state income tax rate that applies to Social Security benefits.

[6] At least 15 states tax Social Security benefits: Colorado, Connecticut, Iowa, Kansas, Minnesota, Missouri, Montana, Nebraska, New Mexico, North Dakota, Rhode Island, Utah, Vermont, West Virginia and Wisconsin. See David Baer, "State Taxation of Social Security and Pensions," American Association of Retired People (AARP), Public Policy Institute, Issue Brief No. 13, June 1992.

[7] Assumes the individual receives a benefit of $10,000 and the couple receives a $20,000 benefit. Someone who always earned the average wage retiring at age 65 in 1993 would be entitled to a benefit of $9,853. *1993 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, Washington, DC, April 1993, Table II.F.12, p. 112.

The argument for taxing Social Security benefits is that the beneficiaries paid for only a small portion of their benefits through payroll taxes.[8] Even if the argument is accepted, beneficiaries should be taxed at the same marginal tax rate as all other taxpayers. For example, a portion of Social Security benefits could be included in the ordinary income of elderly beneficiaries — taxable at ordinary income tax rates. Then the elderly would face the same marginal tax rates as younger taxpayers. Exemptions could be raised to prevent undue hardship for the low-income elderly without increasing marginal tax rates.

Encouraging the elderly to work and to save is important to the economic well-being of the nation. The withdrawal of elderly workers from the labor market is costly for the nation as a whole. In addition to their talents, they contribute to the nation's output of goods and services, and to both tax revenue and Social Security revenue, when they work. The Labor Department warns that in the long run we face labor shortages and elderly workers will be needed to help fill the gap.[9]

Although the elderly constitute only 12 percent of the population, they hold about 40 percent of all capital assets in the United States.[10] The driving force behind the American economy is its ability to combine labor with larger and larger amounts of capital. More capital per worker leads to more output per worker. These productivity gains result in higher wages and a higher standard of living for all Americans. To the degree that government discourages saving for the retirement years everyone is worse off — old and young.

---

[8] Note that the argument can easily be reversed for young workers. Many of today's young people will pay more in Social Security taxes than they will ever receive in benefits. So, if the goal is to make taxes equal benefits, we should lower the payroll tax for the current generation.

[9] *Labor Market Shortages*, U.S. Department of Labor, 1989.

[10] Aldona Robbins and Gary Robbins, "Taxing the Savings of Elderly Americans," Appendix B.

Mr. BUNNING. Thank you. Mrs. Johnson will inquire.

Mrs. JOHNSON. Thank you. That was a very interesting exchange amongst you on a difficult issue. I think pretty much you covered my questions. Thank you.

Mr. BUNNING. Mr. Herger.

Mr. HERGER. No questions.

Mr. BUNNING. Mr. Jacobs.

Mr. JACOBS. Mr. Chairman, I just have an observation for the record. I think what we need here is a primer between taxes and benefits. Taxes are something citizens pay to the government. Benefits are something the government pays to citizens.

For example, if you had somebody on welfare and he or she found a job, took it, and performed it, we don't say that that person had a marginal tax increase because he or she could no longer receive welfare benefits. Yet I hear now and then people indicate that if the government will not pay Social Security benefits to someone who is not retired by the kind of definition that has been a part of the act since the thirties, that that person somehow or another, because of the denial of benefits, had a marginal tax increase. I might add that much of the Social Security benefit could be classified as welfare since it hasn't been paid for by the recipient. We don't call that a marginal tax. We say that that person no longer is eligible for the taxpayers to help him or her. Now, the next thing I want to say is nothing.

Mr. GOODMAN. May I respond to that?

Mr. KLECZKA. The nothing or——

Mr. GOODMAN. I have great respect for Congressman Jacobs.

Mr. JACOBS. I return that respect, sir. Obviously, you are a scholar. We have a difference of opinion. I have no disrespect for you, I assure you.

Mr. GOODMAN. But just real quickly——

Mr. BUNNING. No. Mr. McCrery will inquire.

Mr. MCCRERY. Dr. Goodman, if you would like to expound upon your objection to that statement.

Mr. GOODMAN. It really doesn't matter whether we call a withdrawal of welfare benefits a tax or a withdrawal of benefits. Economists can calculate an implied marginal tax rate, so that from the point of view of the welfare recipient, the question is if you go out and earn $1, what do you lose.

The same analysis can be applied to the elderly. That is what is going to determine behavior, not whether we call it a tax or whether we call it a benefit. What does the person get at the end of the day if he goes out and earns $1, that is the critical question.

Mr. MCCRERY. Thank you, Dr. Goodman.

In fact, you have precisely laid out why the explanation Mr. Jacobs gave us is of little import. In fact, some economists do talk in terms of marginal tax rates with respect to the welfare system, and the incentives in that system, so I don't think it is particularly important whether it is a benefit or whether it is income.

The fact is, as you pointed out, the penalties imposed—whether it is a tax or a withdrawal of benefits—by the government has an effect on that person's behavior, and that is what we are talking about here today. That is what most of you have talked about today, and I agree that the current system has the effect of discour-

aging work on the part of seniors in this country, and therefore we lose a good bit of productivity.

We lose some of our most productive workers, and I think that is a shame, so I am glad to hear your testimony today, glad to know that most of you, at least, agree that the increase in taxes imposed upon senior citizens in the 1993 bill was ill advised. I am glad you agree with us that we ought to put it back to the State that it was in prior to the 1993 tax bill. Thank you, Mr. Chairman.

Mr. BUNNING. Mr. Levin.

Mr. LEVIN. Thank you very much. Let me just ask a couple of questions to those of you who favor the repeal of this. Do you have any ideas as to how we would make up the difference for the Medicare fund? Dr. Goodman, do you?

Mr. GOODMAN. I don't have an opinion. Do you have an opinion?

Mr. LEVIN. You don't have any suggestion as to how we do that?

Mr. GOODMAN. No particular suggestion.

Mr. LEVIN. How about a general one? I mean seriously, because I don't think this should be judged, I want to make it clear, solely on that basis. If something is basically inequitable, we should try to take action to remedy it, but it is relevant to the issue where we make up the difference.

Mr. GOODMAN. Well, I think there are a lot of problems in the Medicare program, and the program needs very careful and serious attention from the Congress and from this committee. One of the things it needs to change is we can't keep giving first dollar coverage and lavish health care benefits to elderly Americans who, after all, have more after-tax income and more assets than the younger population, and expect the younger population to keep bearing that burden. We are going to have to do something that involves the elderly taking more financial responsibility for their medical bills. That is my general comment.

Mr. LEVIN. So your proposal would be to give back, to return some of the money that we tax, but then to assess them as they obtain health care?

Mr. GOODMAN. No, I don't have a specific proposal, but generally the elderly population as a group are going to have to take, it seems to me, more responsibility for medical bills, and that is the general way in which we should seek to solve the problems of Medicare.

Mr. LEVIN. But isn't that what this does in part? What this does is to say to seniors somewhat on an income level basis, you are going to pay more for your health care because this goes into the Medicare fund, so I am not quite sure——

Mr. GOODMAN. You don't have to solve the problem that way. As Mr. Entin pointed out, there are other ways to solve this problem. You could take Social Security benefits and make them part of taxable income, period, and then you wouldn't have these real high marginal tax rates or you could take half the benefits or 85 percent of benefits. There are different ways to solve the problem without having the severe high marginal tax rates apply to elderly investment income and wage income.

Mr. LEVIN. So if we did that, making—if we came up with this same amount of money from taxing Social Security benefits, it would change the impact of the tax, right? It would shift the tax

burden more from higher income to middle income and lower income seniors, would it not?

Mr. ENTIN. Not necessarily, sir. If you pick your thresholds carefully, you can hit roughly the same group of people you are hitting now, and to roughly the same extent you are hitting them now, but you don't have the interaction with the other income.

It is a change in method to get roughly the same money from roughly the same group without the side effect. If you are chopping wood and you have the choice between a dull axe and a sharp axe, and the dull axe is going to bounce off the log and hit you in the foot and the sharp axe is going to cleave the wood properly, you may get the same splitting of the wood, but you are going to get it more safely with fewer side effects because you take the sharp axe—in this case, the alternative tax mechanism.

Mr. LEVIN. I understand that. Let me ask you this, though, if you don't relate it to other income, how do you relate it so that——

Mr. ENTIN. I can explain that if I have 30 seconds.

Mr. BUNNING. You have 1 minute.

Mr. ENTIN. A person with high Social Security benefits had a high earnings history, otherwise the formula would not have given him a high benefit.

Mr. LEVIN. But wait 1 minute, high but nothing compared to—you can have people who——

Mr. ENTIN. Follow me for just a moment. If you have had high earnings—suppose you are getting maximum benefits because you have had maximum covered earnings all your working life. Contrast that with someone whose benefits are below average because his earnings were quite low all his working life.

You will find an enormous correlation between the high beneficiary and high pensions and high saving and high alternative income versus the below average beneficiary who, because he had very little to save with all his life, probably has a small pension and very small savings. So the groups of people who have high benefits also tend to be the groups of people who are over these thresholds, whether it is the 50-percent or the 85-percent threshold.

So if you simply have an exempt amount of benefits, people below that tend to be lower income, and people above that tend to be higher income with the higher pensions, with the higher interest, with the higher dividends. It is true, you may find somebody who has very high Social Security benefits, but very little other income. However, that would have to be a person who was quite well to do all of his working life, but frittered it all away and did no saving at all, and is falling back on these high Social Security benefits in his old age. I don't feel sorry for that person when you look at the damage you are doing to the national economy with these high tax rates.

There are very few people who have very little other income who would be taxed under this alternative system.

Mr. LEVIN. Mr. Chairman, thanks for your indulgence, we went a bit beyond. I hope someone else will pick up that line of questioning because, as I understand the Social Security system, you may be calling people high income who are very much in middle-income ranges, and I think there would be a substantial shift in burden if we followed yours from high income to middle income.

Mr. BUNNING. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. Mr. Goodman, I want to go back to the $1 and $3 that you mentioned about the benefits for those 65 to 69. There is really not a reduction in benefits that are received by those individuals. I mean the benefit level stays the same, 65 to 69 based on previous earnings and contributions, whether they work or they don't work.

The $1 out of $3 is actually a penalty that is assessed on those who work and earn beyond the limit; is that not true?

Mr. GOODMAN. That is correct.

Mr. COLLINS. Ms. Moon, you are apparently the only one on the panel to really argue against tax—that argued that taxing benefits for seniors just ensures that they pay a more fair share. How do you—what do you mean, pay more fair share? These people have worked for years and are retired. Do you not consider that their previous history was participating and fair?

Ms. MOON. I believe that social insurance benefits are very important to Americans. But, I also believe that it is very important to maintain the actuarial balance in the program, and over time we are going to have to face some changes in both Social Security and Medicare. My support for this particular piece of tax policy is not because I think it is the ideal tax policy if I were going to redesign our whole system of taxes and government programs, but when I look at the range of options, particularly in terms of what will happen if we roll back this tax, I don't see any of them as improvements.

I could agree with my colleagues about ways to change the taxation of Social Security so that it is done in a slightly fairer manner, but I think that these specific proposals would pass additional burdens onto lower income individuals. I understand why the thresholds were put in place which lead to the spikes in marginal tax rates. They are there to protect low-income senior citizens, and I think that that is a very important principle to retain.

If what we are talking about here is changing taxation of Social Security to make it fairer, I don't have an objection. But I don't think that that is what the Contract With America is saying. I think it is saying let's roll taxation of Social Security benefits back, and get rid of it, and then it is silent in terms of what the next step will be. The likely next steps are the reason why I am here talking about this proposal, which I oppose but not because I think that senior citizens are undeserving.

Mr. COLLINS. Does anyone else care to comment on that?

Mr. SHREVE. Just to this whole issue that we are talking about right now that Mr. Levin opened, and I guess I am the resident oldtimer on this panel, and I can speak from a little different perspective. This whole problem is complicated and now is interwoven because of the fact that the additional moneys that were raised when the level went from 50 to 85 percent went into the Hospital Insurance Trust Fund.

If that is stopped, then as I mentioned, there becomes a $15 billion or so shortfall in a 5-year period. That has to be made up somehow, and the whole thing started not because Social Security was in trouble and the hospital insurance thing was added as something to do to avoid a point of order on the Senate side dealing

with the Social Security trust fund, and so what we have is a complicated situation that has implications for the Hospital Insurance Trust Fund.

It has implications for the recipients of Social Security, and it also has implications on the budget deficit, and I think all of these are going to have to be addressed together. I don't think we can tinker with one part of it and tinker with another part and tinker another part and have it all come out. I think we have to look at what the serious problem is, that there is a budget deficit, that we do have an unfair system of taxation at this point, and that we have a Hospital Insurance Trust Fund that has a drop-dead date of 6 or 7 years hence.

Mr. COLLINS. In other words, what I hear you saying is that in order to put—the manner in which the funds were put into the Hospital Insurance Trust Fund was just a means of raising revenue, even though it went into a trust fund as the Social Security is supposed to go into a trust fund. Those trust funds are income, and they do help offset and hide a true deficit; is that not what I understood you to say?

Mr. SHREVE. That money goes into the Hospital Insurance Trust Fund, but that was not the original intent of the increase in the tax. The benefits went from a taxation level of 50 percent to 85 percent in order to reduce the deficit, not to help the insurance trust fund, but because of a procedural thing on the Senate floor, it wound up going into the Hospital Insurance Trust Fund.

Mr. COLLINS. That is right. Thank you, sir.

Mr. BUNNING. The gentleman's time has expired. Mr. English will inquire.

Mr. ENGLISH. Thank you, Mr. Chairman. I simply want to thank the witnesses for taking the time to appear and provide their individual perspectives on this issue.

As the chairman knows, we have already had hearings which Mr. Entin has participated in on this issue before the subcommittee. I am grateful for your appearance here today, and I will simply yield back my time.

Mr. BUNNING. Mr. Kleczka will inquire.

Mr. KLECZKA. Thank you, Mr. Chairman. Let me follow up on the line of questioning that Mr. Shreve was responding to. Even though the dollars from the 85-percent taxation of benefits went into the Medicare Trust Fund, is it not true that those $15 billion would be available to fund programs coming out of that trust fund?

Mr. SHREVE. Yes, the $15 billion is for the Medicare part A.

Mr. KLECZKA. Right, so it had the effect of not only helping out on the deficit because it was a balance in the trust fund, but when those funds were needed for Medicare part A expenses, they would be used?

Mr. SHREVE. That is right.

Mr. KLECZKA. Now, with you advocating repeal of that tax revenue, know full well that the Medicare Trust Fund will now be broke. In fact, it had an ending surplus of $3 billion, which is not much to speak of. Now, could you help this committee in indicating how best to replace those needed revenues?

Mr. SHREVE. As I indicated, I think that is a very complex problem which we are not going to settle in——

Mr. KLECZKA. But wait 1 minute, it is easy to come before the committee and advocate tax decreases, but know full well for your constituent group, which is a major constituent group of mine, it is going to provide a very big hardship.

This committee and the Republican contract are looking at some very gigantic cuts in Medicare, OK? This will exacerbate that problem.

Mr. SHREVE. Exactly.

Mr. KLECZKA. What we are doing by your advocating repeal of this actual taxation is to take some dollars and put it in this pocket for the senior citizen, knowing full well that under the Contract we are going to take it out plus the wallet, OK? So I would be very—I would be extremely careful of your position on this because I think you are going to do more harm than good for the people that you represent.

Know full well that once this tax is repealed, 80 percent of the benefits are going to go to families, senior families with incomes over $75,000 a year, OK? But when it comes to cutting Medicare, that distribution will not be the same because the cuts are going to go to the poorest and the least able to afford them, sir.

Mr. SHREVE. Exactly, and that is why in the past we have worked with this committee in helping to——

Mr. KLECZKA. Well, then work with me today and indicate how we can make up those lost revenues, which will total $15 billion.

Mr. SHREVE. I can't come up with $15 billion.

Mr. KLECZKA. You know what? I got the same problem because I can't, either. Now we have a real dilemma.

Mr. SHREVE. As I say, we are willing to continue to work with the committee in that respect.

Mr. KLECZKA. Well, swell. Mr. Entin, do you have any response or any recommendation for the committee?

Mr. ENTIN. I recommended a revenue neutral change.

Mr. KLECZKA. I'm sorry, could I finish the question unless you know the question before I ask it. Do you have any possible solutions as to replace $15 billion in the Medicare Trust Fund?

Mr. ENTIN. I don't have to. I recommended a revenue-neutral change in the testimony.

Mr. KLECZKA. You don't have to, OK, good. Thank you.

Mr. BUNNING. Mr. Christensen will inquire.

Mr. CHRISTENSEN. I wanted to ask Dr. Goodman if he had any input on the question that was asked Mr. Shreve, and whether or not taking the moneys into the Hospital Insurance Trust Fund maybe didn't set a bad precedent. Mrs. Moon said that she might have an idea for going along with fairness in terms of the tax policy. Mr. Entin, Dr. Goodman, would you identify a better tax policy for seniors and Social Security benefits if there is one. Do you have any suggestions?

Mr. GOODMAN. Well, I agree with a couple of the principles that Marilyn Moon laid out in her testimony, and one of them is if people earn the same income, they should be taxed at the same rate, and if we regard Social Security income as income, then we should put Social Security income into the taxable income of the elderly, or at least some portion of it. That would be a fair way to treat

Social Security income. Then an elderly person and a young person earning the same income would pay the same tax rate.

Mr. CHRISTENSEN. So there could be an argument made for dropping the tax altogether?

Mr. GOODMAN. Yes, but what I am saying is you could take Social Security benefits or some portion of Social Security benefits and make it part of every elderly person's taxable income. If the person only had Social Security benefits, they wouldn't pay any income taxes, but if they have a lot of income, they would be paying taxes on their Social Security benefits along with other income. You would still have a very modest—modest is the wrong word, you would still have the elderly facing the same marginal tax rates as young people.

Mr. ENTIN. I think either of the approaches in my testimony would accomplish what I think you are trying to get at. If you were to try to raise roughly the same revenue with some exempt amount of benefits, you would have an enormous overlap of something like 80 percent of the same people being subject to taxation of benefits as are under current law, but you wouldn't have the tax spikes. You wouldn't have that much of a revenue differential you would have to make up for.

If you really were trying to tax Social Security benefits the same way everybody else's income is taxed, you would probably simply have to say, "You have contributed a certain amount over your lifetime to Social Security. We won't tax you on your benefits until they have exceeded that amount, and then anything else you receive must be added into taxable income." That is the way we used to treat pensions.

I think that would gain you quite a bit of revenue. If you really want to keep sheltering some of the middle-income people from the taxation of benefits, you could give them an exempt amount on top of that, and I think you could still roughly break even.

Again, the overlap wouldn't be perfect, but it would be enormous, and you wouldn't be making that radical a change. But if you go that route, you would have to eliminate the 50-percent taxation of benefits, and the 85 percent, getting rid of both thresholds, and go to an exempt amount instead. You need to be bolder to have less trouble.

Ms. MOON. One thing we should be very clear about here is that, with the exception of the American Association of Retired Persons, all the members of this panel are not saying roll back taxes on seniors. My two colleagues on the panel are simply saying do it in a different way.

I am satisfied to leave the taxation where it is in terms of fairness. I think it does a pretty good job of meeting the test of fairness. It is a little awkward, but this results from good intentions to protect lower income seniors. I would not be opposed if the proposal of this committee was to accept the changes others on this panel have discussed, if the exempt amount was set at a high enough level so it achieved the protection of low-income individuals.

I think it is unrealistic to talk about rolling back this tax and not talking about what will happen in place of it. Something will

happen in place of it, and my fear is that the response in Medicare will be less desirable than the tax that we have now.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

Mr. BUNNING. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. Mr. Shreve, let me ask you directly, would you support this proposal if it was your understanding that it was going to be financed directly by cuts in the Medicare program?

Mr. SHREVE. I don't think we could support anything at this point that is going to produce more cuts in the Medicare program because they sustained a very great number of cuts in recent years.

Mr. NEAL. I am on your side on that entirely. In a followup question, would you oppose the Contract With America if you determined that it was going to be financed by cuts in Medicare? Would you urge your members to do that?

Mr. SHREVE. I don't know, all I can say about the Contract With America, it is a document. It is not a piece of legislation, and until we have legislation that we are looking at specifically, and we know what the tradeoffs are, I don't think we can take a position until we know precisely what the gives and the takes are.

Mr. NEAL. Well, the other side is purporting that this document will leave very little room for any sort of negotiation. It will leave very little room for modification, and as a result, I guess the question that we are trying to pose on this side is where will you be once you determine that it is going to be financed by huge cuts in Medicare.

Mr. SHREVE. We are going to have very serious reservations because, as I say, there is only so much that can be cut out of Medicare and still have a Medicare program because access then becomes a problem.

Mr. NEAL. OK. I think that is fair enough, and let me ask Mr. Goodman; Mr. Goodman, in your testimony you seem fairly flexible about what you were laying out in front of us. How would you propose that we make up the $15 billion cut and avoid touching Medicare?

Mr. GOODMAN. OK, No. 1, I think on a dynamic scoring basis, this tax cut pays for itself.

No. 2, put that aside, the right way to tax Social Security benefits is to make Social Security benefits part of everyone's taxable income, and that way if you are poor you won't pay any more taxes, but if you are wealthy, you will. That is the right way to do it. You don't have to put them all into taxable income. You could put some portion of it, but that way you hit wealthier—the wealthier elderly will pay more taxes, but their marginal tax rates will still be comparable to young people's marginal tax rates.

Mr. NEAL. How would you—the dynamic scoring piece, now you have intrigued me by offering that reference. How would you suggest or how would you counter the argument that has been offered by Alan Greenspan and other leading economists, including many think tank people who are not given to partisan political activity? That dynamic scoring under careful scrutiny and being put under the magnifying glass really doesn't make it?

Mr. GOODMAN. Well, with all due respect to Alan Greenspan, it was his committee that proposed this tax, and the original proposal

was even worse than what we have now, and I don't think that committee ever considered what this tax does to marginal tax rates and I don't think it ever considered that this tax is really a tax on the pension plans and deferred savings accounts of young people, and if you take into account that this is a tax on capital, including all deferred savings and that those taxes affect behavior, then it seems to me you have to recognize that this can't be good for the economy.

Mr. NEAL. Are you a supporter of Mr. Greenspan?

Mr. GOODMAN. I am not a supporter, I am not a detractor. I think he has done, until very recently, a reasonably good job at the Federal Reserve.

Ms. MOON. Could I say something about dynamic scoring?

Mr. NEAL. Please do.

Ms. MOON. Even if dynamic scoring were used, this rollback of the taxes would still leave a $15 billion deficit in the Hospital Insurance Trust Fund. It wouldn't make any difference if there were dynamic scoring or not because those dollars would not be dedicated to the Hospital Insurance Trust Fund.

Mr. NEAL. OK.

Mr. ENTIN. A small portion would be, if you did get a larger labor force, and they were paying more payroll taxes, a portion of that payroll tax would be dedicated to the Hospital Insurance Trust Fund. Part of the problem is you have all of these firewalls in the tax system, this tax goes here, that goes there, this other one goes into the highway trust fund, etc. Then there is Medicare part A, and Medicare part B that are separate from the Social Security retirement program.

When you are dealing with the total budget, you really need to leave yourselves a little bit more flexibility to take a little bit from over here and put it over there in case you don't want to take it out of the hospital insurance program. You may want to take it out of some other program or sell off some government assets somewhere to tide you over until you have time to actually fix hospital insurance.

Right now you have tied yourself up in knots. I appreciate your difficulties, but I am sorry, you were the ones who passed that large knot-tying exercise.

Mr. NEAL. Do you think Mr. Greenspan ought to be reappointed?

Mr. ENTIN. I was referring to Mr. Greenspan's chairmanship of the National Commission on Social Security Reform back in 1982 and 1983 that led up to the 1983 Social Security amendments. I don't think anyone here is upset with his performance at the Federal Reserve Board. It was the National Commission exercise that led to this particular problem.

Mr. BUNNING. The gentleman's time has expired.

Mr. NEAL. Thank you, Mr. Bunning.

Mr. BUNNING. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman. I want to thank all of our witnesses for being here and helping us on this issue of taxation related to Social Security income.

I can appreciate the fact that many Americans believe that we should reduce taxes or that the marginal tax rates are too high. I

would like to focus on the fairness of the relative treatment of income.

I would like to think that there is some rational basis for our Tax Code giving tax preference to some income. Social Security, for example, is not subject to the normal income taxation for certain people at certain income levels and certain percentages.

I would like to know why there should be a tax preference for Social Security income vis-a-vis private pension plans or other types of income that people invest in or receive which is subject to normal taxation.

In private pensions, there is a tax provision that states that any contributions that one makes with dollars, that that person has already paid taxes on, can be taken back out without that person paying a double tax. That makes sense and so does the provision which states that the other incomes that you receive from your pension plans should be subject to the normal tax rules.

For Social Security the Tax Code is very different. In the 1993 tax provisions, we used, for people of incomes over the $40,000 threshold, rough justice to say that 85 percent was approximately what the Social Security recipient did not contribute on after-tax dollars. This 85 percent mark was used to try to give some parity between Social Security and private pension returns. I would just like your justification for the repeal of the 1993 tax provisions on the Social Security income. Why should there be a tax preference for those who receive Social Security versus those who receive a private pension fund?

Mr. GOODMAN. My position is that this is the worst, most harmful way that I can think of to raise $4 or $5 billion a year.

Mr. CARDIN. You are missing my point. What is the differential? I am trying to take two taxpayers in the same situation, one receiving a private pension, the other is receiving Social Security; one paying taxes, the other not.

In the exact same economic circumstances, what is the justification for giving tax preference for income received by the Social Security recipient when that recipient never paid any taxes on that income?

Mr. GOODMAN. I don't believe there is any justification and therefore as I have said and Mr. Entin has said, the fair and right way to do it is to make Social Security income part of everyone's taxable income, so that the elderly pay taxes on their benefits and face the same rates as younger people.

Now, I recognize that if you promise people for a long, long time that it is not going to be done that way, you have a political problem and maybe also an economic problem in making that change, but you are right. There isn't an argument for treating the two kinds of income differently.

Mr. ENTIN. I agree. We didn't recommend that you not tax the benefits. We just simply highly protested the way it was tied in with other income and led to these peculiar tax spikes. As for the 85-percent figure, you raise a very good point. These are arbitrary percentages. They may or may not accurately reflect what the individual paid in contributions versus what the individual gets back in benefits, and what part of the contribution (the employee's half) has not yet been taxed.

Furthermore, over time, the relationships are going to change wildly. You know about the very large impending deficit of the system. Either you are going to have to raise the taxes or trim the benefits, and fairly soon. But when you do that, 85 percent, if it is the right number now, will certainly not be the right number down the road. I would not quite know how to tell you what is the right number.

Ms. MOON. The rationale for continuing some preference for Social Security income is that taxing the incomes that older persons have will lower their standards of living. In that case, Social Security might not be sufficient.

If so, then you would want to readjust Social Security to make it higher to return the net impact to a more desirable level. I believe that older Americans with low incomes need that additional protection. Those at higher levels don't need nearly as much protection, and, thus, while I think this is rough justice at best, it is a reasonable tax policy in a world in which we seldom have the ideal tax policy on the table.

[The following was subsequently received:]

Bringing lifetimes of experience and leadership to serve all generations.

January 20, 1995

The Honorable Bill Archer
Chairman, Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Archer:

In the interest of time, I did not respond to Representative Cardin's question at the January 19th hearing regarding a rationale for taxing Social Security income differently from private pension income. I would appreciate your inserting my written response in the appropriate place in the hearing record.

Some maintain that Social Security is like a private pension, and therefore should be taxed more like a pension. While both programs provide income in retirement, the simple fact is that Social Security is not a private pension. Social Security is a mandatory, government-sponsored, portable program with almost universal coverage. The private pension system is a voluntary, employer-established program that is rarely portable and covers less than fifty percent of the workforce. Social Security is based on a progressive benefit formula that provides a greater rate of return for low-wage earners. The private pension system is based on myriad plan designs that more often favor the relatively higher income earner. Social Security is partially pre-funded with generally no access to contributions before retirement (or disability). Private pensions are generally advance-funded, and access to money pre-retirement is common. Social Security is social insurance and is the base of retirement security. Private pensions represent a privately sponsored, tax-subsidized income supplement.

Those who argue that Social Security should be taxed as a pension fail to fully recognize these substantial policy differences. In fact, policy goals often have led to different tax treatment where fundamental differences exist. For example, the tax code treats mortgage interest payments different than rental payments (even though both are for housing), and employer provided health benefits different than wages (even though both are forms of compensation). Similarly, Social Security is appropriately taxed differently than a pension.

The 1993 tax may serve to undermine the program. By adding additional taxes to an already progressive Social Security benefit formula, these changes risk undermining the widespread public support the system enjoys. Dramatic changes that substantially erode net benefits will further undermine public confidence that the Social Security system will provide a fair return on contributions.

Once again, thank you for letting the American Association of Retired Persons testify at the January 19th hearing.

Sincerely,

Robert Shreve

Robert Shreve, Chairman
AARP Board of Directors

Mr. CARDIN. Thank you.

Mr. BUNNING. The gentleman's time has expired. Let me try to clarify a couple things that I have heard since I have not had a chance to question anyway. We talked about cuts in Medicare.

In the 1993 reconciliation bill there were no real spending cuts if you want to talk about cuts, I call them reduction of increase because they weren't actually cuts. They were a reduction in increase of about $56 billion in that reconciliation bill, and Mr. Neal has left, but he also talked about cutting Medicare to pay for these benefits.

If he is talking about reducing the increase that is projected for the next 5 years in the budget that will be coming down, there was approximately an 11-percent increase projected in Medicare increases, and if you are talking about reducing the increase from 11 to 6 percent, it seems to me that is still a 6-percent increase in funding for Medicare, not a reduction, so I am having trouble with the word "cuts."

The fact of the matter is if we are talking about low-income seniors, another portion of the Contract is aimed at raising the earnings limit, I am talking about people who go to work, not passive income. I am talking about actual wage earners. We are penalizing that senior who is dependent on Social Security income to pay their bills with a Social Security earnings limit now, and I think it is very important that we look at the consequences of that social policy that we now have in effect in our Tax Code because it is a social policy.

It is bad policy to say to a working senior that if you earn over this amount of money, we are going to penalize you, and you are going to have to give back part of your Social Security benefit. The senior that needs to work is the person that we have to really look out for, the senior who—is collecting Social Security on top of other unearned income, savings, pensions. We don't want to make a social policy in this country that penalizes savings, either, and those are people we are talking about penalizing with raising this tax up.

So I want to make sure that it is understood that part of the Contract addresses the working senior, the person who has to work to pay their bills. By increasing the earnings limit over a period of 5 years to $30,000, I think we are going to do and accomplish that goal. When seniors cannot pay their bills on Social Security income, we have to address that, and we are going to do that.

I would like to see us adopt dynamic scoring. I heard Chairman Greenspan's testimony at the Budget Committee and I dramatically disagree with Chairman Greenspan. That is my privilege. He said that we don't have enough data to do it. I hate to tell you this, but Great Britain has been doing it in their budget scoring for quite a long time, and so we ought to have the same skills in the United States of America that they have in Great Britain. We can estimate a little better through a different scoring method how many dollars we are going to receive, and I am sure with all the data that the Federal Reserve gets in trying to project what to do as far as interest rates are concerned, fiscal policy, we ought to have the ability to score better than we do now. If necessary, let's go to Great Britain and England and find out how they do it.

I want to thank you all because your testimony was very good, and it is very important that we understand the social policies and the political reality of reducing taxes. These policies have a very dramatic effect on what we are going to do here, and it also has consequences on our senior citizens. Again, thank you for your testimony.

Mr. BUNNING. The last panel of the day, Beau Boulter, former Member of Congress, Robert Ball, former Commissioner of Social Security, and Martha McSteen, the president of the National Committee to Preserve Social Security and Medicare, and for the record we will accept Arthur Flemming, former Secretary of Health and Human Services. We will accept his statement for the record, and Mr. Boulter, if you will begin, thank you.

STATEMENT OF HON. BEAU BOULTER, MEMBER, NATIONAL ADVISORY BOARD, UNITED SENIORS ASSOCIATION

Mr. BOULTER. Thank you, Mr. Chairman. Beginning in 1984 when we started or when Congress started taxing Social Security in order to resolve the Social Security crisis which existed at that time, and to make sure that the moneys were used for that purpose, Congress required that all tax receipts would be credited to the Social Security trust funds, thus it is clear that that tax was to make Social Security solvent again, and then because of the high economic growth and long sustained economic recovery coupled with low inflation, the Social Security taxes greatly outpaced the payments, and that still is true today, so that the Social Security trust funds are running a huge surplus.

There is a common perception that this surplus is squirreled away somewhere, but, of course, the truth is that the Social Security receipts are deposited in the general treasury. The payments are paid out of the general treasury, and the surplus is credited to the Social Security trust funds in the form of U.S. Government securities. But there is, as we all know, there is no separate pool of money anywhere, and as often has been said, even by many Members of Congress, this surplus is used for everything under the sun from paper clips to battleships, so clearly the 1993 tax increase on Social Security is not for Social Security.

What about hospital insurance? I know that question has been asked several times, hospital insurance. It is my view, as a member of the National Advisory Board of United Seniors Association that the hospital insurance program is going to have to be dealt with separately, that the several billion-plus dollars a year that we get from this tax increase is not going to be adequate to deal with that problem, and beyond that I agree much with what has been said before by the earlier panel, that we don't take care of structural deficit problems by continually raising marginal tax rates, which is what is being done with the 1993 tax increase.

What about using the tax increase for deficit reduction? Well, I used to serve in Congress and when I was here at least we used to say that for every dollar of new taxes, spending increased by about $1.50. I suppose that that probably is still somewhat accurate today, but in any event, we are not going to solve the deficit with this 1993 middle-income tax increase, which is what it is.

We are going to have to solve the deficit simply by, I think, two ways, and that is economic growth and cutting spending, and that is what United Seniors Association is for. We are a little bit different of a group than you have heard from earlier in the day. We are a seniors group.

I am not an economist like Dr. Goodman or some of these others have been. We do represent seniors, but we are a very conservative seniors group. As some of you know, we are growing very fast.

I was visiting with the executive director of the President's White House Conference on Aging, a gentleman doing very, very good work, in my view, and he said, well, look, we look at United Seniors Association and we see a group that is very, very active and a group that takes some very firm positions, and we do.

The group that I represent and most of our members, which are somewhere around 400,000, oppose tax increases of any kind, and we strongly believe in less government and less spending, and I am, frankly, very pleased that our grassroots views are the majority views today in the House. So I identify with all the remarks that have been made about marginal tax rates. That is not the way to solve the problem, and we strongly support the repeal of the 1993 tax increase, not only as an issue of fairness for seniors, but also as part of the congressional agenda, to spur economic growth and to make our country competitive again.

[The prepared statement follows:]

Testimony of The Honorable Beau Boulter
on behalf of United Seniors Association, Inc.

Before the
House Committee on Ways and Means

Thursday, January 19, 1995

Mr. Chairman and Members of the Committee:

My name is Beau Boulter and I had the privilege of serving with many of you during the four years I represented the thirteenth district of Texas in this House. It is indeed a pleasure to see my former colleagues here.

Today, I appear before you on behalf of United Seniors Association.

United Seniors Association is a non-partisan, non-profit grassroots educational and lobbying organization with more than 400,000 members nationwide. We are essentially a conservative seniors' organization, advocating lower taxes and less government. We opposed all of President Clinton's 1993 tax increases, especially the increased taxation of Social Security benefits which was included in the Omnibus Reconciliation Act of 1993, or OBRA '93.

We worked hard, with then-Congressman Jon Kyl and Senator Trent Lott, to repeal that provision of OBRA '93, and I appear before you today in support of Title II of the Senior Citizens' Equity Act.

It is the position of United Seniors Association that the tax increase on Social Security benefits — the Senior Citizens' tax — is a tax hike on middle-class Americans. It is, effectively, a reduction in Social Security benefits based on presumed wealth; that is, the benefits tax results in means-testing of Social Security.

The Senior Citizens' tax results in double taxation for many, and by increasing seniors' marginal tax rates, discourages some of this nation's most productive and experienced workers from re-entering the labor force.

The Senior Citizens' tax undermines middle- and upper-income seniors' faith in the Social Security system, and provides future retirees with a disincentive to participate in the Social Security system.

The History of the Taxation of Social Security Benefits

As you know, for nearly half a century Social Security benefits were not taxed as income. Then, in 1983, a bipartisan majority of Congress agreed that for some households up to one-half of Social Security benefits could be treated as taxable income.

Under the 1983 Social Security amendments, when a retiree's adjusted gross income (AGI), tax-free interest income and one-half of OASDI benefits exceeds a threshold — $25,000 for single taxpayers, $32,000 for married couples — some portion of OASDI benefits are subject to taxation. For every dollar by which retirees' incomes exceed one of these thresholds, 50 cents worth of OASDI benefits are treated as taxable income.

As a result of the so-called deficit reduction legislation enacted a decade later, in OBRA '93, a second set of thresholds was introduced. For every dollar single taxpayers earn over $34,000 and for every dollar married couples earn over $44,000, 85 cents worth of OASDI benefits are now subject to taxation.

Who is Affected by the Benefits Tax, and How?

Nearly one in every four Social Security beneficiaries — about eight million retirees — are subject to some taxation of benefits. Those on the high-end of the income scale lose up to one-third of

their benefits due to the tax, and for some semi-retired seniors, working can mean a marginal tax rate of more than 100 percent.

Because the thresholds are not indexed to inflation, they effectively move lower each year, and more and more seniors each year will find their OASDI benefits subject to taxation.

The Social Security Administration has projected that, under the old law, by the year 2030 income taxation of benefits would recapture about 4.3 percent of total benefits outlays. Estimates reported by C. Eugene Steuerle and Jon M. Bakija in their book *Retooling Social Security for the Twenty-First Century* suggest that by raising the maximum taxable income to 85 percent, Social Security would recapture an additional three percent of benefits outlays.

In dollars and cents, we're talking about roughly $4.6 billion this year. That's a lot of money to you and me, Mr. Chairman. But it's not that much when we're talking about an earned entitlement program which now posts an annual surplus of — and reduces the federal budget deficit by — more than $50 billion.

Indeed, one of the problems with Congress' expansion of the tax on benefits is that under the 1993 formula, the revenues raised do not even go into the Social Security surplus, as is the case under the 1983 law. Instead, the revenues go to help pay for the troubled HI program and to reduce the deficit.

Even if every penny did go into the OASDI trust funds, the revenues still would not be helping to pay for benefits. Rather, because the federal government loans the Social Security surplus to itself, the revenues would go to pay for everything from "battleships to paper clips," as has been pointed out before.

The Tax on Benefits is a Tax on Middle-Class Americans

When President Clinton proposed and Congress passed the Senior Citizens' Tax, they raised the taxes of middle class Americans — something the President, at least, promised not to do.

President Clinton's claim that his tax increases soaked only the "rich" is completely false. The thresholds the President and Congress established are, as noted before, $34,000 for singles and $44,000 for couples. As you know, Mr. Chairman, that's middle class in the real world.

The increased taxation of Social Security benefits raised taxes for 6.1 million middle income senior citizens. The tax increase is projected to take $26 billion away from seniors over the first five years. The middle class of senior citizens, earning $50,000 to $75,000, will pay the largest portion of the new tax — $1.4 billion in 1994 alone.

Middle class seniors have fewer options to make up lost income, while their expenses — medical and otherwise — are often as great or greater than those of their younger counterparts.

And, because the thresholds for this middle-class tax are not indexed, it will bite deeper and deeper into the ranks of middle-class seniors as the years go by.

The Tax on Benefits Results in Double-Taxation for Many

The Senior Citizens' tax represents a tax on after-tax dollars for many. Setting aside the fact that under the scheme used to determine taxable income "tax-free" interest is added to outside earnings and one-half of Social Security benefits, some retirees above the higher thresholds find their contributions — taken from after-tax earnings — taxed again.

This double taxation will become even more prevalent as future retirees begin crossing the income thresholds at lower real levels.

United Seniors Association opposes all double taxation of savings, and supports efforts by Majority Leader Armey and others to end that confiscatory practice.

The Tax on Benefits Stifles Productivity, Minimizes Government Revenue

The Senior Citizen's tax provides some retirees with a paralyzing antidote to any desire they might have had to continue working. The high marginal tax rates they would pay on additional income could actually make earning more money a losing proposition.

Many middle-class seniors already face marginal tax rates of more than 50 percent. Under the current income tax code, a millionaire faces a 39.6 percent federal income tax rate, as well as state and local income taxes. A senior in the 28 percent tax bracket can potentially face a higher marginal tax rate when the earnings test and the taxation of Social Security benefits are added to the federal income tax burden.

Once a single senior reaches the income level of $34,000, not only is the next $1 of earnings subject to the 28 percent income tax, but an additional 85 cents in Social Security benefits become subject to the income tax.

When the earnings test is taken into consideration, this senior in effect loses 33 cents in Social Security income and at the same time faces additional income taxes of 35 cents, so that the $1 earned translates into only 32 cents. And that's before paying state income taxes and FICA taxes.

Economists Gary and Aldona Robbins, in a study for TaxAction Analysis, calculate that repealing the 1993 Social Security taxes would reduce the economy-wide marginal tax rate on capital, and thus increase investment, by $332 billion in the year 2000, creating 91,000 jobs. The additional economic growth would add $97 billion to the GDP between 1995 and 2000, and higher economic growth would generate an extra $17 billion to federal payroll, corporate and personal income, and excise taxes, bringing the net revenue loss from the repeal to only $9 billion over five years.

The Tax on Benefits Undermines Faith in the System

The keystone to Social Security is the popular perception that it is a sort of contributory pension plan — that one's contributions over the years determine what one gets back. It was originally designed to be just that, but was changed to a pay-as-you-go social insurance plan before the first benefits were ever paid out.

But in order to maintain public support for the program, the federal government has continued to foster the mistaken belief that workers' contributions are squirreled away somewhere, earning interest, and will one day be returned to the workers when they retire.

As an investment, Social Security performs rather poorly — and the rate of return will only diminish in the future.

But Social Security works, and it works because taxpayers across all income levels have historically felt they have a stake in the program. No matter how successful you eventually become, we have told workers, you will get the same rate of return on your contributions as anyone else.

Start means-testing Social Security — and the tax on benefits is a means test — and soon, those who are more successful, and thus will see more of their benefits confiscated, begin to resent having to hand over to Uncle Sam 15.3 percent of their earnings.

Take away that keystone of fairness, and those who contribute more to the system and receive less will no longer want to participate. We can already see how this breach of trust is affecting the attitudes of the so-called Generation X — their resentment is growing, and soon, younger workers could revolt entirely against a program they see purely as an income transfer from their pockets to the pockets of their parents and grandparents.

Proponents of the Senior Citizens' tax point out that seniors generally face a much lower federal tax burden than younger families at similar income levels. They say that by including some portion of Social Security benefits as taxable income, this gap is closed.

But I say everyone is paying too much in taxes. Our government is trying to do too much, and it is taxing middle-class Americans to death to do it.

We all know that federal budget deficits arise from too much spending, not from too few taxes. The Joint Economic Committee a few years back released a study showing that for every new $1 the federal government collected in revenues since 1949, it had spent $1.49. Clearly, new taxes are not the answer to our deficit problem.

In fact, since 1981 Congress has raised taxes six times for the stated purpose of "deficit reduction." Each time, the deficit increased rather than decreased.

It is true that we need to fundamentally reform the Social Security system; in fact, United Seniors Association will soon release a major proposal for doing just that. But the portion of the Senior Citizens' tax that goes into the OASDI trust funds is today spent on anything but Social Security, which is more than paying for itself. As for the portion of the tax that goes toward reducing the deficit, a better solution would be, as I suggested a moment ago, to cut spending.

The bottom line is this: eliminating the 1993 Social Security taxes isn't just about fairness to seniors or maintaining public support for Social Security -- though these are reasons enough for repeal. Eliminating the increased taxation of Social Security benefits is also an important part of the overall congressional agenda of creating jobs and spurring economic growth.

It is our pleasure to support your repeal of the 1993 tax increase, Mr. Chairman. But I urge you to go further and remove the 1983 tax as well. It would be good for the seniors who suffer reduced benefits; it would be good for the labor market and the economy; and it would be a first step toward keeping the faith with tomorrow's retirees.

I look forward to working with you in the future on behalf of United Seniors Association.

Thank you.

Mr. HOUGHTON [presiding]. Thank you very much, Mr. Boulter. Maybe, Mr. Ball, you would allow me to introduce Mrs. McSteen first. Would you like to proceed with your testimony, Mrs. McSteen.

STATEMENT OF MARTHA MCSTEEN, PRESIDENT, NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

Ms. MCSTEEN. Thank you very much. I am pleased on behalf of the national committee to support both the repealing of the 1993 increase in the taxation of Social Security benefits and allowing tax-free accelerated death benefits under life insurance contracts. There are five reasons why the proposal to repeal the increased tax on Social Security benefits makes sound public policy.

The increased taxation affected about 13 percent of Social Security beneficiaries in 1994, and it is estimated that it will affect about 17 percent in 1998, unless it is repealed. The national committee estimates that affected beneficiaries will save an average of $158 in 1996, increasing to about $662 in the year 2000.

No Social Security benefits were taxed during Social Security's first 44 years, and up to 50 percent have been taxed only for the last 10 years. The national committee is concerned that the increase in the taxation of Social Security benefits could undermine future public support for Social Security. That is because the support for the higher tax is built on two flawed assumptions.

First, that most low- and middle-income beneficiaries will not be affected by the increased taxation; and second, that Social Security should be taxed like a private pension. Third, the bracket creep has been eliminated for every taxpayer except Social Security beneficiaries.

Over time many moderate- and low-income retirees will see their income pushed over the thresholds for paying tax on benefits because the thresholds are not indexed. Fourth, some defend the increased tax as fair because they believe that Social Security is not progressive, yet the benefit formula already is progressive.

Support for taxing benefits grows out of the belief that all beneficiaries receive huge windfalls, windfalls that upper income beneficiaries don't need. The so-called windfalls that earlier generations received under Social Security, typical of all pay-as-you-go pension plans in the early years, are no longer true for Social Security benefits.

For the average earner who retired at 65, taking into account COLAs and continued accrual of interest, it takes about 16 years to receive back the combined employer-employee OASI payroll taxes plus interest.

Last, one assumption underlying taxing up to 85 percent of benefits is that this is similar to the tax treatment of private pensions. However, private pensions with an employee contribution are currently overtaxed. This has not been a major controversy because most private pensions, unlike Social Security, do not require direct employee contributions.

The second subject of today's hearing concerns the tax treatment of accelerated death benefits. Another positive aspect of the Contract would permit tax-free distributions from life insurance policies to pay medical bills and living expenses of chronically or termi-

nally ill individuals. Life insurance companies developed this alternative in response to the needs of its clients.

Permitting payments to the insured for expenses of a terminal illness is sound public policy. Additionally, more than 80 percent of long-term care is provided in the home by family and friends. This assistance enables chronically ill individuals to remain at home rather than be institutionalized. It also saves the government money for Medicaid nursing home care it might otherwise have to pay.

The $500 tax credit proposed in the Contract provides some assistance for these families. The national committee looks forward to the passage of the provisions in the Contract With America which would repeal the 1993 tax increase on Social Security benefits and would provide favorable tax treatment for accelerated death benefits and home care expenses. Thank you, Mr. Chairman.

[The prepared statement and attachment follow:]

TESTIMONY OF MARTHA McSTEEN
NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

I am Martha McSteen, President of the National Committee to Preserve Social Security and Medicare, a grassroots, education and advocacy organization representing millions of senior Americans. I am pleased to appear before the Ways and Means Committee to express the National Committee's support both for repealing the 1993 increase in the taxation of Social Security benefits and allowing tax free accelerated death benefits under life insurance contracts.

There are five reasons why the proposal to repeal the increased tax on Social Securitybenefits makes sound public policy.

One, the 1993 budget bill increased the amount of Social Security benefits subject to tax from 50 percent to 85 percent for individual beneficiaries with income above $34,000 or for couples with income above $44,000. The Administration consistently claimed that the 1993 budget package would only increase taxes for the upper one percent of Americans and while that was true for American taxpayers under age 65 it was not true for senior taxpayers.

The increased taxation did affect about 13 percent of Social Security beneficiaries in 1994 and it is estimated that it will affect about 17 percent in 1998—unless it is repealed. Therefore, National Committee members strongly endorse the proposal in the Contract with America to repeal the tax increase.

Under the proposal in the Contract with America, the amount of benefits taxable will decline gradually from 85 percent to 50 percent. The National Committee estimates (see Table 1) that affected beneficiaries will save an average of $158 in 1996 increasing to $662 in the year 2000.

Table 1. Impact of Contract with America Repeal of 85 Percent Taxation of Benefits on Social Security Beneficiaries

Year	Percent of Benefits Taxed	Revenue Reduction	Number of Beneficiaries Affected	Average Tax Savings for Beneficiaries Affected
1996	75%	$0.9 billion	5.7 million	$158
1997	65%	$2.2 billion	6.2 million	$355
1998	60%	$3.1 billion	6.7 million	$463
1999	55%	$4.1 billion	7.2 million	$569
2000	50%	$5.1 billion	7.7 million	$662

Source: SSA. National Committee estimated number of beneficiaries affected in 1997, 1998 and 1999 and average tax savings. Revenue estimates and average tax savings are for fiscal years.

Secondly, no Social Security benefits were taxed during Social Security's first 44 years and up to 50 percent have been taxed only for the last ten years. The National Committee is concerned that the increase in the taxation of Social Security benefits could undermine future public support for Social Security. That is because support for the higher tax is built on two flawed assumptions—first, that most low and middle income beneficiaries will not be affected by the increased taxation of Social Security benefits, and, second, that Social Security should be taxed like a private pension.

Bracket Creep

Third, "bracket creep" has been eliminated for every taxpayer except Social Security beneficiaries. Individuals have paid tax on 50 percent of Social Security benefits with income above $25,000 ($32,000 for a couple) since 1984 when benefits were first taxed. Over time, many moderate and low income retirees will see their income pushed over the thresholds for paying tax on benefits because the thresholds are not indexed. In 1984, these thresholds were high enough so that only ten percent of beneficiaries paid tax on benefits. By 1998, 26 percent of beneficiaries will pay tax on benefits according to the Social Security Administration. While the income thresholds for paying tax on 85 percent of benefits are higher, they are also not indexed. As a result, most middle income and even some low income beneficiaries will be affected over time.

And since the threshold for married couples is only 29 percent higher than for individuals, married couples are more likely to pay tax on 85 percent of benefits than individuals especially if the individual is still in the work force.

And, the increased tax is a heavier burden on middle income seniors with income between $40,000 and $80,000 than it is on upper income seniors whose taxable Social Security benefits are capped at no more than 85 percent of Social Security benefits.

Excessive Progressivity

Fourth, some defend the increased tax as fair, because they believe that Social Security is not progressive. Yet the benefit formula already is progressive. Taxing up to 85 percent of benefits is excessive and discourages retirement savings.

Although frequently not acknowledged, the Social Security benefit formula favors low income workers at the expense of upper income workers. Benefits for a low earner are approximately 58 percent of average earnings, 43 percent for an average earner and only 24 percent for the maximum earner. If a maximum earner with a benefit of $1,195 in 1995 would receive 43 percent of average earnings, his or her benefit would be $946 a month higher. This $946, which the maximum earner does not receive, is in effect a "tax" to provide more adequate benefits for a low income worker.

Support for taxing benefits grows out of the belief that all beneficiaries receive huge windfalls, windfalls that upper income beneficiaries don't need. But the so-called windfalls that earlier generations received under Social Security, typical of all pay-as-you-go pension plans in the early years, are no longer true for Social Security benefits today. For the average earner who retired at age 65 in 1994, taking into account COLAs and continued accrual of interest, it takes 16 years to receive back the combined employer-employee OASI payroll taxes plus interest. It takes a maximum earner 22 years. With the average male life expectancy at age 65 of 15 years, the average earner breaks even and the high earner subsidizes the low earner.[1] Factoring in the reduction in benefits due to the taxation of benefits could add three or more years to the number of years it takes to receive back contributions.

False Private Pension Analogy

And lastly, one assumption underlying taxing up to 85 percent of benefits is that this is similar to the tax treatment of private pensions. However, private pensions with an employee contribution are currently overtaxed. This has not been a major controversy, because most private pensions, unlike Social Security, do not require direct employee contributions.

The government fully taxes private pensions except for the nominal value of the original employee contribution. It does so even though inflation means the original contribution is worth a lot more in today's dollars. In order to correct this inequity, the Department of the Treasury in 1984 proposed to exclude from taxable income not only the nominal employee contribution to a private pension but also the inflation adjusted value. While the proposal was not adopted, the reasoning behind it is still valid. Just because some private pensions are overtaxed now doesn't mean that Social Security benefits should also be overtaxed.

If Social Security contributions were indexed so that beneficiaries were not paying tax on inflation, the taxable portion of Social Security benefits for a single high wage earner who will be 65 in 1995 would be around 60 percent of Social Security benefits, much lower than the current 85 percent. The taxable portion would be even less than the current level of 50 percent for many younger individuals.

Favorable Tax Treatment for Accelerated Death Benefits and Home Care Expenses

The second subject of today's hearing concerns the tax treatment of accelerated death benefits. We would also like to comment on a related issue on the tax treatment of home care expenses, one of the subjects of yesterday's hearing.

Another positive aspect of the Contract with America would permit tax-free distributions from life insurance policies to pay medical bills and living expenses of chronically or terminally ill individuals. Life insurance companies developed this alternative in response to the needs of its clients. Permitting payments to the insured for expenses of a terminal illness is sound public policy. Individuals currently are reluctant to accept accelerated death benefits, however, because of the high taxes imposed.

More than 80 percent of long-term care is provided in the home by family and friends. This assistance enables chronically ill individuals to remain at home rather than be institutionalized. It also saves the government money for Medicaid nursing home care it might otherwise have to pay. Many families perform great sacrifice in providing home care assistance with little or no support from the government up to now. The $500 tax credit proposed in the Contract with America provides some assistance for these families. Unlike a tax

---

[1] Geoffrey Kollman, "How Long Does It Take New Retirees to Recover the Value of Their Social Security Taxes?" Congressional Research Service (94-5 EPW), updated January 3, 1994, p. 9, illustration 10.

deduction, it is more valuable to those with low taxable income than those with high taxable income.

Conclusion

The National Committee looks forward to the passage of the provisions in the Contract with America which would repeal the 1993 tax increase on Social Security benefits and would provide favorable tax treatment for accelerated death benefits and home care expenses.

Mr. HOUGHTON. Thank you very much, Ms. McSteen.

Mr. Ball, we would like to have your testimony.

STATEMENT OF HON. ROBERT M. BALL, WASHINGTON, D.C., FORMER COMMISSIONER OF SOCIAL SECURITY

Mr. BALL. Mr. Chairman and members of the committee, on this issue of how to tax Social Security benefits, my own view is somewhat different from either rescinding the 1993 increase in the tax or just keeping the present law at 85 percent. All other retirement income, IRAs, Keoghs, 401(k) plans, individually bought private annuities, government career plans, pension plans, particularly the ones that are contributory, are all treated the same. Any income that has not previously been taxed is taxed on receipt.

I see absolutely no reason why Social Security shouldn't be treated just the same. Social Security is not just a poor people's program. It is not just aimed at getting rid of poverty. Social Security goes to people at all income levels, and there is no reason why the tax treatment shouldn't be like other types of retirement income.

Now, I would make one differentiation in Social Security tax policy from the general rule that I spoke of earlier, and that is I think at least temporarily, and temporarily may be quite a long time, that the exemption at the bottom should be continued.

I don't take that position on theoretical grounds. I think it would be better if we didn't have those exemptions and let the income tax work its will in terms of protecting low-income elderly people, like all other people are in the country. We have a progressive income tax and low-income people don't have to pay it, and I think that ultimately the same rules should apply to older people as to everyone else, but the problem is the practical one of arriving at this situation gradually without the disruption of sudden change.

I have been for taxing Social Security benefits for at least the last 30 years, maybe longer, and treating it just like other retirement income, but when Stanley Surrey, Assistant Secretary for Tax Policy, and I tried to do this some 30 years ago, the opponents of taxing Social Security got everybody stirred up by making it seem that what we were proposing was to tax everybody's Social Security as if it were an excise tax on Social Security benefits. To make absolutely clear that low-income people would not be taxed— and if you didn't have these exemptions—40 percent of Social Security beneficiaries wouldn't have to pay a tax anyway—in the last couple of decades, I have been for having an explicit exemption for low-income people.

It does create some problems, as you heard earlier. I don't think it is the ultimate good policy, but as long as it is unindexed, it is a way of gradually working around to what I think is a correct policy, and that is to in every respect treat the taxation of Social Security benefits just like all other retirement income. Social Security is the only exception. I see no reason whatsoever for this exception.

[The prepared statement follows:]

TESTIMONY OF ROBERT M. BALL, WASHINGTON, D.C.
FORMER COMMISSIONER OF SOCIAL SECURITY

Mr. Chairman and Members of the Committee:

My name is Robert Ball. I was Commissioner of Social Security from 1962 to 1973. Prior to my appointment by President Kennedy, I was the top civil servant at Social Security for about 10 years, and have had a total of some 30 years of service at the Social Security Administration. Since leaving the Government, I have continued to write and speak about Social Security, health insurance, and related programs.

I was Staff Director of an Advisory Council on Social Security to the Senate Finance Committee in 1948, a council which recommended the major changes that became the Social Security Amendments of 1950. I have also been a member of the statutory Advisory Councils on Social Security in 1965, 1979, and 1991, and am now a member of the Advisory Council currently studying the program. I was also a member of the small negotiating group from the National Commission on Social Security Reform in 1982-1982, the Greenspan Commission, which reached an agreement with the White House on a series of recommendations that became the basis for the important 1983 amendments. I am currently Chair of the Board of the National Academy of Social Insurance.

I have long believed that the same tax policy that applies to other types of retirement income should apply to Social Security. I see no reason for any special treatment of Social Security income. Social Security is not a poor people's program (although it does prevent poverty for some 15 million beneficiaries and prevents millions more from falling into near poverty); it is a universal retirement, life insurance, and disability insurance program. Benefits go to people at all income levels and fairness requires that the same taxation rules should be applied to their Social Security income as to IRAs, Keogh plans, 401(k) plans, private pension plans, whether they are contributory or not, and Government-career plans.

Although in detail the taxation of income from these various plans appear to be somewhat different, the taxing principle is the same: Any income that has not previously been taxed is taxed on receipt. Thus, in non-contributory private pension plans, since none of the benefit has been previously taxed, all is taxable to the retiree as received. In the case of contributory Government-career plans, such as Civil Service or the Congressional Retirement System, benefits are taxed to the extent that they exceed what the retiree paid in.

In other types of retirement plans, too, if a payment into the plan was not taxed when made, the entire income is taxed on receipt, and if the payment was from after-tax income, as in a privately bought annuity, only the interest accumulation is taxed when the annuity is paid out.

The application of this policy to Social Security would be to make Social Security benefits taxable to the extent that they exceed the employee's contributions. Present law differs from this policy in two respects:

(1) The taxation of benefits applies only to those with total incomes above specified thresholds: $25,000 a year for a single person and $32,000 a year for couples. Those with incomes above these thresholds have at least 50 percent of their Social Security benefits included in gross income for income tax purposes, and those whose incomes are above $34,000 if single and $44,000 for couples, have 85 percent of the Social Security benefit included in gross income.

And, (2) The proportion of the benefit taxed after the higher threshold is exceeded, 85 percent, is an approximation of the amount that would be taxed under the general rule, rather than the exact amount. The approximation is used to save administrative work for the Social Security Administration, which thus avoids figuring out individual-by-individual the exact excess of benefit over contributions. The 85 percent figure was selected to protect retirees from paying more than the taxation principle would require. In most instances the 85 percent is less than if the amount were exactly calculated.

On the first exception, (1) above, from the general application of the taxing principle, one might well ask, "Why this exemption for lower income people?" The answer is, "Experience." Even without the specific low income exemptions, about 40 percent of beneficiaries wouldn't pay taxes anyway because the progressive features of the income tax protect those with low incomes, but it might not be clear that this was the case. When I and the then Assistant Secretary for Tax Legislation of the Treasury, Stanley Surrey, first proposed taxing Social Security benefits some 30 years ago, the opposition got everyone excited, regardless of their income, because they presented their case as if the proposal was to tax everyone's Social Security benefit, sort of an excise tax on Social Security! So in recent years, as a practical matter, I have favored an explicit income exemption to make it absolutely clear that the tax wouldn't apply to those with low income. I believe that from a policy point of view, it would be preferable not to have these special income exemptions, but I think we have to get to that position gradually. Keeping these thresholds unindexed will gradually require more people to pay the tax, and finally only the general provisions of the income tax will protect low income people, as is the case for other types of income.

On point (2), the substitution of a presumptive figure, 85 percent of the benefits for individual calculations, now seems to me undesirable. I believe that the taxation of Social Security benefits ought to be calculated individually and that the beneficiaries should pay on the amount by which their benefits exceed what they have paid in. In total, this will result in more income from benefit taxation than the 85 percent rule. Modern technology makes it possible to do the calculations, and it would be fairer to apply exactly the same rules as with other retirement income. I would favor having this rule apply to benefits going to individuals above the thresholds of $25,000 for singles, and $32,000 for couples, thus dropping the higher exemption in present law before the 85 percent rule is applied.

What I am proposing, of course, goes in the opposite direction from the legislation you are currently considering. But I see no basis for returning to the 50 percent rule for Social Security when all other retirement income is taxed to the extent it has not been taxed previously. Of course, it is important not to tax income twice, but beneficiaries of Social Security now, and in the future, will have paid in much less than 50 percent of their benefits. It is not just the employer contribution that needs to be taxed on receipt in order for the treatment to be comparable to other retirement income, but also taxes should be paid on all of the benefits that exceed the employee contribution.

On first glance it may seem difficult to reconcile the statement that beneficiaries will get back much more than what they and their employer pay in with recent calculations which show that those now young, with their employers, will pay in over a lifetime just about enough to get their money's worth. But there is no conflict. In a calculation to determine the extent to which Social Security beneficiaries get their "money's worth," it is proper to take the employer and employee contribution, and to add interest on the combined contribution to compare with the benefits paid out. However, in applying the general tax rule to Social Security only the employee contribution has been taxed and all benefits that exceed these contributions should be taxed as received.

One might also ask, "Why in the 1983 amendments, which first taxed Social Security, was only 50 percent of the benefit included in gross income?" The answer is that it was simply the most that those of us who favored taxation could get, and it had, at least, the superficial appeal of the employer having paid 50 percent of the total contribution (which had not been taxed), and the employee paying 50 percent (which had been taxed). There was no attempt to rationalize the policy in terms of bringing the treatment into line with the way other retirement income was treated. That came later with the 85 percent proposal that became law in 1993.

When one considers the history of the taxation of Social Security benefits, or rather the lack of it before 1983, it is not surprising that the initial step was only a partial step. Up until 1983 Social Security benefits had not been taxed at all and whenever the issue had been raised, Congress reacted in no uncertain terms that they thought it a bad idea. When the 1979 Advisory Council on Social Security proposed taxing Social Security benefits, the Senate immediately passed a resolution, practically unanimously, stating that they would never do such a thing. It was possible to begin taxing Social Security at all, only because the income from the tax was to be returned to the Social Security Trust Funds and because in 1983 Social Security very much needed more income. It was a compromise driven by the desperate financial situation of the program at that time. The fact that some of us believed it was good policy probably did not have a great deal to do with its acceptance.

But why weren't Social Security benefits taxed from the beginning of the program? There is no law on this, only early Treasury rulings. These rulings were apparently based on what I consider the mistaken notion that Social Security was similar to other payments that had been exempted in previous rulings because they were considered gratuities rather than earned rights. Since gratuities are not taxable to the recipient, Social Security was ruled exempt. This original interpretation had some basis in the way the law was set up. In 1935, when the Social Security Act was first drafted, the Supreme Court had been invalidating a high proportion of new social legislation that came before it. There was concern that the Court might also invalidate Social Security. To reduce the possibility of constitutional challenge, the titles in the Social Security Act granting benefits were kept entirely separate from the titles imposing taxes. There was clearly no constitutional prohibition against Congress granting benefits, and there was no doubt that Congress could levy taxes, but there was concern, at that time, that connecting the two in a social insurance system -- a new concept in the United States of 1935 -- might be overturned by a majority of the Supreme Court.

When Treasury later considered the question of taxation, they apparently reasoned that if the benefits weren't connected to the taxes paid, there was a basis for thinking of them as a Government grant, a gratuity, and not taxable. In the early Treasury rulings, the Treasury referred to previous rulings on other unearned income as precedents. It seems clear now that Social Security benefits are paid for by earmarked deductions from workers' earnings matched by their employers, and that even though the amount of the benefit is not strictly related to what individual workers have paid in, few people today would see it as a gratuity. The Treasury ruling, however, had governed for so many years that it was clear in 1983 that legislative action was desirable if the policy was to be changed.

Today the taxation of Social Security benefits is a relatively small but nevertheless significant part of the long-range financing of the program. Under present law, in the long-run, these taxes will represent about one percent of annual covered payrolls for Social Security, more than one percent if what is going into the Hospital Insurance program is added in. If the provision for taxing benefits and putting the proceeds into one of the Social Security Trust Funds were eliminated, the loss would have to be made up for in some other way. Even reducing the income from taxation of benefits, as proposed in the legislation you are considering, would make the long-range actuarial balance of these programs worse by a total of 0.36 percent of taxable payrolls. On the other hand, extending the taxation of benefits further for those above the thresholds of $25,000 and $32,000, by following the rules applied to other retirement income, as I propose, would further reduce the long-range actuarial balance by 0.14 percent, a swing of a half percent of payroll.

The short-run effect of the change under consideration is also important. Returning to the law in effect before the 1993 amendments is estimated to reduce the income to the Hospital Insurance Trust Fund by $15 billion over five years. (It is a peculiarity of the present law that the proceeds from those taxes on Social Security benefits which were imposed by the 1993 amendments go into the Hospital Insurance fund rather than the OASDI fund. This came about because it would have required 60 votes in the Senate to increase the income of the Social Security fund, but this was not the case for hospital insurance. At some point this anomaly needs to be cleared up. Clearly the proceeds of taxes on OASDI benefits should go to the OASDI funds.) Moreover, cutting back on the amount of taxation increases the deficit in the unified budget of the United States. Any such increase should be offset elsewhere.

For me, the most important question for long-run policy is the application to Social Security of the tax policy applied to other retirement income. I favor treating Social Security income above the first threshold just like other retirement income. I have not attempted to evaluate whether the tax policy applied to retirement income generally is the best possible policy. My whole point is to treat Social Security in the same way other retirement income is treated. If the treatment of other retirement income is changed, then Social Security should also follow the new rules. This is a matter, not only of equity, but of what is good for Social Security.

Some people have asked why I oppose benefit cuts and yet support the taxation of benefits. Isn't the tax equivalent to a benefit cut, they ask? It is at any particular time, but the development of tax policy may take a very different direction from the development of Social Security policy so that they are not necessarily equivalent over time. If income taxes are increased because of a set of circumstances that has nothing to do with Social Security, Social Security beneficiaries should get less income, and if, on the other hand, taxes are reduced, the income of Social Security beneficiaries should be increased like that of other taxpayers. This is what changes in the policy call for and when the new policy is applied to other income, what possible reason is there for treating Social Security differently?

I see taxing Social Security benefits, not only as fair, but as a way of identifying the program with all other earned retirement income, and thus making clear that Social Security is not welfare, but similar to all other earned pension and retirement income rights. Treating Social Security just like all other benefits paid as a right, rather than giving it special tax treatment, emphasizes its character as a contributory system paying its own way. Thus, I believe, it is important that the tax treatment follow the same principles, not just follow them half-way.

I am interested in the money, too. Social Security needs it for the long run, although it is well financed for the next 20 to 25 years. The unified budget needs the income now. But the principle of treating Social Security like all other retirement income is equally important.

Mr. HOUGHTON. Thank you very much, Mr. Ball.

Mr. Christensen will inquire.

Mr. CHRISTENSEN. Thank you, Mr. Chairman. I have two questions. One, I wanted to get your views, Mr. Boulter, from what you felt the sense of your membership is toward the flat tax proposal. I want to ask Mr. Ball a question first.

According to the Congressional Research Service, it currently takes average workers who retire at age 65, 17.9 years to get back all that they and their employers paid into Social Security. High earners it takes 24 years.

In other words, they would have to live until 82 and 89 before they get back their entire investment. That is before you factor in the tax increase from the 50 percent to 85 percent. After you figure in the tax increase that the Clinton administration heaped upon the backs of senior citizens, that goes up to, I believe, the average earner is 36 years and for higher income earners, age 101 for high wage earners to get back their investment.

Isn't it true that more and more workers will never live long enough to get back what they paid into Social Security, especially when you figure in the tax that was recently imposed upon the seniors?

Mr. BALL. I don't think that is a valid way of figuring how taxes operate. In any other type of retirement income, if you figure in the tax on that income which varies, of course, depending on how high your total income is, you will have instances where if you take the tax into account, people would not be getting back fully what they had paid in.

Those numbers that you are using from the Congressional Research Service are higher than I have seen before, and I would like to examine them. They seem high to me, and more than I have ever heard from Social Security actuaries.

Mr. CHRISTENSEN. OK. Mr. Boulter.

Mr. BOULTER. Congressman, our group is supporting the flat tax. I am sure that our membership would, by a big majority, be in favcr of that. We are polling them. I better be right on this, but our members pretty much know how we believe, and that is why they join, and we oppose these high marginal tax rates and tax increases. We think a flat tax or something like the majority leader has proposed is good for the economy and is fair to all.

Mr. CHRISTENSEN. Would the majority of your members be under the exemption of, say, the Armey proposal of say the $38,000, $38,000 or less in income? Do you know whether they would fall in that or not? Do you think a lot of them would not have to pay any of the income flat tax?

Mr. BOULTER. I think a lot of them would be under that exemption.

Mr. CHRISTENSEN. How about you, Ms. McSteen?

Ms. MCSTEEN. Our average age member is 68, and the annual income is around $30,000.

Mr. CHRISTENSEN. OK.

Mr. BALL. Mr. Christensen, could I ask you if you know what interest rates the CRS was using in the examples you referred to and whether they used the entire OASDI rate or just that part devoted to retirement benefits?

Mr. CHRISTENSEN. I don't have that figure, Mr. Ball. Thank you, Mr. Chairman.

Mr. HOUGHTON. Thank you very much. Mr. Jacobs will inquire.

Mr. JACOBS. Mr. Boulter, can you tell us the most recent time the Federal accounts were in balance for a fiscal year?

Mr. BOULTER. Not since I have been running for Congress or been serving or been interested in the political process as an active adult, I don't believe. When we had a balanced budget?

Mr. JACOBS. I think it was fiscal year 1969?

Mr. BOULTER. 1960 something.

Mr. JACOBS. 1969, I think. Didn't that follow the 10-percent surcharge tax increase in fairly rapid order?

Mr. BOULTER. I do not know, Mr. Jacobs.

Mr. JACOBS. It was passed in 1968. You say that the 1963 act had no effect on the deficit. Did I understand that to be your——

Mr. BOULTER. You mean the 1983?

Mr. JACOBS. 1993, I beg your pardon.

Mr. BOULTER. My point there is that Social Security should not be used for deficit reduction.

Mr. JACOBS. No, I thought you simply——

Mr. BOULTER. But, in fact, that it is being used for lots of purposes, including financing the deficit.

Mr. JACOBS. That is not correct. The 1993 tax on Social Security benefits, the increased amount of your free Social Security benefits that you have to include in your taxable income does not relate to the Federal funds budget at all, does it?

Mr. BOULTER. It goes into hospital insurance and deficit reduction.

Mr. JACOBS. How do you get deficit reduction by its going into hospital insurance? It is a trust fund.

Mr. BOULTER. Because you are borrowing money from the trust funds for all government purposes.

Mr. JACOBS. Regardless of where you borrow the money, if you borrowed it at the bank, would you say that the bank was financing the Federal funds budget or would they have just lent the money, it was an obligation to pay?

Mr. BOULTER. I would say if the income into the Social Security trust funds on the books is about, what, $65 billion more than outgo last year, and that money is being used for other purposes, that it is being used for other purposes, including deficit reduction.

Mr. JACOBS. But don't you ignore the interest that it has accrued on the loan? I mean, if the bank lends you $1,000 to go on vacation, can you say the bank is squandering my deposit by financing a vacation, or can you say the bank has a contract that earns interest for me and the real question is whether you will pay it back, not what you did with it?

Mr. BOULTER. I am not sure of what——

Mr. JACOBS. I am not accusing you of doing that, I think that would be stupid but——

Mr. BOULTER. I am not sure I understand your question. I know I have heard you say today that this money, that the tax increase is used for hospital insurance, and is used for deficit reduction.

Mr. JACOBS. You are entirely right on the first. You kind of lose me on that second corner, though. That is almost like saying all

cottage cheese is made in cottages. You could say, then, that every Social Security tax paid is used for deficit reduction.

Mr. BOULTER. Let me ask, do I understand correctly that the tax receipts for Social Security go into the general treasury? Do I understand that correctly? Am I correct in that? That is what I stated on my testimony. Am I correct?

Mr. JACOBS. I don't usually answer questions from witnesses, but I think the answer is it goes in a trust fund of which the Treasury Department is custodian.

Mr. BOULTER. Benefits are paid out of that same fund.

Mr. JACOBS. I am sure you would agree with that.

Mr. BOULTER. The surplus is credited on the books to the Social Security trust fund, but in the form of government securities. That is my testimony. So that money is being used for other purposes. That is widely acknowledged.

Mr. JACOBS. Why is it my life savings, the bulk of them, are invested in U.S. securities? Because people like Jane Bryant Quinn tell us that is the safest investment you can make for obvious reasons, that the Federal Government would be the last institution to go down after the banks and S&Ls, but you can say that we are financing the Pentagon or helping finance social programs or something like that, but what we are interested in is that our account is credited each 90 days with the interest. So, no, I don't think that is correct to say that it is used for deficit reduction until it is borrowed. You could say the Japanese are reducing our deficit, too, because we borrow money from them.

Mr. BOULTER. It has been borrowed. It has been borrowed. I am simply saying it should not be used for deficit reduction. It should not be used for other governmental purposes. I don't even think it should be used for hospital insurance.

Mr. JACOBS. That was one of the big arguments at the time, would it be used for deficit reduction, deposited into the Federal funds budget, or would it be plowed back into the Social Security. I am sure Ms. McSteen remembers that, and ultimately it passed the House doing what you said. It was for deficit reduction, but in the conference it was redirected to the trust funds, but we may be arguing about semantics. We are definitely arguing after our time has expired.

Mr. HOUGHTON. Without being accused of choking off debate here, I would like to thank the witnesses, thank the members of the panel, and I would assume that Dr. Flemming's remarks will be put into the record.

Mr. BALL. Mr. Chairman, I took the red light very seriously in my summary statement. Could I say about two sentences more?

Mr. HOUGHTON. Sure.

Mr. BALL. I think the bottom line is that we just can't afford this cut in taxes for the hospital insurance program nor if it were made part of the social security program. Both of those funds are going to need more money. Social Security is well financed for the next 20–25 years, but not for the really long run. For these social programs with their dedicated taxes, we can't afford this cut.

Mr. HOUGHTON. Thank you very much, sir.

[Whereupon, at 2:50 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

AFFORDING CARE
611 G Street, SW
Washington, DC 20024
(202) 479-2543

January 19, 1995

Honorable Bill Archer
Chairman
Ways and Means Committee
House of Representatives
1102 Longworth Building
Washington, DC 20515

Re: Senior Citizens' Equity Act - Accelerated Death Benefits

Dear Mr. Chairman:

We are writing to offer comments and suggestions regarding the accelerated death benefit tax exemption provisions of the Senior Citizens' Equity Act.

Affording Care is a national, non-profit, all-volunteer organization which conducts workshops, issues newsletters, dispenses information and provides counseling to seriously ill persons and those who assist them about insurance, financial planning and public entitlements, drawing upon our volunteers' wide career backgrounds in these areas. We have taken the lead in "consumer" education and advocacy in the issues revolving around "living benefits" and related mechanisms for terminally ill persons' raising desperately needed cash from their life insurance policies before death. As such, we are probably close to unique among those commenting upon this particular sub-provision of the Contract in that we have no business or financial stake in the insurance, viatication or related enterprises in the field--our only concern is the provision of wider options, along with useful information, to seriously ill persons so that they can make wise and beneficial decisions about money in what may be their last months of life. To this end, we work with patients with all serious diagnoses (for example, cancer, AIDS, heart disease) without regard to personal background, financial status, political belief or age. Where possible, we favor private financial solutions for those we work with, although we do also advise on such matters as SSDI, SSI, Medicare and Medicaid as well. We accept no commercial funding other than a few small advertisements in our occasionally-produced, free newsletter; our costs are largely met by donations from volunteers' own funds.

As you know, accelerated death benefits are paid out by insurance companies to verifiably terminally ill insured policyholders with life expectancies of six to twelve months, and the payout amount ranges from only a portion to nearly all of the death benefit amount, depending upon

policy provisions. The Contract provision before the Committee would exempt from the presently-applicable taxation accelerated benefits received by a taxpayer during the last year of life. This change is both logical and compassionate inasmuch as death payments received by an insured's life insurance beneficiaries after his death are and have been traditionally tax-free (unless estate assets, together with the insurance payouts, total over the $600,000 threshold for estate taxation--an event covering only a tiny minority of cases). This change in tax law will not only ease the plight of terminally ill persons whose incomes have been cut because of medical inability to work, it will also prevent the bizarre and indefensible result of our present tax laws: terminally ill persons deterred by taxes from realizing desperately-needed cash on their life insurance policies who literally die destitute (and what's worse, often forced thereby on publicly-funded welfare programs like SSI and Medicaid) whose beneficiaries, after their deaths, are often enriched--usually tax free!

But only a small percentage of terminally ill people can use accelerated benefits to meet their living expenses and medical costs. This is because only a minority of life insurance policies have accelerated death benefit clauses; the six month or one year life expectancy limitation closes out most terminally ill persons who need money earlier in the course of illness; and many insurance firms with acceleration riders available on their product lines choose to medically underwrite (i.e., exclude from the option) even present policyholders or those who can qualify for the underlying life policy (this is true, for example in conversions from employer group term life policies, where departing, fatally ill employees do have the right under the group contract to convert the same amount of coverage into an individual policy without medical exclusions--but not the right to add on an otherwise-available acceleration clause).

As a result, accelerated benefits meet the needs of only a minority of insured, fatally ill persons who seek to avoid poverty and becoming public charges in their final days. What has filled the gap has been viatication: the sale of policy ownership or control rights to a business investor which verifies policy provisions and the insured's medical prognosis, pays any remaining lifetime premiums and collects the full policy face amount at death. Because viatical investors are classic free enterprise entrepreneurs, they offer selling patients less than the full amount due at death--not only to take some profits but also to meet high overhead costs associated with policy and medical verifications, future premium payments, the cost of financing sale prices and extensive customer service personnel costs. Thus, policy sale prices can range from 55% of face value to over 80%, depending on the innumerable variations present in a given policy upon the life of a given individual patient.

Viatication has been questioned for having a somehow "improper" profit motive. But this motive is basic to our economy and our society. After all, who would question the **bona fides** of insurance companies, physicians and even hospitals, all of which operate for "profit"? Viatication serves a desperately-needed function in our society, and its emergence in recent years has made the final days of thousands of terminally ill people more bearable--and simultaneously lessened resort to government welfare programs for those in genuine need. Any abuse can and will be rooted out by state regulation (already in effect in California,Kansas, New Mexico and New York) initiated pursuant to the Model Code recently promulgated by the National Association of Insurance Commissioners. These issues can be, should be and will be appropriately addressed at the state level--they certainly don't belong at the federal level, and in particular have no place in considering the pre-death taxation of insurance money.

In light of the above, we strongly recommend that proceeds of life insurance policy viatication be treated identically with accelerated death benefits in being made exempt from federal taxation--a step already taken by the California and New York income taxation codes. We believe that this exemption should be available to all terminally ill taxpayers whatever their age, and not just to those over age 65.Finally, to make this exemption fully meaningful, we strongly urge that the life expectancy horizon be set at two or three years. A one year limit that matches the niggardly limits life insurance firms offer in their acceleration riders effectively denies the tax benefit to the bulk of financially needy, no-longer-able-to-work, gravely ill but still-ambulatory persons while conferring protection only upon those who are nearing or are already in a bedbound, hospice-level quality of life where financial concerns have telescoped solely into coverage for deathbed care (which, curiously enough, will almost always be available without much fuss from Medicare and Medicaid).

We thank you for hearing our concerns with strengthening this thoughtful and comprehensive piece of legislation. If we can be helpful to you and your staff on this question, please do call us at (202) 479-2543.

Yours truly,

Thomas P. McCormack
Washington Representative

STATEMENT OF CAROL PECK
PROGRAM DIRECTOR FOR FAMILY SUPPORT
CATHOLIC CHARITIES USA

Thank you for the opportunity to provide written testimony regarding the proposed Family Reinforcement Act refundable tax credits as they relate to adoption expenses.

Catholic Charities USA is the nation's largest, private, social service organization. The network of 1,400 agencies and institutions and thousands of concerned individuals works to reduce poverty, support families, and empower communities in the United States.

Catholic Charities agencies and institutions, with more than 266,000 staff members and volunteers, provide social services ranging from adoption and counseling to food and housing. People of all religious, national, racial, social, and economic backgrounds receive services from Catholic Charities.

Catholic Charities USA promotes public policies and strategies that address human needs and social injustices. More than 3.8 million people turned to Catholic Charities for help in 1993. 1.3 million of those individuals were children and adolescents who were 17 years of age or younger.

Catholic Charities agencies have a long and proud history of making permanent placement plans for children in need of families. Even before 1910 when the National Catholic Conference (now Catholic Charities USA) was founded, our agencies were providing quality permanent placement plans for children available for adoption.

In 1993, Catholic Charities agencies served 38,915 individuals involved in adoption placements. Adoptive homes were found for 3,100 children including 1,377 special-needs children and 241 children from other countries. Other services included services to adult adoptees, pre-adoption foster care, and post adoption services.

Although Catholic Charities USA would support an increase for qualified expenses for legal child adoption, we have concerns about the proposed legislation supplanting the current reimbursements available under the nonrecurring adoption expenses available under Tax Reform Act of 1986. On December 14, 1988, the Department of Health and Human Services published a final rule to implement nonrecurring adoption expenses throughout Title IVE under the Social Security Act. That rule asks that states share in the cost of nonrecurring expenses for special needs adoptions.

With limited resources available for qualified adoption expenses, we question legislation which would cost over $900 million dollars over the next five years which would not specifically address special needs adoptions. There are currently 30,000 children who are waiting for families but are hard to place because of their ethnic heritage, because they are older children, because they belong to sibling groups, or because they have a physical or mental disability. In 1995, the Child Welfare League of America

anticipates that 70,000 to 85,000 of these children are likely to be waiting for adoptive families.

Under current law, families can be reimbursed through Title IVE with matching state funds up to $2,000 once a special needs adoption has been finalized. The current legislation permits families to adopt special needs children who are waiting in foster care for permanent placement.

Although we agree that the $5,000 tax credit would certainly help families to pay for qualifying legal adoption expenses and help promote adoptions, it is aimed primarily toward those parents with incomes that are high enough to pay qualifying fees up front. The proposed tax credit will not benefit parents who do not have the money to spend before they can get it back in the form of a tax credit.

We additionally have concerns that a tax credit rather than a cash reimbursement, could encourage a rise in both agency and legal fees. For example, agencies and attorneys that currently charge a $5,000 fee will be tempted to raise their fees once they are aware that adoptive parents will receive a tax credit after the money has already been spent on the placement. $5,000 would currently cover only about half the costs for the adoption of a healthy infant. For a special needs child, the costs are far greater.

Our agencies are able to defer their fees under current law for special needs placements. They are able to carry the bill over until the family is reimbursed. If the adoptive family does not have the money to pay for one time agency expenses, our agencies can bill for service and hold the balance of that bill until post finalization of the adoption.

With a tax credit, adoptive families pay these one time fees up front. Many families who adopt special needs children do not have the out of pocket money necessary for one time expenses. Under current law, the family is able to pay the vender (in our case the agency handling the placement) once the adoption is completed. There is a partnership between the federal government and the states so that costs can go directly to an agency when the adoption is completed.

Under tax credit the family would have to pay the actual costs up front. Agencies would not be able to recover these costs under the proposed legislation. Private adoption agencies would not be able to collect and would have to waive or reduce their fees because they are committed to finding homes for handicapped children, children of color, and older children waiting for families. From an agency perspective, the proposed legislation would not help.

Under current law our agencies are able to at least recoup $2,000 for special needs adoptions within three to six months of the finalized. The question that begs to be asked if the proposed legislation is passed is what place will a private agency have in finding homes for hard to place children? We believe that the public and private system should be encouraging agencies to help find homes for these children. We ask that any new legislation assist private agencies to participate in adoption, not put them out of business because they can no longer afford to pay for all the costs associated with adoption placements.

We also have concerns about how "qualifying expenses" would be defined. We recommend that the guidelines for expenses be clearly defined to include:

- Home study expenses that would include necessary physical and psychological exams;
- Legal fees and court costs;
- Supervision of the placement prior to adoption
- Reasonable and necessary adoption fees by the placement agency;
- Reasonable travel, transportation, food, and lodging costs for the child and parents when necessary to complete the adoption placement.

Finally, Catholic Charities USA would like to take this opportunity to express our appreciation that the Contract with America recognizes the importance of adoption. We do feel however, that the proposed legislation would disproportionately help one group that is already able to afford adoption expenses at the expense of another group that may not be wealthy but are willing to lovingly accept children who are hard to place. With the limited resources available for adoption, is this the direction we want to take?

Thank you for the opportunity of offering this written testimony.

STATEMENT OF DAVID S. LIEDERMAN, EXECUTIVE DIRECTOR THE CHILD WELFARE LEAGUE OF AMERICA

The Child Welfare League of America (CWLA) appreciates the opportunity to submit testimony on Title I of H.R. 11, the Family Reinforcement Act, which proposes a refundable tax credit for adoption expenses. CWLA encourages the federal government to extend its commitment to help children with "special needs" to find loving adoptive homes. CWLA is a membership organization representing 800 public and voluntary child-serving agencies that assist some 2.5 million vulnerable children and their families each year. More than 300 of these agencies provide adoption services.

CWLA commends this Committee for considering the needs of adopted children and their families. Helping children find families who can care for them through adoption is an important commitment on the part of the federal government. CWLA supports federal efforts to defray the costs related to adoption and to help children secure loving homes. CWLA particularly supports those federal efforts that assist children with "special needs" find adoptive families who can care for them such as the current entitlement (IV-E of the Social Security Act) which reimburses states for a portion of their expenses for foster care and adoption assistance for children with special needs.

CWLA strongly urges members of this Committee to maintain full support for the Title IV-E Foster Care and Adoption Assistance Program as you review new child welfare proposals. It would be misdirected federal policy to reduce or trade support of the IV-E Adoption Assistance subsidies to families who adopt "waiting" children with special needs in order to fund a new tax credit as proposed in H.R. 11.

CWLA also suggests that the proposed tax credit be limited to those taxpayer families who adopt children with special needs. In this time of scarce resources, it seems important to provide funds in a way that will enable the majority of children awaiting adoption to find loving homes.

WHO ARE THE CHILDREN AWAITING ADOPTION?

Seventy-two percent of children awaiting adoption have one or more "special needs." "Special needs" refers to those children who may be school age, part of a sibling group, children of color, or children with special physical, emotional, or developmental needs. Children with special needs include the rising number of children who are HIV affected or infected, and those who are drug exposed. An estimated 30,000 abused, neglected, abandoned children with special needs are legally free and awaiting permanent adoptive families, and another 70,000 to 85,000 are likely to need adoption in the near future. As homelessness, substance abuse, and HIV/AIDS compromise and destroy more and more families, their children suffer complex health, mental health, and developmental problems and the families who adopt them often need special training and assistance.

WHO ARE POTENTIAL ADOPTIVE FAMILIES?

The type of families who adopt special needs children varies dramatically: childless couples, older parents who have already raised a family; single parents, two-parent working families; and families from a wide range of ethnic and cultural backgrounds. Families nationwide adopt from all educational backgrounds, all income levels, and all types of religious backgrounds. The number of some families seeking to adopt has increased dramatically as couples marry later and frequently delay their attempts to have children until their mid-thirties to early forties and experience difficulites. At the same time, the majority of young women who have babies are choosing to keep their infants and raise them within the context of their extended families. This has led to a dramatic decline in the number of infants available for adoption.

The opposite is true for the thousands of children in foster care who are waiting for adoptive families. Far fewer families than needed have been recruited for the large numbers of school age children; children with brothers and sisters who need to be adopted together; children of color; and children with serious physical, emotional, or developmental needs.

HOW MANY CHILDREN ARE ADOPTED EACH YEAR?

The data available indicate that approximately 118,800 adoptions were completed in 1990 (the most recent year for which information is available). Of these, approximately 51% are relative adoptions, including stepparent and other kinship adoptions, and approximately 49% are non-relative adoptions. The U.S. Department of Health and Human Services'(HHS) newly implemented Adoption and Foster Care Analysis and Reporting System (AFCARS), began in 1994 to collect more reliable data on foster care and adoption nationwide. HHS expects to have initial data available later this year.

H.R. 11 TAX CREDIT PROPOSAL

H.R. 11 proposes a dollar-for-dollar tax credit of up to $5,000 for adoption expenses including adoption fees, court costs, attorney fees, and other expenses directly related to the legal adoption of a child. For individuals with incomes over $60,000, the credit would be reduced. The proposed credit would not be available for taxpayers whose income exceeds $100,000. The Congressional Budget Office estimates that the proposed tax credit would cost $900 million over five years.

The federal government has been historically, and we believe appropriately, most concerned with removing the obstacles to the adoption of children who have special needs. It is more difficult to find adoptive families who are able to care for these children. These children often may require extra emotional, physical, or medical care. Accordingly, the Economic Recovery Tax Act of 1981 (P.L. 97-34) put into place a deduction of $1,500 for qualified adoption expenses to help reduce the financial burdens for taxpayers who adopt children with special needs. This initiative, which was repealed by the Tax Reform Act of 1986 (P.L. 99-514), cost the federal government between $9 million to $12 million per year. The tax deduction was repealed because Congress found that it had provided relatively greater benefits to higher-income taxpayers, who presumably had relatively less need for assistance, and no benefits to nonitemizers or to individuals whose income was so low that they had no tax liability. The tax credit proposal contained in H.R. 11 is substantially higher than the tax benefit provided by this previous tax law and it would benefit primarily infant adoptions for which no incentive is needed.

COST EFFECTIVENESS OF ENCOURAGING SPECIAL NEEDS ADOPTION

Adoption assistance is an investment in children which results in significant economic savings to the taxpayer. By providing federal subsidies to 40,700 children during 1983 - 1987, federal and state governments saved $1.6 billion in foster care costs according to a 1993 study by Westat Incorporated. Targeting resources to help children who need adoptive families leave foster care not only makes good economic sense, it has been shown to provide these children with the best opportunity to develop into useful, productive adults who become taxpayers rather than becoming dependent upon government subsidies as adults. Adoption makes good sense for a humane society, and it makes good economic sense as well. The availability of federal financial assistance is often the critical difference between a child in foster care becoming part of an adoptive family or remaining in foster care indefintely.

CWLA urges this Committee to maintain its current efforts by providing subsidies to reduce the financial burdens for families who legally adopt these children with special needs. The Adoption subsidies currently provided through the Foster Care and Adoption Assistance Program, Title IV-E of the Social Security Act must continue. This program provided adoption assistance for an estimated 90,800 children in FY 1994. Without this assistance, many of those children otherwise would still be awaiting permanent adoptive families. A tax credit provided to families who adopt children with special needs would complement this federal effort.

THE CONCORD COALITION

1019 19th Street N.W., Suite 810, Washington D.C. 20036
202 467 6222 ♦ (Fax) 202 467 6333

STATEMENT OF MARTHA PHILLIPS
Executive Director
THE CONCORD COALITION

February 3, 1995

Before the Committee on Ways and Means
U.S. House of Representatives

On behalf of the Concord Coalition and its 150,000 members in state and local chapters across the country, thank you for the opportunity to present our views on the tax provisions of the Contract With America.

Mr. Chairman and Members, The Concord Coalition believes that this is the wrong time for tax cuts. We strongly urge the Committee to set aside tax cuts for another day when the nation has a balanced budget and our children enjoy a greater measure of economic prosperity. We stand ready to help this committee and others reduce spending and bring about that day.

Public opinion polls indicate that the American people are deeply concerned about the huge deficits that are being incurred needlessly year after year. When President Clinton was sworn into office, the public debt stood at about $4 trillion. By the end of this calendar year, it will exceed $5 trillion -- about $20,000 for every living American man, woman, and child. By the end of fiscal year 1998, yet another trillion dollars of debt will have been incurred if the government stays on its present path.

Americans are properly anxious about a federal government that loads on a trillion dollars of borrowing in three short years. Their concern generated momentum for the recent House passage of the Balanced Budget Amendment to the Constitution. The Concord Coalition strongly supports the Balanced Budget Amendment and hopes for speedy Senate consideration and quick ratification by the States.

Passing the Constitutional amendment, however, is only a preliminary step. Achieving a balanced budget will be far more difficult. The Congressional Budget Office estimates that upwards of $1.2 trillion of deficit reduction between now and 2002 will be required in order to reach balance by the effective date of the Constitutional amendment. This means that Congress cannot wait for several years to determine whether or not the amendment will be ratified. It must begin this year to put into place a coherent set of policies that will assure compliance with the balanced budget requirement for the year 2002.

The first step toward a balanced budget is NOT a package of tax cuts. Enacting tax cuts now would only make the already daunting task of balancing the budget even more difficult. The cuts under discussion are large. The Treasury Department's initial estimates peg the Contract tax cuts at $97.7 billion in fiscal year 2002, the year we are supposed to balance the budget. President Clinton's proposed tax cuts reduce revenues by about one-quarter that amount, but still a large one-year figure. To pay for the tax cuts, in compliance with pay-as-you-go budget enforcement rules, a number of tough spending-cut decisions will have to be made.

The Concord Coalition is willing to support tough spending-cut choices -- but for deficit reduction, not for tax cuts. If these tough choices are squandered on paying for tax cuts, it will be all the harder to find additional spending cuts to reach a balanced budget by the deadline. Some people gloss over that difficulty by talking about "gliding to balance" or "slowing the rate of spending growth." But glide paths and spending slowdowns do not happen automatically or painlessly. Congress must review existing programs and enact specific policy changes to reduce benefit payouts to specific groups, individuals, business entities or state or local governments.

Using up these hard won spending cuts to pay for tax cuts only uses up political capital to stay in place. Any savings that can be found should be used first to reduce the deficit. Once that goal has been accomplished, there will be plenty of time to talk about tax cuts.

It is argued that the proposed tax cuts would revitalize the economy, increase savings, and lead to greater prosperity. However, our economy is hardly crippled. Gross domestic product grew last year at a four percent rate, about as fast as most economists think is sustainable, and faster than some think is wise. Unemployment is relatively low. As to increasing savings, it is hard to see how any policy that discourages deficit reduction would increase savings. The Federal Government is using for current consumption most of the funds that individuals and businesses in our nation are able save each year. Reducing the budget deficit would reduce this dissaving. This, in turn, would leave more funds available for investment in the physical, human, intellectual and technological capital required to sustain economic growth and lead to improved standards of living. Thus, The Concord Coalition believes that balancing the budget would do far more than tax cuts to strengthen the economy over the long run.

Could Concord Coalition members use the promised tax cuts right now? Sure. Who couldn't?

Are the tax cuts -- which, after all, wouldn't amount to much on a per family basis -- worth the long term price? Are they worth jeopardizing the opportunity to balance the budget? We don't think so.

Testimony

of

William & Patricia Condit

on

H.R. 11 - the Family Reinforcement Act

before the

Committee on Ways and Means

U.S. House of Representatives

January 18, 1995

Mr. Chairman, and Members of the Committee, thank you for the opportunity to testify today on behalf of the Family Reinforcement Act of 1995 sponsored by Congresswoman Vucanovich and many others. We are Bill and Pat Condit, the proud adoptive parents of two foreign-born children, Maya and Tom. Our family now resides in Burke, Virginia.

Our story is not unlike that of many - perhaps most- adoptive couples. We sought to have children in the "conventional" manner but without success. Pat went through the tests administered to women with fertility problems and Bill was checked out as well. In our case, we both had fertility problems sufficiently daunting for us to say to each other after a year of questioning further extraordinary medical measures, "Let's look into adoption." And so we did.

By then (1980) we lived in Duluth, Minnesota, where Bill worked for the Department of the Interior. The local social services people informed us the typical wait for infants born in St. Louis County was about seven years! That being much too long, we elected to write to several agencies around the country that aid in adoption of foreign kids and discovered the Children's Home Society of Minnesota in St. Paul could help us.

After the usual battery of counseling, home visits by a social worker, gathering of letters of reference, etc., the orphanage in Guatemala that we chose to work with (AGAND, a Spanish language acronym for Guatemalan Association for the Assistance of Abandoned Children) sent us a tiny picture of a then six-weeks old girl with some very sketchy information about her birth mother's plight and why she was placing her daughter for adoption. Based solely on this information, we were given the choice of adopting this child, or waiting for another referral. We said "yes" and Bill

carried her picture in his wallet like some prospective parents carry sonograms of *in utero* babies. After what seemed like months of paperwork delays, we found ourselves flying to Guatemala City to pick up our daughter, who we named "Maya" after the indigenous people of that beautiful country. A State Department glitch delayed our return to the U.S. for a week, but all in all, we had a relatively easy encounter with the difficulty which adoption of foreign-born children can bring to couples.

That must have been the case, because only a year later we set about finding a boy child for our family. Again, the Children's Home Society and AGAND fulfilled our needs. In 1982 we adopted our son, Tomas, who like his adoptive sister is a descendant of the "indigena de Guatemala." Maya and Tom are now naturalized citizens of the United States and "teenagers!" Like children everywhere, they bring their parents much happiness with occasional sorrow. Are we glad to have chosen adoption as an option? Yes, without question, but it was not easy financially.

In fact, at Bill's salary as a federal employee at the GS-9 grade level supplemented with Pat's earnings as a part-time respiratory therapist, the cost of adopting our children may have been prohibitive had not Bill's maternal grandfather died a year earlier leaving his grandchildren each a small inheritance. In contrast, had we been able to have kids "biologically" the costs of prenatal visits, labor and delivery, and post-natal care would have been covered by the health insurance policy we had through the Federal Employees Health Benefits Act, subject only to deductibles and co-payments (and even the out-of-pocket medical expenses are deductible on one's income taxes).

But adoption expenses are not so covered by any health insurance of which we are aware, nor are the costs deductible against income on any 1040 form or schedule that we can find. This seems inequitable to us, and to most adoptive parents with whom we have spoken. We believe Title I of H.R. 11 would at least begin to correct this unfairness for middle-class adoptive parents. In our case, the costs associated with the adoption of each of our children was approximately the $5,000 limit, albeit in 1980 and 1982 nominal dollars. We have heard stories of domestic adoptions costing significantly more, and we know the fee that the orphanage in Guatemala imposes on prospective adoptive parents to help feed and clothe the children waiting there has risen sharply since then.

Nonetheless, we believe the cap on the tax credit seems to us to reasonably balance fairness to adoptive couples with tax revenue concerns. We hasten to add that Bill and Pat Condit will see none of the tax benefit proposed in H.R. 11, nor are we asking for a retroactive credit. Those costs were "sunk" a long time ago, as economists are wont to say. We simply wish to

add our voices to those who argue the current tax code discriminates against adoption thereby reducing the likelihood this option will be considered.

By all accounts, there are tens of thousands of kids in need of parents and no dearth of prospective parents unable to conceive their own children. Why shouldn't the government "reinforce" these potential families by removing - or at least lowering - the financial barrier to bringing them together. Our social worker fourteen years ago told us this poem to an adopted child:

"Not flesh of my flesh,
nor bone of my bone,
but nevertheless my own.

Never forget,
for a single minute,
you didn't grow under my heart...
but in it."

We think that this advice remains sound today. Help make adoption a more readily available option to middle-class families. Please enact H.R. 11 into law.

TESTIMONY OF THE HUMAN RIGHTS CAMPAIGN FUND
BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
REGARDING THE FAMILY REINFORCEMENT ACT (H.R. 11)
FEBRUARY 3, 1995

A provision in the Family Reinforcement Act--part of the Republican "Contract With America"--would provide a $500 tax credit for people providing home care for seriously ill or severely disabled parents, stepparents, and grandparents. Encouraging home care would keep families together, save on the costs of nursing homes and hospitals, and relieve pressures on Medicare and Medicaid. This is a good idea, but it could be better.

Consider two families. Alan and Alice, a married couple in their 40's, both have full-time jobs. They live with Alice's mother, Ann, who is 75. Ann suffers from Alzheimer's Disease. She cannot wash, dress, or feed herself, and needs substantial help with all three activities.

Ben and Betty are a retired married couple in their 60's. Their son, Bob, 40, suffers from AIDS and has returned home to spend the last few months of his life with his parents. Like Alice's mom Ann, Bob needs substantial help to perform the ordinary activities of daily life.

As it currently stands, the Family Reinforcement Act would give a tax break to Alan and Alice, the two-income couple with the sick mother, but not to Ben and Betty, the retired couple with the sick son. The proposal provides a tax credit for those who live with a "qualified person" who needs "substantial assistance" to perform "at least 2 activities of daily living," such as bathing, dressing, and eating. But "qualified person" under the proposal includes only parents, stepparents, and grandparents.

Encouraging both families to care for their sick loved ones at home makes sense. Not only does home health care keep families together, it is also much cheaper than hospitalization, which can cost $4000 per day.

Home health care can cost as little as $70 per day. Home care also beats the cost of nursing-home care and hospital care. With Medicaid and Medicare the fastest growing portions of the federal budget, encouraging home care can help ease federal budget pressures and make a major contribution to a more competitive economy.

In addition, home health care, because it "protects the patients from hospital-borne infections," can actually be healthier than hospitalization, according to Dr. Greg Haessler,

medical director for the Princeton Financial Group, a Des Moines, Iowa insurer.

Finally, in many cases--Alan and Alice and Ben and Betty are typical examples--home health care is provided by family members rather than hired help. Granting these family health-care providers a tax credit recognizes the traditional family value of caring for one's own.

But if encouraging home care of sick relatives is such a good idea, why limit the tax credit to parents, stepparents and grandparents? Families caring for other loved ones, including children like Bob, have the same needs. Home Health care is beneficial regardless of the patient's precise relationship with the caregiver.

The case of families with adult children with AIDS illustrates this point. With AIDS already the leading killer of young adult Americans, caring for AIDS patients will take an increasing toll on our economy, making savings in AIDS-care expenses even more crucial in the years ahead. End-stage AIDS patients are already among the major users of home care, and a growing number of providers are developing specialized home-care programs for patients with AIDS.

Moreover, AIDS leaves the patient subject to numerous "opportunistic" infections that kill AIDS patients. Home health care can help avoid many of these infections, by keeping the patient out of an environment rife with infection: the hospital.

Finally, AIDS in an adult child introduces tensions into the family at least as grave as those introduced by other diseases. Few parents can easily accept that their child will die before them. Surely families with a critically ill adult child need support and strengthening as much as families with seriously ill parents or grandparents.

In testifying on the tax credit proposal, Assistant Treasury Secretary Leslie Samuels described a "basic principle of tax policy": fairness, including the "equal treatment of equals." There's an old saying that the law should be just before it is generous.

"Pro-family" should include all families. The Contract With America must be a contract with all Americans. In enacting a tax credit to support families with a severely disabled or seriously ill member, Congress should include those who care for sick children and other loved ones, not just parents.

STATEMENT OF LINCOLN NATIONAL CORPORATION, LINCOLN NATIONAL LIFE INSURANCE COMPANY, AND FIRST PENN-PACIFIC LIFE INSURANCE COMPANY ON THE SENIOR CITIZENS EQUITY ACT, H.R. 8

For hearings held before
The Committee on Ways and Means
on January 19, 1995

Lincoln National Corporation and Lincoln National Life Insurance Company, of Fort Wayne, Indiana, and First Penn-Pacific Life Insurance Company, of Oakbrook Terrace, Illinois (the "Lincoln National Companies") submit this statement for inclusion in the record of the hearings held by the Committee on Ways and Means on January 19, 1995 concerning the Senior Citizens Equity Act, H.R. 8. The Lincoln National Companies are pleased to express their strong support for the provisions of the Senior Citizens Equity Act that provide clarifications for the tax treatment of accelerated death benefits and long-term care insurance.

We consider the Senior Citizens Equity Act well framed in providing tax clarifications for accelerated death benefits and long-term care insurance, and we compliment the drafters on both their willingness to step forward in this area and their foresight in so doing. H.R. 8 makes much-needed clarifications in the tax law, and is quite timely in view of the substantial and rising interest in "living benefits" provided through life insurance contracts. This fact, coupled with the importance of facilitating efficient funding for the often great costs of long-term care and terminal illness, make enactment of these tax clarifications both important and necessary.

There are two types of "living benefits" addressed by H.R. 8 that are increasingly offered in connection with life insurance contracts: (1) accelerated death benefits, usually provided by a rider on a life insurance contract which accelerates payment of the contract's death benefit when the insured becomes chronically ill (including the "long-term care acceleration rider") or when he or she becomes terminally ill (the "terminal illness rider"), and (2) so-called "non-acceleration" long-term care benefits, provided under a rider which pays long-term care benefits when the insured becomes chronically ill but which does not affect the values, including the death benefit, of a related life insurance contract (sometimes referred to as a "stand-alone" long-term care rider).

H.R. 8 addresses accelerated death benefits in section 306 of the bill, while non-acceleration long-term care benefits offered in connection with life insurance contracts are addressed in section 301 of the bill (specifically in proposed section 818A(d) of the Internal Revenue Code). H.R. 8 also addresses long-term care insurance offered independent of any life insurance contract in sections 301-303 of the bill. This statement focuses on the tax clarifications made for life insurance rider products, although we support the tax clarifications which H.R. 8 provides for long-term care insurance generally.

Accelerated Death Benefits

In General. Since the late-1980s, many life insurance companies have begun offering accelerated death benefits in connection with their life insurance contracts. The purpose of accelerated death benefits is to allow chronically and terminally ill policyholders to receive the full value of their contracts prior to death, not just their cash surrender values, to help them manage the added financial burdens occasioned by their illness.

People primarily purchase life insurance for income protection, to provide for a surviving spouse or children in the event of the insured's premature death. As individuals reach older ages, their need for income protection becomes less important. But, at such times, the built-up value of the life insur-

ance contract may be used to address other insurance needs that are then arising -- the risk that an illness will place substantial financial burdens on the family. Accelerated death benefit riders provide access to the "entire" value of a life insurance contract (including its pure insurance element) to pay long-term care or terminal illness costs. These riders thus substantially complement an individual's insurance protection after retirement, recognizing that one of the greatest risks, or emergencies, that individuals can face at this time is the financial crisis that arises upon an insured's chronic or final illness.

Accelerated death benefits constitute an important addition to the benefits offered under life insurance contracts. If they were not available, a chronically or terminally ill individual would likely be faced with poor financial options -- either avoiding life-time expenses to the extent possible or cashing in his or her life insurance contract to cover expenses. If forced to surrender the contract, the individual would lose the pure insurance element of the contract (the excess of the contract's death benefit over the cash surrender value). Under an accelerated death benefit rider, however, both the pure insurance element and the cash surrender value are available to provide benefits.

Long-Term Care Acceleration Riders. Under a long-term care acceleration rider, accelerated death benefits are paid to chronically ill individuals in the same circumstances as under stand-alone long-term care insurance contracts. When benefits are paid under the rider, however, there is a dollar-for-dollar reduction in the death benefit of the related life insurance contract -- the rider "accelerates" payment of the death benefit. Benefit payments under such a rider are made periodically, either in reimbursement of actual long-term care expenses incurred (subject to limits set forth in the rider) or as a stated percentage of the life insurance death benefit.

Terminal Illness Riders. Under a terminal illness accelerated death benefit rider, benefits are paid upon establishment of the insured's terminal illness (when the insured's life expectancy is 12 months or less). Most riders pay the benefits in a lump sum rather than on a periodic basis, although it is not uncommon for some portion of the life insurance death benefit to remain after the accelerated death benefit payment. For example, a rider might provide that 50 percent of the death benefit may be paid out as an accelerated death benefit, with the remainder to be paid out to the beneficiary when the insured dies.

Methods of Purchase for Long-Term Care Acceleration Riders and Terminal Illness Riders. There are several methods by which insurance companies are compensated in connection with accelerated death benefits, but, in all cases, the cost is only the time value of money cost associated with paying the death benefit prior to death. In the case of long-term care acceleration riders, the cost is typically assessed through stated charges imposed prior to the chronic illness, e.g., through a monthly rider charge. Therefore, in contrast with terminal illness riders, discussed next, the full undiscounted death benefit can be paid out as benefits under a long-term care acceleration rider.

In the case of accelerated death benefits payable under terminal illness riders, there are two mechanisms by which the cost is typically assessed: (1) through the so-called "lien method" or (2) in the form of a "back-end" discount. Under the lien method, the accelerated death benefit is paid out in the form of a loan: the loan is secured by a lien against the death benefit payable under the related life insurance contract, and interest accrues on this loan. Insurers generally require that some portion of the death benefit remain unencumbered by the lien after the accelerated death benefit payment is made, so that interest can be offset against this amount upon death. When

terminal illness accelerated death benefits are paid out through the discount method, the accelerated death benefit payment typically will represent 85 percent to 90 percent of the death benefit extinguished by the payment. The 10 percent to 15 percent difference represents the interest cost of paying the death benefit early.

As indicated above, for all accelerated death benefits, the insurance company need only charge for the time value of money cost associated with paying the death benefit prior to death. As a result, accelerated death benefits represent an inexpensive way for policyholders to acquire insurance protection against the costs associated with chronic or terminal illness. The low incremental cost of these benefits, together with the wide-spread current ownership of cash value life insurance, provides a large number of people with the ability to acquire these beneficial insurance coverages.

"Non-Acceleration" Long-Term Care Insurance Riders

We also strongly support the tax clarifications provided by the Senior Citizens Equity Act for "stand-alone" long-term care insurance. These tax clarifications are provided in sections 301-303 of the bill, and address both long-term care insurance benefits offered in connection with a life insurance contract and those offered independent of any life insurance contract. In the former case, it is our understanding that proposed section 818A(d), which addresses long-term care benefits offered under life insurance contracts, was included in the long-term care portion of H.R. 8 to address "non-acceleration" long-term care rider benefits, i.e., long-term care insurance riders which do not accelerate payment of the underlying life insurance contract's death benefit.

An example of a non-acceleration long-term care rider is the so-called "extension rider," which pays long-term care benefits only after a long-term care acceleration rider has paid out the entirety of the underlying life insurance contract's death benefit. Another example of a non-acceleration long-term care rider would be one similar to that described in IRS Private Letter Ruling 9106050 (November 16, 1990) which operated as an independent long-term care insurance contract attached to a life insurance contract.

The Proposed Legislation

We are very pleased that the Senior Citizens Equity Act contains provisions which clarify the tax treatment of accelerated death benefits and long-term care insurance. These clarifications are especially timely given that use of living benefits under life insurance contracts has flourished in recent years. With these clarifications, life insurance policyholders will be able to utilize their contracts in an efficient manner to assist them in dealing with the potentially devastating costs associated with chronic and terminal illness.

There are several minor technical changes, however, that we would recommend for improvement of the bill. We believe that the recommendations, set forth in the attached appendix, will help assure that the bill achieves its goals.

Conclusion

Accelerated death benefits and long-term care insurance provide an efficient and effective way for individuals to achieve some "piece of mind" in regards to the potentially devastating cost of chronic or terminal illness. Thus, it is entirely appropriate that favorable clarifications in the tax status of such benefits be provided at this time, to remove any unintended disincentive that may exist because of the current tax uncertainty.

APPENDIX

SUGGESTED TECHNICAL MODIFICATIONS TO THE ACCELERATED DEATH BENEFIT AND LONG-TERM CARE PROVISIONS OF H.R. 8

Matters Relating to the Section 7702 Definition of Life Insurance

Treatment of Rider Charges. When accelerated death benefit or long-term care rider charges are made against a life insurance contract's cash value to fund the rider, there may not be a corresponding reduction in "premiums paid" for the life insurance contract, within the meaning of section 7702(f)(1) of the Code, and this may prevent the life insurance contract from being able to mature on its promised benefits. This problem has been addressed in prior bills by providing for an increase in the guideline premium limitation under section 7702(c)(2) in any case where such charges do not reduce "premiums paid." (See proposed section 7702B(d)(3) in section 7402 of S. 2357, 103d Cong., 2d Sess.)

As an alternative to legislative language, we note that a specific grant of regulatory authority exists in section 7702(f)(1), under which "premiums paid" can be reduced by "amounts received with respect to [a life insurance contract] which are specified in regulations." If this approach is to be taken, it would be very helpful for this Committee's report to indicate that the Treasury Department should exercise its regulatory authority under section 7702(f)(1) in respect of accelerated death benefit and long-term care rider charges.

Application of the Section 7702(f)(7) Adjustment Rule. A related problem regarding "premiums paid" arises when payments of accelerated death benefits result in the application of the section 7702(f)(7) adjustment rule. Long-term care acceleration riders generally make periodic payments, so that the death benefit may be reduced by a relatively modest amount each month. In addition, while terminal illness riders can pay out all of the death benefit, many pay out only a portion of the death benefit, leaving some life insurance so that the beneficiary will receive a death benefit on the insured's death. Thus, under either type of rider, the life insurance contract, with a reduced death benefit, may remain after accelerated death benefits are paid, and this necessitates application of the section 7702(f)(7) adjustment rule under current law. This adjustment rule will often produce extremely harsh results in such circumstances -- adjustments may cause a life insurance contract to collapse either when or within a short time after accelerated death benefits commence. This is because the adjustment rule will reduce the guideline premium limitation, but the payment of accelerated death benefits (and any consequent reduction of the life insurance contract's cash value) apparently will not reduce "premiums paid."

We believe it would be appropriate to create a statutory rule to address how the section 7702(f)(7) adjustment rule should apply upon the payment of accelerated death benefits, and we would be pleased to provide any technical assistance that the Committee may require in this regard. Alternatively, this problem could be substantially ameliorated if the Treasury Department were to issue regulations indicating that "premiums paid" is reduced by any payments of accelerated death benefits, to the extent such payments reduce the cash value of the life insurance contract. If this approach is to be taken, it would be very helpful for this Committee's report to indicate that the Treasury Department should exercise its existing regulatory authority under section 7702(f)(1) to this effect.

Modification of "No Material Change" Transition Rule

The transition rule in section 307(d) of H.R. 8 is intended to prevent the addition of a long-term care or accelerated death benefit rider to a life insurance contract from constituting a modification or material change of the contract. Under this rule, adding such a rider would not disrupt any "grandfathering" that exists with respect to a life insurance contract, nor would it

subject the contract to a change in its limitations under the technical rules of sections 101(f)(2)(E), 7702(f)(7), and 7702A(c)(3). Thus, if a life insurance contract is currently governed by a set of rules under prior law, e.g., it is a section 101(f) flexible premium life insurance contract, the addition of a rider would not, in and of itself, cause the contract to become subject to a new set of rules. Further, if the contract is already governed by current law, e.g., section 7702A, the addition of a rider would not trigger a section 7702A(c)(3) material change.

As currently drafted, however, the rule does not appear to accomplish this purpose fully and unambiguously. We therefore recommend that the following changes be made:

- The rule currently appears to be limited to "determining whether section 7702 or section 7702A" of the Code "applies to any contract." This might be interpreted as limiting application of the rule to older, grandfathered contracts, denying its relief to recently or newly issued contracts. To clarify that this is not intended, the phrases "determining whether" and "applies to any contract" should be deleted.

- The rule currently has no application to terminal illness riders -- only long-term care riders are expressly covered -- and fails to mention section 101(f) contracts. The rule should be changed to cover the omitted riders and contracts.

- The rule currently appears only to address the addition of riders. The rule should be expanded to include the conformance of an existing rider to any of the Act's requirements, e.g., those of proposed section 818A(b) or (c).

Thus, we respectfully suggest that the transition rule be modified to read as follows (deleted language is stricken, new language is underscored):

> (d) Issuance of Certain Riders Permitted.-- For purposes of ~~determining whether~~ sections 101(f), 7702 or 7702A of the Internal Revenue Code of 1986 ~~applies to any contract~~, the issuance, whether before, on, or after December 31, 1995, of a rider on a life insurance contract providing long-term care insurance or accelerated death benefit coverage, or the conformance of such a rider to the requirements of this Act, shall not be treated as a modification or material change of such contract.

Long-Term Care Acceleration and "Non-Acceleration" Riders

It is our understanding that the treatment of long-term care benefits under H.R. 8 has been bifurcated, so that benefits from "non-acceleration" long-term care riders are addressed in section 301 of the bill (in proposed section 818A(d) of the Code) and benefits from long-term care acceleration riders are addressed in section 306 of the bill (in proposed section 101(g)(1)(B) of the Code). We believe it is entirely appropriate to address these benefits in the manner done in H.R. 8, given the operation of long-term care acceleration riders. Also, proposed section 818A(d) is necessary given the existence of products such as the extension rider. To alleviate any potential confusion arising from this bifurcated treatment, it would be helpful if this Committee's report, in addressing the accelerated death benefit provisions of H.R. 8, included the following language:

> The treatment of benefits from long-term care insurance riders to life insurance contracts that accelerate the life insurance death benefit is addressed in the accelerated death benefit provisions of the Act. In contrast, the treatment of benefits from other long-term care insurance riders is addressed in the long-term care insurance provisions of the Act.

STATEMENT TO THE WAYS AND MEANS COMMITTEE OF THE UNITED STATES HOUSE OF REPRESENTATIVES BY THE NATIONAL ASSOCIATION OF PEOPLE WITH AIDS

THE GRANTING OF TAX-FREE STATUS FOR ACCELERATED BENEFITS AND VIATICAL SETTLEMENTS

JANUARY 19, 1995

William J. Freeman
Executive Director

The National Association of People With AIDS (NAPWA) wishes to express its strong support for those sections in H.R. 8, the "Senior Citizens Equity Act" (the "Act"), that propose granting tax-free status to accelerated benefits received by terminally ill people as a subsidiary benefit of their life insurance policies. NAPWA believes, however, that people who are eligible for such payments would be better served if the Act were amended to extend the grant of tax-free status to the proceeds of viatical settlements of life insurance policies.

While the purely mechanical elements of the two types of transactions differ -- accelerated benefits clauses provide the insured with some percentage of the face value of their life insurance policy as an element of the life insurance contract while viatical settlements provide the payment of a mutually agreed upon percentage of the face value of life insurance policies by an investor in exchange for the naming of that investor as beneficiary -- the practical results of the two transactions are the same: a terminally ill person receives cash to provide for crucial needs created by their illness.

We believe that this expansion of tax-free status, in addition to providing equity for those terminally ill people whose lives are insured, but whose insurance policies do not include an accelerated benefits clause or who, due to the stringent requirements of many of the clauses, don't qualify, will help to create a more free and equitable market for life-insurance policies. Previous to the creation of the viatical settlement industry and the proliferation of viatical companies, no life insurance policies included accelerated benefits clauses. Now, however, market forces have created competition that gives people living with HIV real choices when they plan for their futures.

In 1992, NAPWA published *HIV in America: A Profile of the Challenges Facing Americans Living With HIV*. Among the findings of this landmark needs assessment was documentation of the long-held but heretofore anecdotal belief of the degree to which AIDS is financially devastating for nearly all people living with HIV, including a significant number of people who remain employed. Over half of the survey respondents reported significant difficulties in providing for basic personal needs such as rent, food and medicines. Of course, many people with expensive, chronic disease can no longer afford to work, whether or not they remain physically able to do so. It is ironic that a society that places such a high value on self-reliance has formulated public policies that effectively force individuals to stop working in order to qualify for vital benefits. Since a great many people living with HIV or other chronic illness find themselves unable to afford private health insurance or are excluded from coverage due to spending caps or preexisting condition clauses, they are forced to impoverish themselves in order to qualify for Medicaid benefits. This forced poverty leads to an unconscionable waste of both public and private resources.

Unfortunately, little organized research has been conducted on the non-medical repercussions of HIV disease status on factors such as income, housing, food and other nutritional supports, etc. Medical costs and related support programs have been analyzed, however, and the results of that analysis clearly indicate the depth of financial need among this population. Only 31.4% of Americans with asymptomatic HIV disease, 29% with symptomatic disease and 25.9% of people with AIDS are covered by private health insurance. And while 37.3% of people with asymptomatic infection are covered by some form of public insurance -- primarily Medicaid -- that figure rises to 62.3% for people with an AIDS diagnosis.

Meanwhile, the cost of care for people living with HIV disease continues to rise. In 1992, the last year for which such figures are available, the cost of treating an individual with asymptomatic HIV disease was approximately $6,400 per year. That cost jumps to more than $13,500 per year when the patient develops symptoms, and to over $40,000 annually when AIDS-defining conditions appear. At the same time, many private health plans that remain available to people living with HIV require the insured to pay large deductibles -- often over $2,000 a year -- and co-payments of 20% or more. In addition, treatment for HIV disease is heavily reliant on prohibitively expensive prescription drugs which remain uncovered under many medical plans. People living with HIV also pay out many thousands of dollars for nutritional supplements, large doses of vitamins and experimental treatments in order to stay as healthy as possible for as long as possible.

Complicating these difficulties is the scarcity of work opportunities for people living with HIV disease. Among the people surveyed for NAPWA's needs assessment, 30.9% were fully employed, 10.5% were employed part-time, and 58.5% were unemployed. Since 89% of the cases of AIDS in American males and 83% in females that were diagnosed through June of 1994 were among people between the ages of 20 and 49, the prime working years, any financial benefit provided by private sources -- such as private employer funded benefits -- as versus to public resources such as Medicaid or Social Security Disability -- provides important relief for strained government programs.

For all the above reasons, we believe that it is vital to people living with HIV and with other terminal or "dread diseases" that Congress act to exempt from taxes both viatical settlements and accelerated benefits under the conditions outlined above. This would involve the following modifications to H.R. 8:

- Amend Section 306 to include all types of accelerated benefits mechanisms specifically including viatical settlements. Tax-free status should be granted to any individual who is either terminally ill or suffering from a dread disease who decides to accelerate their benefits.

- Further amend Section 306 to set out definitions of "terminal disease" (less than 24 or 36 months to live), and "chronic illness" and "dread disease" (to allow the benefit for those whose condition is debilitating and who have no hope of recovery but whose prognosis is not terminal). This amendment is particularly important to our constituents because, while typical accelerated benefits provisions allow the insured to "cash in" their policies only when their medical condition suggests that they are likely to die within six months, typical viatical agreements allow the viator to cash in their policy when they are within two years of death. Because the average survival time after an AIDS diagnosis is between 18 and 24 months, and since many people cannot continue to work full-time after their diagnosis with an AIDS defining opportunistic infection, this two year window better meets the needs of people with HIV disease.

- Amend Section 306 to include a provision which protects individuals from having to include the potential value of accelerating their benefits as an element in means testing for Social Security Disability, Medicaid or other public benefit programs. This should remain an option for people who are ill, not a prerequisite.

We hope that you will give due weight to these suggestions in continuing your work on the Contract With America.

***

The National Association of People with AIDS (NAPWA) is dedicated to improving the lives of the more than one million people in the United States living with HIV/AIDS at home, in the community and in the workplace. Founded in 1983 by a coalition of people with AIDS, NAPWA serves as a national information center and voice for the needs and concerns of all people infected and affected by HIV.

STATEMENT OF ARTHUR S. FLEMMING
CHAIRMAN, SAVE OUR SECURITY COALITION

I. Introduction

A. Soon after the Social Security Act was passed the Commissioner of Internal Revenue was asked if the benefits under social insurance for retirees were taxable.

1. The Commissioner ruled that they were gratuities and as such were not subject to taxation.
2. This ruling prevailed until 1983 when Congress decided that a portion of social security benefits should be taxed and the existing revenue designated for the Social Security Trust Fund.
3. The Congress had never before addressed, pro or con, the subject of taxation of social security benefits.
4. The exclusion of social security benefits from taxation was not a part of the initial commitment.
5. Private pension or income from private retirement funds are subject to taxation.

II. Body

A. Under present law, people with income and social security benefits above the threshold of $34,000 for unmarried individuals and $44,000 for married individuals, must include up to 85 per cent of social security benefits in their adjusted gross income.

B. The Contract With America would provide that not more than 50 per cent of social security benefits would be subject to income tax, regardless of the level of the beneficiary's total income.

1. The phase out would occur between 1996 and 2000.
2. The proposal would reduce tax receipts deposited by law in the Hospital Insurance Trust Fund by $15 billion over the five year period 1996-2000 and by $48.5 billion over the ten-year period--1996-2005.

III. Conclusion

A. This proposal is opposed because it would mean that Government would be taxing private pensions and private retirement income at much higher rates than they would be taxing social security benefits.

1. It is opposed also because it would reduce the revenues needed for the Hospital Insurance Trust Fund.

2. Furthermore, the increase from taxation of benefits of 50 per cent to 85 per cent over the threshold of $34,000 and $44,000 affected only 13 per cent of taxpayers reporting social security benefits in 1994--those at the high end of income affecting beneficiaries.

B. It is believed that it is wise Government policy to reduce the gap between taxes paid on private pensions and the receivers of income from private retirement income plans and taxes paid by social security beneficiaries, and to use the income from social security taxes for the strengthening of the social security trust funds.