PRESIDENT'S FISCAL YEAR 2000 BUDGET

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

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THURSDAY, FEBRUARY 4, 1999

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

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

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
January 28, 1999
No. FC–4

Archer Announces Hearing on the President's Fiscal Year 2000 Budget

Congressman Bill Archer (R–TX), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on President Clinton's fiscal year 2000 budget proposals within the jurisdiction of the Committee. The hearing will take place on Thursday, February 4, 1999, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.

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

BACKGROUND:

On January 19, 1999, President Clinton delivered his State of the Union address. In it, he outlined numerous budget and tax proposals. Among them was a proposal to set aside 62 percent of projected budget surpluses over 15 years for Social Security's cash reserves. One-quarter of this amount would be invested by the Federal government in stock markets. The President proposed setting aside another 11 percent of projected surpluses to create individual retirement accounts, which would be in addition to Social Security and another 15 percent for Medicare. Among other things, the President proposed a number of new tax credits. His budget is expected to include various other tax, fee, and revenue increases.

The details of these proposals are expected to be released on February 1, 1999, when the President is scheduled to submit his fiscal year 2000 budget to the Congress.

In announcing the hearing, Chairman Archer stated: "I look forward to receiving the President's budget proposals. The President has already announced many interesting ideas and it's appropriate we review them in complete detail. I'm sure they will raise important questions for thoughtful discussion."

FOCUS OF THE HEARING:

The Committee will receive testimony on the President's fiscal year 2000 budget proposals from Secretary Rubin. The Secretary is expected to discuss the details of the President's proposals which are within the Committee's jurisdiction.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the close of business, Thursday, February 18, 1999, to A.L. Singleton, 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 200 additional copies for this purpose to the Committee office, room 1102 Longworth House Office Building, by close of business the day before the hearing.

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 submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

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

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. 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.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS MEANS/'.

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

Chairman ARCHER. The Committee will come to order. The Chair invites guests and staff to take seats.

Mr. Secretary, good morning, and good morning to everyone in the room.

We are glad to have Secretary Rubin here to discuss the administration's budget proposal for Social Security, Medicare, tax relief, and other important priorities. This is pretty much an annual event.

Secretary RUBIN. Yes, sir.

Chairman ARCHER. This morning I am going to begin with an announcement concerning one of Congress' top priorities for the year, and that is education.

In 1997, we worked across party lines to improve education. We passed 220,000 new Pell grant scholarships for deserving students. We made interest on student loans deductible. We created tax-free education IRAs, and in legislation last year, we gave families a $1,500 tax credit for the first 2 years of college, the Hope Scholarship, to cover the cost of tuition and other expenses. We also provided a lifetime learning credit for those students continuing their education in college, graduate school, and job training. Mr. Secretary, we did that together, and I think that was a great, great accomplishment for the country.

Today, I am pleased to build on our success in education by announcing another initiative that will help build more public elementary and secondary schools across the United States. This initiative is not narrowly targeted, but is available to every school district, from the Spring Branch Independent School District in my district, to larger school districts in Los Angeles, New York, and everywhere in between. This plan is universal; it covers the cities, the suburbs, and the farms.

When we get to a tax bill this year, I will include in it a $1.4 billion school construction initiative that makes permanent changes to tax-exempt bond rules that will spur school construction now and in the future. This plan will make it much easier for State and local governments to comply with the current complicated bonding rules that takes money out of their school construction funds.

In short, the proposal will do three things. It will provide more money for school districts, it will reduce paperwork for State and local governments, and it will give greater flexibility to school districts regarding issuing bonds and building public schools.

Education is vital to our Nation's future, and I am proud to be a part of a Congress that puts education first.

Mr. Secretary, when we talk about the budget, we are talking about basically the blueprint for government action in all types of fields in the next year. I am sure that Members will have many, many questions on a variety of subjects. We are happy to have you here, and I hope we can find a way to work together this year as we did in 1997 to do good things for this country.

Welcome, and after Mr. Rangel makes his comments, we will be pleased to have your testimony. In the meantime, without objection, each Member will have the opportunity to submit a written statement and have it included in the record at this point.

[The opening statement follows:]

Opening Statement of Hon. Bill Archer, a Representative in Congress from the State of Texas

Good morning Mr. Secretary. We're glad you're here to discuss the Administration's budget proposal for Social Security, Medicare, tax relief, and for other important priorities.

This morning, I want to begin with an announcement concerning one of Congress' top priorities for the year. Education.

In 1997, we worked across party lines to improve education.

We passed 220,000 new Pell Grant scholarships for deserving students.

We made the interest on student loans deductible. We created tax-free education IRAs. And last year, for the first two years of college, we gave families a $1,500 tax credit—the HOPE scholarship—to cover the cost of tuition and expenses. We also provided a Lifetime Learning Credit for those students continuing their education in college, graduate school, and job training.

Today, I'm pleased to build on our success in education by announcing another initiative that will help build more public schools all across the United States—from the Spring Branch independent school district in Texas to larger school districts in Los Angeles, New York and everywhere in between. This plan is universal. It covers the cities, the suburbs, and the farms.

My 1999 tax bill will include a $1.4 billion school construction initiative that makes permanent changes to tax-exempt bond rules to spur school construction now and in the future. This plan will make it much easier for state and local governments to comply with complicated bonding rules. In short, this proposal will do three things:

It will provide more money for school districts

It will reduce paperwork for State and local governments

And it gives greater flexibility to school districts regarding issuing bonds and building public schools

Education is vital to our nation's future and I'm proud to be part of a Congress that puts education first.

Mr. Secretary, I look forward to discussing the rest of your budget with you and I hope we will be able to count on the Administration's support so we can, in an appropriate and effective way, help improve education for all our young people.

Chairman ARCHER. Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman.

Mr. Secretary, first, let me thank you for the leadership that you have given to our country by stressing solid fiscal policy and your temperament, your tolerance, and your ability to bring forth issues that are not Democratic or Republican but are sound tax policy and good for the people of our great country. And let me pause to thank my Chairman for picking education as an issue that he would focus on to start this hearing.

We were chatting earlier, and we hadn't discussed this, but I certainly wish I had brought it up because if Democrats are being charged with stealing good Republican ideas, I hope that they steal this Democratic idea of supporting public schools so that we can start off together by reading from the same page.

I don't know what your school construction legislation would do, but I am ready to walk down any road with you that would build on the fundamental premise that cannot reject any students. Instead of fighting about whether we should have individual education accounts or vouchers, let the private school be supported, but let us make certain that we have a sound public school system, because in so many of our communities the public school system is being broken because buildings are not serviced, teachers are not qualified, kids are put out into the street without adequate training, and drugs and violent crime are prevalent. This country can't continue with 1.8 million people in jail. Everyone agrees that a good solid education is the best way to avoid all of these pitfalls.

So, I hope that this will be a great area that we can use to bridge the appearance of a gap between our parties by working with the administration for a sound public school system.

In the areas of Social Security, tax cuts, and Medicare, bridging the gap is going to be more difficult, but I hope it is possible because I truly don't believe that Republicans or Democrats win if we get a label of a do-nothing Congress. I think that we all have a second chance to improve upon the reputation that politicians have, especially those of us in Washington.

The President will be getting a second chance for a terrible mistake that he has made in his private life. The American people are giving him a second chance, and soon he will know that he has 2 years to work on a legacy that he can be proud of. Republicans will be given a second chance to remove the stigma about the way they have handled the President's mistakes so that in the year 2000 the party of Republicans will not be considered "dead men walking."

The Democrats also will have a second chance. We are in the minority, and we have to prove that we can do better. And we can't do that by fighting each other. We have to do that by showing that we have the ability to provide the leadership to try to work out our differences.

Education is easier than Social Security. But maybe, just maybe, the leadership of our parties can find out how far apart we are. Maybe we can't do Social Security, and we will move to Medicare. Our constituents are not looking for a Republican solution or a Democratic solution, and that is certainly true when it comes to preserving the Social Security Trust Fund.

Let's not start off with, say, a debate about a 10-percent tax cut across the board, because that would cause us to lock into a very partisan position.

So, we have the President's budget. It makes a lot of sense to me. Some may wish to improve a some part of it—this is the first day of the beginning of the campaign for the year 2000. I think that we will all be better off in trying to see where we agree than to lock into positions this morning.

Mr. Secretary, thank you so much for your past service, and we look forward to working with you in the next 2 years of this Congress.

Chairman ARCHER. Mr. Secretary, welcome again. If you would like to summarize your testimony, without objection, your entire written statement will be printed in the record. We are happy to have you and will be pleased to receive your testimony.

STATEMENT OF HON. ROBERT E. RUBIN, SECRETARY, U.S. DEPARTMENT OF THE TREASURY; ACCOMPANIED BY HON. SYLVIA MATHEWS, DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Secretary RUBIN. Thank you, Mr. Chairman.

Let me first say that I appear with Sylvia Mathews who is Deputy Director of OMB, and she and I will both be glad to respond to questions after I deliver my testimony if I may.

Let me start by expressing the appreciation for the opportunity to discuss the President's fiscal year 2000 budget. This has, as you say, become an annual event, Mr. Chairman, and, I think, a very useful one.

With the result of the fiscal policy of the past 6 years that the economy has helped produce and the ongoing interaction between the two, this Nation has, as you know, gone from a very large and increasing deficit to a period of surpluses that are projected to continue for a long, long time to come. In our judgment, Mr. Chairman, that gives us all, working together, as you correctly say, a historic opportunity to meet challenges that will affect our economic and social well-being for the decades ahead. And that is the purpose that lies behind the President's budget.

The core of that budget is fiscal discipline, and, thereby, to increase the national savings in order to promote economic growth, retirement security in the years ahead.

Let me briefly comment on the last 6 years, if I may. In 1992, the deficit was $290 billion and projected to increase substantially. And that was after a period in which the Federal debt had, roughly speaking, quadrupled over 12 years. The President responded with an economic strategy that was focused on fiscal discipline. It also included investing in people and open markets. This strategy has contributed to moving us from these very substantial deficits to surpluses and what many consider the best economic situation in decades. The very high rate of job creation, the lowest unemployment rate in decades and real increases in incomes across all strata.

I believe, Mr. Chairman, that it is very useful to look at what has happened and also the strategy that has contributed to what has happened as a guide for policy to the future.

Let me also stress that tax burdens on working families are at record lows compared to recent decades. For a family of four with a median income, the Federal income and payroll tax burden is at its lowest level in 21 years in part because of the child tax credit that this Congress and the President, working together, enacted in 1997. For a family of four with half the median income, the income and payroll tax burden is at its lowest level in 31 years, in part because of the 1993 expansion of the earned income tax credit as well, of course, as the Child Tax Credit. And for a family of four with double the median income, the Federal income tax burden is at its lowest level since 1973. Overall, tax revenues have risen as a percentage of gross domestic product, GDP, primarily because the most affluent have had large increases in income in part because of bonuses tied to stock prices, in part because of capital gains, and also because of increase in corporate income.

Against that background, the President's new budget proposes that in order to increase jobs, raise standards of living, promote retirement security, we must save, save the great preponderance of the projected surpluses and not consume them for tax cuts and for spending. Specifically the budget proposes that 62 percent of the surpluses be allocated for Social Security and 15 percent of the surpluses be allocated for Medicare. These resources will then be used predominantly to paydown publicly held Federal debt and, in part, to purchase equities both of which, in effect, preserve our National savings, and, by preserving national savings, promote economic growth rather than eliminating national savings that is represented by the surplus, which, in our judgment would adversely effect economic growth.

In addition, national savings is increased by allocating 12 percent of the surpluses for creating new, universal savings accounts.

Finally, the budget insists, as you know that none of the surpluses be used, at all, for any purposes until Social Security is put under firm, financial footing.

Let me focus for a moment on debt reduction. When President Clinton was elected, publicly held debt equaled 50 percent of gross domestic product. Under the President's plan, 80 percent of the surpluses, allocated to Social Security, and all of the surpluses allocated to Medicare will reduce the debt held by the public. As a result, by 2014, publicly held debt will decline to about 7 percent of GDP. This reduction of debt as a percentage of GDP will have three effects.

First, the government will not have to finance Federal debt and thereby will consume less of national savings thus making capital more readily available to the private sector which in turn will reduce interest rates, and, I believe, increase job creation and standards of living.

Second, when the President came into office, debt service costs to the Federal Government in 2014 were projected to constitute 27 percent of the Federal budget. Under the President's proposal, and because of the progress made to date, it is now estimated that debt service cost will be 2 percent of the Federal budget in 2014.

Third, the decrease in debt means that the Federal Government will have enormously increased capacity to access external capital should that need arise.

In addition, the President's budget strengthens Social Security and Medicare. With regard to Social Security, the President has proposed two measures that, taken together, would extend the life of the Trust Fund to 2055. The first is the purchase of Treasury special, nonmarketable securities which are, in effect, a first claim against the general revenues of the Federal Government to meet the already existing Social Security commitments. The second proposal is that, of the 62 percent of the surpluses transferred to the Social Security Trust Fund, about one-fifth should be invested in private sector equities.

I have expressed concern from time to time about investment in equities by the trust fund. Let me make two observations, if I may, about this particular proposal.

First, it would result in roughly 15 percent of the trust fund being invested in equities. Equities do have risks, and in my view, at least, those risks are often underweighted in discussions about investment of Social Security in equities. I believe that we have found a prudent balance between the potentially greater return from equities that has existed historically and keeping the investment small enough so that the government is not exposed to undo risk.

Second, we are proposing to have two levels of protection to make sure that there is no political influence in the investment process. Money managers would be from the private sector and there would be no investment function performed by the government. Also, a mechanism would be devised, working with Congress, to provide apolitical oversight and apolitical selection of the managers.

In addition, the President has proposed that a bipartisan process be created to recommend the difficult choices necessary to extend the life of the Trust Fund beyond 2055 to long-term actuarial balance, 2075. However, within the framework of these tough choices, the President is committed to reducing the high rate of poverty for elderly widows and to eliminating the earnings test for working seniors.

With regard to Medicare, we extend the life of the trust fund to 2020 by, again, purchasing Treasury special, nonmarketable securities. In addition, the President proposes that we work in a bipartisan basis to enact reforms after the Medicare Commission submits its report, which I believe is due on, or about, March 1. He also proposes that these reforms should include the coverage of the cost of prescription drugs.

The President has also proposed a new, universal savings accounts. These accounts would receive 12 percent of the surplus, be separate from Social Security, and provide incentives for workers to save for retirement. The government would provide a refundable tax credit of an equal amount for each account and also a match for each additional dollar voluntarily saved with larger matches going to low-income workers.

Finally, the remaining 11 percent of the surplus would not be saved, which means that 89 percent would go to increase national savings. The final 11 percent would not be saved but would be allocated for defense spending and for critical, domestic discretionary investment priorities. This 11 percent supplements other discretionary expenditures that are within the limits proposed by the discretionary spending caps.

Let me very briefly highlight some of the key investments and priorities in the budget. And first let me say once again that all discretionary spending is under the caps and all mandatory expenditure increases are fully offset as required by PAY–GO rules.

In his State of the Union, the President made clear his priority with respect to tax credits, discretionary spending would be education, working families, communities, a strong economy and a strong America in the world.

For education, the budget proposes to help States and school districts build and renovate schools to $3.75 billion of tax credits over 5 years. We also propose to extend section 127 for employer-provided educational assistance.

For working families, the budget proposes a long-term care initiative that includes a new, $1,000 tax credit that will compensate families for the cost of caring for an ailing relative and a new, $1,000 tax credit to assist workers with disabilities. There are a number of programs to help with childcare costs.

Third, for communities, the budget provides for a new market investment initiative that we believe could create $15 billion in new capital investment in businesses in underserved inner cities and rural areas with tax credits and loan guarantees. It also includes an increase in the low-income housing tax credit.

Finally there are a number of law enforcement initiatives which will build on the work that the administration has done in the last 6 years with respect to increasing law enforcement officers on the streets, making the Brady law permanent and banning violent juveniles from buying guns.

Fourth, to help foster a strong economy, the budget proposes to facilitate Y2K amelioration activities for the Council on Year 2000 conversion and to extend the research and experimentation tax credit.

Finally, the budget asks for resources to strengthen America's leadership in the world. I believe that the Congress has contributed greatly to financial stability in the world by, last year, providing full requested funding to the International Monetary Fund, and I believe that a similar contribution can be made this year by approving the request this year to meet all of our financial obligations to the United Nations.

Before I close, let me, if I may, Mr. Chairman, mention one other important element of this year's budget, and one that I believe will be important to this Committee. Our budget contains several proposals aimed at curbing corporate tax shelters which have proliferated in recent years. Corporate tax shelters not only erode the corporate tax base, they also breed disrespect for the tax system both by those who participate in the corporate tax shelters and by others more generally who view the tax system in an unfair fashion.

Our budget proposals address these issues in two ways. One, by increasing disincentives for entering into abusive transactions, those are generic provisions. And second, by attacking a specific tax shelter's transactions of which we are aware. Our department would very much like to work with this Committee and with Congress more generally to deal with this very important problem.

Let me conclude, Mr. Chairman, that restoring fiscal discipline to our country has, in my view and in our view, contributed enormously to the strong economic conditions of the past 6 years. Because of what has been accomplished we now have a unique opportunity to further economic and social well-being for the years and decades ahead. The President has proposed that the surpluses be used predominantly to increase national savings and improve the fiscal conditions of the Federal Government while at the same time strengthening Social Security and Medicare.

The effect of all of this should be to increase jobs, increase standards of living, continue the favorable economic conditions of the last 6 years and improve the economic security of future retirees and workers. We look forward to working together in the bipartisan spirit that you discussed, Mr. Chairman, as we face these critical challenges.

Thank you.

[The prepared statement follows:]

Statement of Hon. Robert E. Rubin, Secretary, U.S. Department of the Treasury

Mr. Chairman, members of this Committee, I appreciate the opportunity to discuss with you the President's FY 2000 Budget, the first budget of the 21st century.

As a result of the fiscal policy of the last six years, the economy it helped produce, and the ongoing interaction between the two, the nation has moved from an era of large annual budget deficits to an era of budget surpluses for many years into the future. And this gives us an historic opportunity to meet challenges that will affect our economic and social well-being for decades to come, including the economic and fiscal pressures created by the retirement of the baby boom generation. And meeting those challenges is exactly what the President's budget does. The core of this budget is fiscal discipline, and thereby increased national savings, in order to promote economic growth and retirement security in the years ahead.

Before I discuss how this budget will meet these challenges, let me review what has taken place in the last six years. In 1992, the deficit reached a record of $290 billion, the Federal debt had quadrupled during the preceding twelve years and both the deficit and debt were projected to rise substantially. The President responded with a three-pronged economic strategy of fiscal discipline, equipping people for the future and open markets at home and abroad. This strategy contributed greatly to moving us from deficits to surpluses, and to what many consider to be the best economic conditions in recent memory—the longest peacetime economic expansion in our history, a very high rate of job creation, the lowest unemployment in decades, and real increases in income across all income strata. It seems to me that focusing on the economic conditions of recent years, and on the strategy that contributed so much to them, provides very useful guidance as we face policy issues going forward.

Let me also stress that tax burdens on working families are at record lows for recent decades. For a family of four with a median income, the federal income and payroll tax burden is at its lowest level in 21 years, in part because of the child tax credit enacted in the 1997 balanced budget plan. For a family of four with half the median income, the income and payroll tax burden is at its lowest level in 31 years, in part because of the 1993 expansion of the Earned Income Tax Credit for fifteen million families as well as the 1997 enactment of the child tax credit. And for a family of four with double the median income, the federal income tax burden is at its lowest level since 1973. While overall tax revenues have risen as a percentage of GDP, that is primarily because affluent individuals have had large increases in incomes, in part from bonuses based on high stock prices and increased realizations of capital gains, and in part because of increased corporate earnings.

Against that backdrop, the President's new budget proposes that in order to generate jobs, raise standards of living and promote retirement security most effectively, we must save the great preponderance of projected budget surpluses, not consume them for tax cuts and spending programs. Specifically, the budget proposes that 62 percent of the surpluses be allocated for Social Security, and 15 percent of the surpluses be allocated for Medicare. These resources will then be used predominantly to pay down publicly held debt of the federal government, and in part to purchase equities, both of which will in effect preserve and invest rather than consume and eliminate the increase in national savings that comes from the surplus. In addition, national savings is increased by allocating 12 percent of the surpluses for creating new Universal Savings Accounts. Finally, the budget insists that none of the surpluses be used at all until we have put Social Security on sound financial footing for the long-term.

Let me focus on debt reduction for a moment. When President Clinton was elected, publicly held debt equaled 50 percent of GDP. Under the President's plan, 80 percent of the surpluses allocated to Social Security and all of the surpluses allocated to Medicare will reduce debt held by the public. As a result, by 2014, publicly held debt will decline to about 7 percent of GDP. This reduction in debt will have three effects. First, the government will not have to refinance federal debt and thereby will consume less of national savings, thus making capital more readily available to the private sector. That, in turn, will reduce interest rates and increase confidence in the economy, increasing economic growth, job creation and standards of living. Second, debt service costs will decline dramatically. When the President came into office debt service costs of the federal government in 2014 were projected to constitute 27 percent of the federal budget. Under the President's proposal, and because of the progress we have made to date, we estimate the debt service costs will be 2 percent of the federal budget in 2014. Third, the decrease in debt means the federal government will have a greatly improved capacity to access external capital should the need arise.

In addition to reducing publicly held debt, the President's budget strengthens Social Security and Medicare. With regard to Social Security, the President has proposed two measures that—taken together—will extend the life of the Trust Fund to 2055. The first measure is the purchase of Treasury "special" non-marketable securities, which are in effect a first claim against the general revenues of the federal government to meet the already existing Social Security commitments. The second proposal is, that of the 62 percent of the surpluses that will be transferred to the Social Security Trust Fund, about one fifth would be invested in private-sector equities.

I have had concerns about investment in equities by the Trust Fund. Let me make two observations about this particular proposal. First, it would result in roughly 15 percent of the Trust Fund being invested in equities. Given that equities do have risks, that seems to me to be a prudent balance between receiving the potentially greater return from equities and keeping the investment small enough so that the Trust Fund is not exposed to danger. Second, we are proposing to have two levels of protection to make sure that there is no political influence in the investment process. Money managers would be from the private sector and there would be no investment function performed by government officials. A mechanism would be devised in concert with Congress to provide apolitical oversight and apolitical selection of these managers.

In addition, the President is also proposing that a bipartisan process be created to recommend the "tough choices" necessary to extend the life of the Trust Fund beyond 2055—to 2075. However, within the framework of these "tough choices," the President is committed to reducing the high rate of poverty for elderly widows—and to eliminating the earnings test for working seniors.

With regard to Medicare, we extend the life of the Trust Fund to 2020 by purchasing Treasury "special" non-marketable securities, as under current law. In addition, the President proposes that a bipartisan process be used to enact reforms, but only after the Medicare Commission submits its report in March, and that coverage of the cost of prescription drugs should be part of any package recommended by this bipartisan process.

Now let me focus on our proposal for the new Universal Savings Accounts. These accounts would receive 12 percent of the surplus, be separate from Social Security, and would provide incentives for workers to save for retirement. The government would provide a refundable tax credit of an equal amount for each account and also a match for each additional dollar voluntarily saved, with larger matches going to low income workers. The exact details of the program would be worked out by the Administration and Congress.

Finally, the remaining eleven percent of the surpluses would not be saved, but would be allocated for defense spending to protect our national security and for critical domestic discretionary investment priorities. This eleven percent supplements other discretionary expenditures in the budget that are within the limits imposed by the discretionary spending caps.

Let me now highlight some of the key investments and priorities in the discretionary and mandatory sides of the President's budget. Leaving aside measures in the budget that are paid for out of the surplus after Social Security has been addressed, all new tax cuts and mandatory spending are fully paid for and the budget complies with the discretionary caps.

In his State of the Union Address, the President made clear that our key investments for the future and our critical priorities were concerned with providing important programs and tax credits for education, working families, communities, and fostering a strong economy and a strong America in the world. Within these broad areas, I would like to focus on just a few specific initiatives.

First, for education, the budget proposes to help states and school districts build and renovate schools through $3.75 billion of tax credits over five years. The budget also proposes to extend and expand the tax deduction for employer-provided educational assistance.

Second, for working families, the budget proposes a long-term care initiative that includes a new $1,000 tax credit to help compensate families for the cost of caring for an ailing relative. The budget also includes a new $1000 tax credit to assist workers with disabilities. And the budget helps with child care costs in three ways: through greater tax relief for working families and for those parents who stay at home, through subsidies to help families pay for child care, and through dramatic increases in funding for after-school programs.

Third, for communities, the budget provides for a "New Markets Investments Initiative" that could spur $15 billion in new capital investment in businesses in underserved inner cities and rural areas through tax credits and loan guarantees. It also includes an increase in the low-income housing tax credit. Finally, the budget calls for a new 21st century policing initiative that would help communities add between 30,000 and 50,000 more law enforcement officers, give law enforcement officials access to the latest crime-fighting technologies, make the Brady law permanent, and permanently ban violent juveniles from buying guns.

Fourth, to help foster a strong economy, the budget proposes to facilitate "Y2K" amelioration activities through the Council on Year 2000 conversion and extend the Research and Experimentation tax credit.

Finally, the budget asks for resources to strengthen America's leadership in the world. The Congress contributed to global financial stability last year by providing the full amount of resources for the International Monetary Fund. I would like to strongly encourage the Congress to approve the request in this budget to meet all of our financial obligations to the United Nations. We are also asking for resources to promote trade with Africa.

Before I close, let me mention one other important element of this year's budget. Our budget contains several proposals aimed at curbing corporate tax shelters. Tax shelters not only erode the corporate tax base, they also breed disrespect for the tax system both by people who participate in the corporate tax shelter market and by others who perceive corporate tax shelter users as paying less than their fair share of tax. Our budget proposals address these issues by increasing disincentives for entering into abusive transactions and by attacking specific corporate tax shelter transactions of which we are aware. The Treasury Department will continue to study additional remedies for the corporate tax shelter problem and to work with the members of Congress and their staffs to address this issue.

Mr. Chairman, restoring fiscal discipline to our country has contributed enormously to the strong economic conditions of the last six years. Because of what has been accomplished, we now have a unique opportunity to further our economic and social well-being for the years and decades ahead. The President has proposed that the surpluses be used predominantly to increase national savings and improve the fiscal condition of the federal government, while at the same time, strengthening Social Security and Medicare. The effect of all this should be to increase jobs, raise standards of living and improve the economic security of future retirees and workers. I look forward to working with the members of this Committee as we face these critical challenges. Thank you very much.

Chairman ARCHER. Thank you, Mr. Secretary.

Mr. Secretary, on January 21, we had our first Social Security hearing of the year, here, in this room. At that time I agreed to move toward the President as a starting point for the Social Security solution by agreeing to wall off 62 percent of the surplus until Social Security could be saved. I think that this is an expression of cooperation moving toward the foundation of the President's proposal.

Now, I also adamantly oppose the investment by the government of Social Security Trust Fund dollars in the private marketplace. I have made a number of public statements over the last 1½ years against that sort of proposal including when the Advisory Board came out with its recommendation awhile back. So, that was not intended to be an immediate negative reaction to the President's proposal.

Once we have walled off the 62 percent, can you explain to me what the administration proposes to save Social Security for 75 years which is our responsibility and obligation with which we are charged?

Secretary RUBIN. Two comments, if I may, Mr. Chairman.

I do think that, as you say, the walling off of the 62 percent did, in a sense, accept the foundation piece of the President's proposal. But the President, as you know, has the view, and I think correctly, that we shouldn't simply wall it off. That we shouldn't do anything else with the surplus until we actually enact a Social Security plan. And I think that for two reasons.

First, the concern is that if we wall it off but don't enact Social Security reform and do the other kinds of things that we may prefer to do that we may, in fact, deal with the Social Security issue. And so, in order to maintain maximum pressure to get Social Security done, his view is that we should first enact Social Security, and that is the view that he has had over the last year, and then go on to do all of the other things that we may want to do and debate what we do with the other 38 percent.

Second, although our proposal is 62 percent, there is no way of knowing what Congress and the administration while working together might ultimately decide. It is possible, and it is quite possible, I suspect, that this would be done with 62 percent of the surplus, and other things would be done to deal with the rest of Social Security, but one can't tell, and, in our view, at least, we shouldn't limit the flexibility of Congress and the administration to deal with Social Security by doing other things with the surplus before Social Security is dealt with. But, predominantly, I think that it is really to maintain the pressure to get Social Security addressed.

Third, to go from 2055 to 2075, as you correctly say, involves a lot of very difficult decisions, and it was the President's view again, I think correctly, as he has said through this whole process, is that what he should do is what he thinks will best move this process forward. And it is his view that at this time what he should do is work with Congress on those kinds of very difficult issues with the concern that if he gets ahead of Congress or gets ahead of the rest of the process then the proposal that he might put forward could create a negative political reaction and actually retard the process rather than put it forward.

As you and I have had this discussion over the course of the last year, his consistent principle has been to do whatever it is that will move this process forward. I must say that we have come a long way following that principle. When you consider that all of last year we did not touch the surplus, we did preserve it for Social Security. We have now positioned ourselves where there seems to be a coalescence around that is using this 62 percent.

So I think that with that principle we have made enormous progress, and we should now do what he says and all work together on these very difficult issues rather than throw out proposals independently of that which runs the risk of those proposals being attacked and setting the process back.

Chairman ARCHER. What actions are currently being taken by the administration to move this ball forward?

Secretary RUBIN. I think that what needs to happen, Mr. Chairman, is for the leadership in the Congress, the administration, once we get through the process that we are in right now, the process of hearings on the budget, to determine a process that could work effectively to move us forward on the difficult decision, just like we do in every other legislation that we face in this Congress. As you said, we have done this on an annual basis.

I have been here 6 years now, and you have been here a lot longer. It seems to me that—you must have started younger—but it seems to me that what we do each time is find some way to work together. At least in the years that I have been here, the modality of that working together has been somewhat different from year to year and then we work together on the very difficult issues, and that is exactly what I would do now.

Chairman ARCHER. I think there is common agreement that we have a very limited window of opportunity, realistically, to address this very difficult problem. I think that it behooves us to move as rapidly as we can.

Secretary RUBIN. I agree.

Chairman ARCHER. I would like to followup on a comment you made in your response that you protected the surplus last year. Did the President sign any legislation last year that spent any of the surplus? If it happened, of course, that was done prior to saving Social Security or Medicare.

Secretary RUBIN. I am sorry, Mr. Chairman, I missed the question.

Chairman ARCHER. Did the President sign any legislation last year that spent any of the surplus prior to saving Social Security and Medicare?

Secretary RUBIN. The only spending that we had last year was the spending that was done in accordance with the budget including emergency spending.

Chairman ARCHER. No, no, it is not whether it was in accordance with the budget. The question was, did the President sign any legislation that spent any of the surplus?

Secretary RUBIN. In my judgment the answer to that question is no. But if what you are referring to, Mr. Chairman, are the emergencies, emergencies are, as you know, provided for under the Balanced Budget Agreement in 1997, and I think that when you calculate the surplus you calculate the surplus net of the budget, and emergencies that are provided for in the Balanced Budget Agreement.

The answer to your question, in my judgment, is no.

Chairman ARCHER. In your judgment, I understand.

Secretary RUBIN. Well, I will take out in my judgment.

Chairman ARCHER. I think that an objective citizen of this country would say that when you project surpluses of a certain amount of money and you do not cover all of your spending under the spending caps, irrespective of whether you call it emergency or supplemental, you have spent part of the surplus that you projected you would otherwise have.

Secretary RUBIN. Well I guess where I would disagree, if I may, Mr. Chairman, is that the surplus, at least as I understand it, in the 1997 Balanced Budget Agreement was a surplus net of both regular spending and also emergencies. There was provision for emergency spending in the 1997 Balanced Budget Agreement.

Chairman ARCHER. But, Mr. Secretary, you can't project surpluses net of emergency spending unless you know what the emergency spending is going to be in advance, and if you know what it is going to be in advance, it isn't emergency spending.

Secretary RUBIN. Well, I think that it actually cuts a little bit the other way, if I may say so. I think that your projection of a surplus is a number based on the regular budget and then it is subject to the contingency of emergencies, and so the actual projection, if you will, is the surplus in accordance with the regular budget net of whatever emergencies may occur that Congress agreed—that is they agreed last year, for example—are duly constituted emergencies.

In other words, the surplus, under the agreement we reached in 1997, the surplus is projected, according to budget, less whatever emergency spending may occur. And of course, for emergency spending to occur, it must be approved by Congress. And you all, I think correctly, agreed that certain matters constituted emergencies last year.

Chairman ARCHER. Mr. Secretary, let me take issue in that regard because I am a firm believer that we do not budget correctly. We should have a contingency fund in every budget that we enact that anticipates the average amount of supplemental spending that will occur. We have supplemental spending every year. There is no State in this country or city in this country that does not provide for a contingency fund for the things that they know will arise, whether for disasters or whatever else. To simply say that we have an unlimited amount to declare anything we want to an emergency, the next year the money has already been spent. This opens the door to say that you could spend the entire surplus and declare it an emergency and there would be no surplus for Social Security or Medicare or anything else. That is a terrible way to budget.

I am urging the CBO and our congressional budgets to include a contingency fund, and I think that if OMB realistically had a budget that made sense they would have a contingency fund up front.

A good example of this is the money being spent for Bosnia that is coming out of the Defense Department budget. We know that those troops are going to be in Bosnia. You will not let us remove the troops from Bosnia. That is not an emergency. And yet when you replenish that money in the supplemental spending bill, you will say that that is an emergency and therefore you can spend the surplus.

Secretary RUBIN. Well, I think that the problem that you have got, Mr. Chairman, look, you are raising a very important, and I think difficult issue. But I think that the problem that you have, and we can ask Ms. Mathews if I am right, that in Bosnia we do pay for that. But I don't know how you anticipate a Hurricane Mitch or a Hurricane Andrew. I don't think that you can—this is a very important budgeting issue, I agree, but I think, unfortunately, Mr. Chairman, that life is more uncertain than projections of average contingency spending might allow. So I think in the final analysis, that what you are going to have to rely on is a sensible definition of an emergency and then a sensible application of that definition by the Congress working with the administration.

Ms. MATHEWS. And in this current budget that we submitted, Bosnia is paid for within our defense budget.

Chairman ARCHER. OK, but it was not last year. We put $1.8 billion in supplemental which you said was emergency spending for the Bosnia operation. That had not been budgeted.

Secretary RUBIN. But Mr. Chairman, I think that unfortunately that the United States is faced with the kinds of uncertainties that you simply can't encompass with projected contingency spending. One doesn't know what kind of hurricanes, typhoons, and other kinds of activities, including, unfortunately when necessary military activities might take place next year.

Chairman ARCHER. Well, Mr. Secretary, all I can say is every other body I know of has a contingency fund based on average expectancy of the things that will come up judged by past year's experience, over many years. And certainly you can't know for sure, but every year we have disasters. Every single year. And we should provide at least a minimal amount as a contingency. Otherwise you simply are discarding this question of surplus. And the American people understand that if the government spends money, irrespective of how you characterize it, they are eating into the surplus.

So, I don't want to belabor that anymore. I have two other quick things that I wanted to ask you.

Secretary RUBIN. Could I just make one more comment? I think we do have though, in the system that we now have, the good fortune of the protection of the integrity of the concept of emergency by virtue of the fact that the President can't do it on his own initiative. The Congress has to approve it. Last year, you, and I think rightly, felt that a number of things were emergencies, and approved the spending. I personally think that your judgment was right.

Chairman ARCHER. Well, Mr. Secretary, I really want to start on a strong, bipartisan foot. [Laughter.]

But let me tell you that when we had to accept your emergency spending, it was with a gun held to our head that the government would be shut down if we didn't do it. And so it was not a voluntary activity on our part. But let's not get back into all of that.

Secretary RUBIN. Well, there are all sorts of pressures that act and apply to all of us, Mr. Chairman, but it was something that we all worked out together.

Chairman ARCHER. But I would rather talk about the future.

In your opinion, can Social Security be saved by an expenditure of the surplus that is less than 62 percent of the projected surplus?

Secretary RUBIN. I'm sorry, you said less than 62 percent?

Chairman ARCHER. Yes.

Secretary RUBIN. Well, there are many different ways to approach the question.

Chairman ARCHER. No, I understand that. But can you pick one that you believe would save it for less than 62 percent? Do you think that is possible?

Secretary RUBIN. If you are asking me if it is possible, there are people, as you know, that would use less than 62 percent. I think that they would use less than 62 percent. There certainly are other approaches to dealing with Social Security. What percentage of the surplus they use, I don't recollect. But there are about half a dozen plans that have now been put forth by various Members of Congress.

My own view is that we have reached a sensible balance in the way that we have proposed this, but there are many other proposals around.

Chairman ARCHER. So, you could conceive of a plan that would save it for less than 62 percent of the surplus?

Secretary RUBIN. Well, one thing that you could do, for example, would be to dramatically reduce benefits. The President happens to feel that benefits should not be reduced, and that is why——

Chairman ARCHER. Well, we do, too. We do, too.

Considering the basic concept that we are not going to increase taxes and we are not going to reduce benefits, is there a way to solve the Social Security problem with less than 62 percent of the surplus, in your opinion?

Secretary RUBIN. And the two posits are that you don't increase taxes and you don't reduce benefits?

Chairman ARCHER. Well, both of us have said that we are not going to cut benefits and that we are not going to increase taxes. That is a bipartisan, public statement on both sides.

Secretary RUBIN. Well, actually, just for the record, what we have said is that we would put 62 percent into the Social Security Trust Fund and that we would not raise the payroll tax rates, and that beyond that, we would have very serious concerns about measures that would effect benefits. But we want to work with Congress on the difficult decisions to figure out how we go from 2055 to 2075.

Chairman ARCHER. OK. But assuming the presumption that we are not going to raise taxes and we are not going to cut benefits, in your opinion, is there a way to solve Social Security with less than 62 percent of the surplus?

Secretary RUBIN. I guess the best answer that I can give you, Mr. Chairman, is that when we put forward our proposal, it involves 62 percent. If somebody has another proposal——

Chairman ARCHER. No. I am just asking. There are many, many proposals. You have looked at a lot of them.

Secretary RUBIN. Yes.

Chairman ARCHER. I am just asking you as you evaluate those, do you think that it is possible that we could——

Secretary RUBIN. Yes, I will give you an example of a way that we could do it——

Chairman ARCHER. I don't need any examples. I just——

Secretary RUBIN. Well, let me give you an example just to show you why I wouldn't do it.

If you wanted to take the whole portion of the surplus that you are putting into Social Security and buy equities with it, if the stock market behaves well, you would obviously capture the historical difference between equity and fixed income rates of return. You would presumably accomplish the same 2055 with a smaller percentage of the surplus. But I personally think that would be an extraordinarily unsound thing to do, but you could try it.

Chairman ARCHER. No, I am talking about a 75-year solution for the Social Security problem and whether it would be possible to do that with less than 62 percent of the surplus when you did not cut benefits and did not increase taxes.

Secretary RUBIN. I guess the best answer that I can give you, Mr. Chairman, is that we put forward what we think is a very sensible proposal. If you have something specific in mind, we would be happy to look at it.

Chairman ARCHER. Well, I am not trying to make a judgment on a plan, I am just trying to determine as a basis for our consideration whether or not it might be possible to do it with less than 62 percent of the surplus.

Secretary RUBIN. I guess the best answer that I can give you, Mr. Chairman, is that I don't know, and I don't know what to tell you. If you were to put forth a plan, let me take a look at it.

Chairman ARCHER. OK. Well, we are still waiting for your plan as a leader of the country, but we won't get back into that.

Mr. Secretary——

Secretary RUBIN. Well, just in the interest of our bipartisan conversation, we put forward a plan. That is precisely what we did. [Laughter.]

Chairman ARCHER. OK.

Mr. Secretary, relative to your proposed government-controlled management of investments in the stock market of the Social Security Trust Funds——

Secretary RUBIN. I'm sorry. The government-controlled what?

Chairman ARCHER. The government-controlled and managed investments in the stock market of roughly $700 billion of the Social Security Trust Fund, can you refer me to the page in the budget so I can see the details and where it is explained?

Secretary RUBIN. I don't know where it is explained in the budget, but I will tell you exactly what we have in mind.

Chairman ARCHER. No, no, no. I really said that since we have got the written budget, I am really just looking for the page where we can see the explanation of that. Can you refer me to the page?

Ms. MATHEWS. Our Social Security framework is described, I think in the pages you have seen, where the totals are laid out in terms of the transfer to Social Security but we have not broken out the equity portion within the document that you have seen.

Chairman ARCHER. OK, but it is hard for me to understand if you don't have it in writing what your specific plan is.

Secretary RUBIN. Can I make a suggestion, Mr. Chairman, and maybe this will facilitate the matter.

Chairman ARCHER. We really should have that in writing, not just some sort of verbal——

Secretary RUBIN. Let me make a suggestion. I would be delighted to send you a letter, if you would like, articulating what I said, or really restating what I have said in my opening statement which is, one, investment we have done entirely——

Chairman ARCHER. No, I am not—that's not——

Secretary RUBIN. There will be no government investment and there would be an apolitical oversight and an apolitical choice of managers.

Chairman ARCHER. That is not what I am getting at. I am getting at the numbers part of it. The budget is a numbers document, and in order to get the complete budget, we need to have some numbers and how it works. Is that in there, and what page is it on?

Secretary RUBIN. There is on page 41 of whatever this document is called, the President's framework to save Social Security.

Chairman ARCHER. Are the specific numbers in there so that we can look at a complete budget and be able to evaluate it?

Secretary RUBIN. The actuaries—I don't have it in my hand unfortunately, Mr. Chairman, but the actuary did give us a letter saying, as you know, that our plan would extend the Social Security Trust Fund to 2055.

Chairman ARCHER. I see a lot of words in here on page 41, but I don't see any numbers.

Secretary RUBIN. My suggestion, Mr. Chairman, is rather than rely on us, and all we are is the administration, we actually now have a letter from the actuary saying that this proposal would extend the Social Security Trust Fund to 2055

Chairman ARCHER. So, this document that we have is really not your budget, it is just a summary of generalities. Is that——

Secretary RUBIN. No, I think that is actually a very good budget, and I think that it is a budget——

Chairman ARCHER. It's not a question of whether it is good——

Secretary RUBIN. Mr. Chairman, again in the interest of our bipartisan dialog, this is the budget. And in order to accomplish all that the President set forward, we are all going to have to work together in putting in place a Social Security plan.

In terms of the issue that you are raising, if you are a little bit uncomfortable about whether or not this plan will get us to 2055, which is I assume is the substantive issue at stake, what we have here is the actuary's letter, these are the career actuaries. They say that our plan will, in fact, extend the Social Security Trust Fund until 2055. I don't know what the date of this letter is, oh, January 26, 1999. So, there it be.

Chairman ARCHER. Well, I have always thought of a budget as being a precise blueprint of numbers that add up in the end to what you are spending and what you are taking in——

Secretary RUBIN. Oh, the numbers——

Chairman ARCHER [continuing]. And what the projections are over the years.

Secretary RUBIN. Mr. Chairman? The numbers—if you are asking about the numbers that effect the budget as a result of our allocation surplus, that is in here. If that is your question.

Secretary RUBIN. What page is that on relative to the investment part in the stock market?

Ms. MATHEWS. The investment portion—in terms of the surplus and the overall budgeting and what we would take from the surplus and how we would net our numbers are on page 377. That is Table S–7.

Throughout most of our summary tables what you will see is that we have included the numbers that include what would happen with the 62 percent, the 15 percent, and that is included in a number of our summary tables. It is all summarized on page 377 in terms of the numbers that affect the bottom lines of the budget. The surpluses, where the surpluses would go, where the dollars would be spent.

Chairman ARCHER. I only have one last, quick question, you have proposed what you call the USA accounts. Can you refer me to the page in the budget where I will find the details of that?

Secretary RUBIN. Mr. Chairman, what we have done is proposed a framework.

Chairman ARCHER. No, I understand that. What I am asking is just one specific question.

Secretary RUBIN. But I am trying to be helpful.

Chairman ARCHER. What page—no, no—because I want to move on and let other Members inquire. I just simply want to know what page of the budget, that we find the details. Perhaps Ms. Mathews can refer me to the page in the budget that gives the details of the USA accounts.

Secretary RUBIN. What we have in the budget is the allocation of 12 percent of the surplus. With respect to the specifics of the accounts, we are still working on that, Mr. Chairman. As soon as we have completed our work we will report back to this Committee.

Chairman ARCHER. OK, that is the answer. There are no specifics in the budget on the USA accounts.

Secretary RUBIN. No, I think actually that the more accurate answer, if I may, is that the 12 percent allocation of surplus, there is a framework that the President set out in his State of the Union Address, and we are working on the specifics at the present time.

Chairman ARCHER. No, I listened to the State of the Union Address, but we now have the specific budget——

Secretary RUBIN. Correct.

Chairman ARCHER. And I am asking Ms. Mathews what page in the budget describes the USA accounts so that we will be able to evaluate them.

Secretary RUBIN. But for the purpose of the budget, which is the question of the numbers, which you correctly said a few moments ago, Mr. Chairman, all that you really need to know is what the cost to the Federal Government will be, and that is the 12 percent of the surplus which we have in there.

In terms of the specifics of the program, we are working on that now, and when we have completed our work, then obviously this is the Committee, this and the Senate Finance Committee will be the Committees that we will be working with on this.

Chairman ARCHER. But, Mr. Secretary, we cannot evaluate the numbers until we know the details of the program. If I send a request for the estimates to the Joint Committee on a tax proposal, and I say, “Well, this is generally what we want to do,” they will say, “Look, until you send me the statutory language and the details, we can’t give you an estimate. We can’t make a judgment until we know the details of the program.”

Secretary RUBIN. And we will——

Chairman ARCHER. And most of the things in the budget are supported by details so we can make a valid judgment. But in any event——

Secretary RUBIN. As will this piece in the very near future. And what we did here, really, was to provide simply, as I said a moment ago, the quantitative, or numerical impact of the President’s proposal with the specifics to be worked on now.

Chairman ARCHER. OK, thank you, Mr. Secretary.

Mr. Rangel.

Mr. RANGEL. Thank you so much, Mr. Chairman.

Mr. Chairman, in the spirit of bipartisanship, could you tell me why that green light went on when I started speaking when it had not been functioning before? [Laughter.]

Continuing with this spirit of bipartisanship, let me pursue some of the Chairman’s line of questioning.

The Chairman has agreed to this 62 percent walled-off figure. Is it the President’s position that he you would not entertain a tax cut until the Congress presented a Social Security proposal that was satisfactory to the President?

Secretary RUBIN. The President’s view, Mr. Rangel, is that we should not do anything with the rest of the surpluses until Social Security has been addressed, and then once Social Security has been addressed, we can have a debate about whether it should be used, for what purpose the rest of the surplus should be used.

Mr. RANGEL. What would the President’s position be on the Medicare Trust Fund?

Secretary RUBIN. The President’s view is that once Social Security is addressed that we should then allocate the surplus in the manner in which I described in my opening statement, and that includes using 15 percent of the surplus to extend the Medicare Trust Fund from 2008 to——

Mr. RANGEL. So will the President not entertain a tax cut until after Medicare has been taken care of as well as Social Security?

Secretary RUBIN. The President believes that what we should do, even though it is the hard path to go and not the easy path to go, is to continue on the path that we have been on these last 6 years, Mr. Rangel, and continue to improve national savings and the fiscal position of our government. And in our judgment, that has contributed enormously to both job growth and increased standards of living in this country.

Mr. RANGEL. And that is consistent with Chairman Greenspan’s view.

Secretary RUBIN. I gather that was the view. I did not actually see that hearing, but I gather that was the view that he expressed at a Senate hearing a week or two ago.

Mr. RANGEL. Now, the Chairman has indicated that a number of the items——

Secretary RUBIN. Could I just say one thing, Mr. Rangel? I'm sorry. I think that there was a remarkable contrast to——

Mr. RANGEL. I didn't answer yes or no, you realize that? [Laughter.]

Secretary RUBIN. I think that there was a remarkable contrast between the 12 years from 1980 to 1992 when the Federal debt quadrupled and the period that we are in now where we have gone from enormous debt to enormous surpluses and we are now seeing the Federal debt come down, and that is what we want to continue.

Mr. RANGEL. Well, you have to admit that that is because of the leadership of Ronald Reagan, so we will move on and leave that alone.

The Chairman is concerned that your budget really does not provide the details that would allow us to legislate. I want to thank you for that because you have not locked us into any position but have given us the flexibility to attempt to reach those goals. I want to thank the Republicans for advocating a 10 percent tax cut across the board. They have not bothered us with any legislation either, specific or otherwise. It is just more general terms. And I can understand the direction in which you would want us to go.

I am concerned that if the President's position is that we have to present to you an acceptable Social Security plan and an acceptable Medicare plan before we can deal with tax cuts, the same thing might apply if Chairman Archer and I wanted to get together and do something in the educational field. Would we have to wait until we have resolved the Social Security Program?

Secretary RUBIN. As you know, Mr. Rangel, the President has been enormously focused on education through the 6 years that he has been here. You have been very much a part of that, and we now have, I think, a very strong proposal on school construction bonds. But even with respect to the measures that the President thinks are so critically important to the future of this country, he believes that we should first address Social Security, with respect to the use of the surplus. Now within the regular budget, obviously there are a whole variety of measures including the school construction bonds.

Mr. RANGEL. Well, I am going to need some direction because, while there is some problem on the other side——

Secretary RUBIN. And can I just say, if I may, Mr. Rangel, the school construction bonds. Since they are paid for in the regular budget and don't draw on the surplus, that can proceed prior to addressing Social Security.

Mr. RANGEL. OK. Well that is a breath of fresh air because I would not want the administration to say that until we resolve the Social Security problem to his satisfaction that this Committee would be out of business.

Secretary RUBIN. No, no. As long as it is in the paid for part of the budget, discretionary or mandatory, then at least it is the

President's—then that is the budget, and the President's view is that that should go ahead.

The question is what do we do about the surplus. And it is with respect to the surplus that he has taken the view that we should not do anything until we address Social Security. And these education provisions are fully paid for in the budget.

Mr. RANGEL. We pretty well know what the President's plan is without the details, of course. Do you know of any other plan that has been recommended by the Majority that is under consideration by the administration? Any ideas or anything? Because, I was joining with Republicans in saying that the President just can't talk about taking care of the Social Security Program. I thought that he had an obligation to bring us something. Well, he has done that, and some don't like some parts of it.

Do you have anything coming from the Majority that we can compare?

Secretary RUBIN. To the best of my knowledge, Mr. Rangel, there is not what you would call a Majority Party proposal. There are a goodly number of specific proposals, well, more or less specific proposals that have come from various Members, some on——

Mr. RANGEL. Yes, but there is no Majority proposal in front of the White House at this point anyway?

Secretary RUBIN. That is correct.

Mr. RANGEL. And I assume that the administration would not—do you have any, Mr. Chairman?

Can I have regular order here because I am always distracted by Members that want to say things to me but don't know how to do it except through you.

Mr. THOMAS. Will the gentleman yield?

Mr. RANGEL. No. Please, please. If you wanted to talk with me, I will be finished in a minute, and I will be glad to talk with you.

What I was trying to say is that the administration doesn't intend to be arrogant enough, I hope, to give us a Social Security bill. You are not going to draft our legislation, are you?

Secretary RUBIN. Mr. Rangel, I think that we are on the right position, and I think that it is for the reasons that you have said. I think that we have provided a very strong—I think that what we—we have done two things, it seems to me. One is that by acting in the fashion that the President did, we avoided having the surplus used for purposes other than for Social Security until Social Security is addressed, and now we have provided a strong framework to move forward.

We could disagree, I suppose, about what is the most effective way to move forward, but I think that in an area like this which is as difficult, in as many ways, as it is, that the most effective way to go forward is on a bipartisan basis rather than putting forth specific proposals that then become subjects to all sorts of criticisms for all sorts of reasons.

Mr. RANGEL. Well, this has been the beginning of our bipartisan relationship with the administration, and we thank you for giving us a broad-based budget. I understand that there will be a bipartisan piece of legislation that would allow us to assume some of the responsibility of determining what is an emergency and what is a hurricane, what are troops in Bosnia, so that the administration will not have to do this crystal ball gazing alone. We will participate in the future.

I don't know what else to ask you to do. I kind of think that what you have done is throw the Social Security Trust Fund problem in our laps. The ball is in our court, and if we don't like what you are doing, I think that we ought to come up with a better plan. If the administration wants us to put it in legislative form, we will be glad to do that on the Minority side.

I want to thank you for what you have done in the past. I ask you to be tolerant with us. We are not used to working in a bipartisan way, and I hope that we will find some way in the House to work more closely together to make it easier for the President, to make it easier for the Congress. But most of all, to make it easier for the American people to see that we are not sent here just to differ. Instead, we have to find some area where we can agree.

Thank you so much. I yield back the balance of my time.

Chairman ARCHER. Mr. Secretary, our effort to encourage the White House to submit a plan on Social Security is not for political partisanship. In the history of Social Security there has been no major reform without the White House or a commission submitting a plan to Congress. The Congress has never, within its own ranks, been able to come to grips with major reform to Social Security, and that is documented for all history. My suggestion, the White House submit us a plan is to give us the best opportunity to reach a solution based on history.

Now, the White House shot down our effort to create a bipartisan commission last year. They opposed it actively, and had a lot to do with its failure in the Senate. We passed it in the House. If we had been able to get White House help on that bipartisan commission, we would very soon be receiving a recommendation on a bipartisan basis as occurred with the Greenspan Commission in 1982.

But, Mr. Rangel's suggestion that all we have to do is whip it together here in the Congress does not pay any attention to the reality of what has happened with Social Security since it began.

Secretary RUBIN. Mr. Chairman.

Chairman ARCHER. And so I just want to make that statement. I recognize Mr. Crane.

Secretary RUBIN. Well, could I respond to that for a moment, though?

Mr. RANGEL. Mr. Chairman, a point of personal privilege.

Chairman ARCHER. Mr. Crane is recognized.

Mr. RANGEL. A parliamentary point of order. Since my name was mentioned, that common courtesy, if not the Rules of Order, would indicate that——

Chairman ARCHER. The Chairman was not inquiring of the Secretary. The Chairman was making a comment to explain a position that the Chairman has taken over the last many months, and I am sure that Mr. Rubin will have the opportunity to express whatever views he has through the questioning in the rest of the hearing.

Mr. Crane.

Mr. RANGEL. I am not the least bit concerned with the Secretary's position. I am concerned because you used my name and described the position that I had stated. A point of personal privilege is not for the Secretary of the Treasury. He is appointed. I am elected.

Chairman ARCHER. Mr. Crane. Mr. Crane is recognized.

Mr. CRANE. Mr. Chairman, it is hard to be heard with all this chatter going on up here at the dais.

I did want to make a reference to a comment made by our distinguished Ranking Minority Member when he did control some time, and that has to do with our bipartisanship and collegiality, and I would like to tell you, Mr. Secretary, that 2 days ago we reintroduced the African Growth and Opportunity Act, and within 24 hours we had 60 cosponsors, 30 Democrats, 30 Republicans. Yesterday we had a hearing on it with Secretary Daley, and then after the hearing we had a markup, and the markup we reported out of the Trade Subcommittee, our bill again, and it had unanimous support, every Democrat and every Republican on the Trade Subcommittee. So, we are making progress in this bipartisan effort, and I congratulate our Ranking Minority Member because he was there for all of this, too.

We, however, are looking down the road in the trade arena, and I would like to ask you a question there that has to do with the administration's effort to try and secure fast track passage because the African Growth and Opportunity Act opens up an opportunity with 48 sub-Saharan African countries to engage in free trade. But, on the other hand, absent fast track, it is kind of meaningless. Is the administration going to help this year overwhelmingly in trying to secure renewal of fast track?

Secretary RUBIN. First, let me say, if I may, Mr. Crane, that I think that your work this year and last year on the African trade bill is both very important. I was in Africa about 6 months ago or so, and there was enormous focus on what you were doing in that area. I think that it is enormously constructive, and, as you say, it is a good example of people working together.

In terms of fast track, as the President said in the State of the Union Address, he very much wants to have fast track legislation passed. The issue is finding, I have forgotten how he put it, but he put it very well, we need to get passed the things that have traditionally divided us and find common ground on environmental issues, labor issues, and the other issues that have made it so difficult to do this in the past. But he very much wants to get fast track legislation, but has recognized that substantively, and otherwise, we have to be able to find common ground in these areas, and that is what we are going to work toward doing.

Mr. CRANE. Well, I would hope that you would communicate to the President, or remind him, that he has the authority to pursue, progress with any country, unilaterally on environmental questions and on labor questions. Please go forward. We will try, in turn, on the trade side, to give him the renewal of that fast track authority.

Let me ask you one other question that is topical right now, and that is your position on various pieces of legislation that are being talked about, or some are already submitted language, dealing with the ban or quotas on steel imports. Mr. Visclosky, as you know, has a bill on the subject. What would the economic impact be on our trading partners? Would such action impact their ability to recover, for example, from the Asian financial crisis, if we went beyond existing trade laws and put bans on the importation of steel?

Secretary RUBIN. I think, Mr. Crane, that you are raising a very difficult issue, and it is particularly difficult at this moment in time. Let me try to give you my view, but it is not a simple view.

On the one hand, clearly, steel imports to this country have increased enormously, and that has created great hardship for the steel industry and workers in the steel industry, and it is an issue that we have been enormously focused on. As the President said in the State of the Union Address, we are fully committed to using our trade laws. We are monitoring this very closely. We are very concerned, if there are unfair trade practices, to deal with them effectively. At the same time that the President is in Japan he has spoken to the appropriate officials, including the Prime Minister, about going back to precrisis levels and the rest. We are negotiating with Russia, as you know, and the December figures are, I gather—or not, I gather, they are reflecting some of what has been happening and exports to this country have gone way down.

On the other hand, there are larger issues here, and I think, maybe, that is what you are alluding to. So, we are very much focused on the issue of steel and unfair trading practices, if they exist, dealing with them and dealing with them forcefully.

But there is a larger issue here, if this is what you are alluding to. We have the most open markets, probably, of any major economy—I would say almost surely, of any major economy in the world. We have 4.3 percent unemployment. In continental Europe, where markets are not as open as our, they have 10 to 12 percent or higher unemployment. In Japan, where markets are not as open as ours, they are now in the, I think, the fifth quarter of recession, if I remember correctly, and the 8th year of very slow growth. I think that our country has benefited enormously from pursuing open markets abroad and from having open markets in this country.

In addition, there are two special factors right now. Number one is the one that you alluded to. There are many countries in crisis around the world. It is enormously in our economic interest. It is important for job creation and the standard of living in this country that these countries recover, and part of that recovery will be exports.

Second, there are tremendous protectionist pressures around the world, and if this, the largest and most successful major economy in the world with 4.3 percent unemployment and rapid growth and all the rest, were to go into a restrictionist mode with respect to trade, I think that it runs a very real risk of triggering protectionist pressures around the world which would have an enormous adverse impact on jobs and standards of living in this country.

Mr. CRANE. I agree with you wholeheartedly, and, in effect, what you are saying is that we have the existing guidelines and laws in place for dealing with dumping. In other words, we don't need new legislation.

Secretary RUBIN. I was actually——

Mr. CRANE. We can examine what some of these trading partners are doing in terms of the increases that are coming into our market.

Secretary RUBIN. I think that we should vigorously enforce our trade laws, Mr. Crane, and I think that what the President did was very important when he was in Japan. I was in Switzerland this past weekend, and I spoke with some very high Japanese officials and also talked about the difficulties arising from the vast increases in exports from Japan, and we have, as you know, have negotiations with Russia to deal with the issue there. We have acted to counter subsidization of steel in Korea.

Mr. CRANE. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman.

I have had difficulties on and off whenever we have had to talk about items that are very serious, significant and important with such a level of flippancy that really, I think anybody watching would want to know whether this is a theatrical tryout or whether it reinforces a lot of cynicism about government today.

I was pretty amazed when the gentleman from New York, given his seniority, said that the Rules of Order would demand it. I assume that he understands that it is Jefferson's manual that we use as the parliamentary structure here.

But I wasn't any more amazed by that than I was amazed by the Secretary's repeated statement that this administration hasn't spent the surplus. You spent $51 billion of the surplus. The problem is that when you spend it, it isn't spending the surplus. When someone else wants to spend the surplus, it is spending the surplus. So, at some point, if we are ever going to possibly move forward in a positive, bipartisan way, the degree to which we are inaccurate is going to be an enormous hurdle to overcome.

I would like to ask you a very specific question about a proposal in the President's State of the Union Message because I can't get the answer. The President proposed a better America bonds for the purchase of greenspace. This is a bond program that would essentially be operated by the Environmental Protection Agency. Can you tell me or the Committee what parts of the current tax-exempt bond law would prevent communities and States from currently buying greenspace?

Secretary RUBIN. From currently buying greenspace?

Mr. THOMAS. Yes.

Secretary RUBIN. To the best of my knowledge, and I may be wrong, Mr. Thomas as I am not an expert in this, but to the best of my knowledge, they can buy greenspace. I think that the question is, how do they fund it?

Mr. THOMAS. Tax-exempt bonds.

Secretary RUBIN. Yes, but what this was doing was to provide tax credits, as you know, to pay the interest on the tax-exempt bonds so that there would be Federal help in doing that.

Mr. THOMAS. They have Federal help today in terms of tax-exempt bonds.

Secretary RUBIN. And this would go further than tax-exempt bonds——

Mr. THOMAS. OK. So there is nothing in the law, that you know of, that would prohibit them from doing that today through the tax-exempt bonds?

Secretary RUBIN. No. But you can have a legitimate debate whether the Federal Government should provide additional assistance. In our judgment, they should provide additional assistance.

Mr. THOMAS. That is fine.

Secretary RUBIN. You may feel differently.

Mr. THOMAS. No, I just couldn't understand why.

Second question. In response to the gentleman from Illinois, and I appreciate that it is always easy to slip into a protectionist mode, especially when it is in your backyard that needs that protection, but the administration did address the steel question and the concerns about job losses in the steel industry, I believe, by offering an ability to carry back their net operating losses over a 5-year period as a suggested partial remedy to the problem in the steel industry today. Is that correct?

Secretary RUBIN. That is correct.

Mr. THOMAS. Well, the steel industry has lost about 10,000 jobs. Oil and gas industry has lost 30,000 jobs. Three times as many jobs lost in an area that is being impacted virtually identically to what is occurring in steel. Why didn't the President offer the same aid to the oil and gas industry?

Secretary RUBIN. I think, Mr. Thomas, that you, again, get into what is a very important, as Mr. Crane said, a very important and, I think, central issue. I believe, and much more importantly, the President believes, and he has said this many times, that if we are going to be a successful economy, a dynamic economy, we are going to have to embrace change, and change takes place as a result of technology, and to a lesser extent it takes place as a result of trade. There are those who think that we should not impede change, we should encourage change. Change also creates, while, on the overall——

Mr. THOMAS. I have three more questions. I thought it was a simple one. Why didn't you extend the same 5-year carryback to the oil and gas industry that you provided to steel?

Secretary RUBIN. No, no, but you very thoughtfully raise——

Mr. THOMAS. I know, but I don't have an hour. I have a yellow light now. Could I have the short version?

Secretary RUBIN. What?

Mr. THOMAS. The short version.

Secretary RUBIN. This is the short version. I have a long version, too. Let me just finish.

All of these kinds of changes also carry with them dislocations, and then the question is, how are you going to react to dislocations. My own view is that what you need to do is to encourage change and then try to deal with dislocations in an effective fashion. It was our judgment that, given the extreme circumstances in steel that this was an appropriate thing to do.

Mr. THOMAS. How do you define extreme circumstances? Loss of jobs?

Secretary RUBIN. I think that the rapidity with which——

Mr. THOMAS. Three times as many jobs have been lost in the oil and gas industry.

Secretary RUBIN. Well, first you have to take a look at the number of jobs that exist in the industry. You have to take a look at over the period of time of which it has happened——

Mr. THOMAS. Look at the scope of the impact across the country in terms of where the jobs are lost.

Secretary RUBIN. No, no, but I think that you have to take a look at something else, Mr. Thomas, which is what are the circumstances that gave rise to the loss of jobs. There have been no decisions yet in the dumping cases, and I do not know how those will come out, but there are many who feel that there are trade practices here that are subject to a lot of question rather than being simply structural or normal market events.

Chairman ARCHER. The gentleman's time has expired.

Mr. THOMAS. Thank you, Mr. Chairman, thank you.

Chairman ARCHER. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman.

In view of the fact that the Chair has not recognized a right of personal privilege, I ask the gentleman from New York if he would like me to yield him some of my time, given the fact that his name was again mentioned in the prior questioning. Would the gentleman like me to yield?

Mr. RANGEL. No. I thank you, Mr. Matsui, but I don't feel that it would be helpful to extend this dialog any further. Thank you very much.

Mr. MATSUI. Thank you.

Mr. Secretary and Director Mathews, I appreciate your testimony, and I have to say that I was one of the ones that did not want the President to come out with his plan on Social Security because I was afraid that the plan would be attacked, and, unfortunately, I think that my predictions proved to be right. This was just an opportunity to put out a plan and then have others attack it.

I would have to say, however, that after reviewing the plan, I think that it is a very good plan. I am now kind of revising my original recommendation to the administration, and I am very, very pleased that you have come up with it because you do solve the problem through the year 2055, and obviously you draw down the debt which is extremely important until—the current $3.7 trillion will be down to $1.2 trillion.

But I am happy that the Chair has suggested saving 62 percent of the surplus for Social Security. I am somewhat concerned, however, about the possibility of using the balance, the 38 percent, because I think, Mr. Rubin, that you are absolutely correct in terms that we don't know what the legislative body is going to do, the House and the Senate, in terms of whether we go over 62 percent or not. And I just point out this morning, that, as all of you know, Mr. Gramm on the Senate side, and Mr. Domenici were going to have a press conference and unveil their new Social Security proposal, patterned after Mr. Feldstein's proposal.

Well, late last night, Mr. Domenici pulled back because he had done a run on it and he pointed out that it went over 62 percent. In fact, it went into general revenues. And Mr. Gramm now has to make a decision as to what he is going to do. But it is quite possible that we in the Congress, in order to satisfy our appetite, might go over that, and so, I would really caution my Democrat and Republican colleagues that we ought to be very, very careful about what we do with that surplus because we can't control what the other body may do. We certainly can't even control what we may do.

I hope that the administration will not change their current strong position on saying Social Security first before spending any of that surplus particularly for tax cuts. I just to have also—we have a balanced budget, but that balanced budget is contingent upon about 200–300 billion dollars' worth of spending cuts that are unidentified in the years ahead. And certainly there is no guarantee that this Congress, or any other Congress, will show the kind of discipline that we promised back in 1997.

Let me take a moment—there is a lot of talk about in the area of Social Security of the so-called carve out, in other words, going into the 12.4 percent, taking 2 or 3 percent of that and then allowing private investment that counts for each individual employee. There is, from what I understand, at least actuarially, about $8 trillion in unfunded liabilities currently, if we are going to maintain the current level of benefits for current generations of workers and also future generations of workers. Am I correct? It is about $8 trillion?

Secretary RUBIN. I think that it is about $8.5 trillion. Something like that.

Mr. MATSUI. And if we penetrate that 12.5 percent, that means that that money does not go to pay the benefits of the current generation of employees, is that correct?

Secretary RUBIN. One of the very serious problems of carve-outs is precisely the point that you are making, Mr. Matsui. If you are going to have carve outs, you are going to have to figure out someway to deal with existing workers and retirees.

Mr. MATSUI. And, so, in other words, this could result in perhaps hundreds of billions or perhaps trillions of dollars over a period of time, depending upon what that carve-out percentage is.

Secretary RUBIN. Depending upon how large the carve out is. The size of the carve out would determine the size of the transition cost, but it would be very substantial, in any case.

Mr. MATSUI. The administration, undoubtedly, will want to make sure, before approving any plan, and obviously the Republicans and Democrats in the House, hopefully, will show some discipline as well, by coming up with that transition cost, if, in fact, we do penetrate into that 12.5 percent.

Secretary RUBIN. I think that any plan for carve outs faces at least two problems, Mr. Matsui, one of which, as you correctly say, is the transition problem. I think that anybody who is going to propose such a plan is going to have to show how they are going to pay the transition costs, and they are very substantial. The other is, if the carve out is an individual account that is invested in equities, or however it is invested, it doesn't matter, if it is a defined contribution, it is exposed to a defined benefit, it is putting the retiree at risk.

Mr. MATSUI. I appreciate this. And let me just conclude by making one further observation. I was on the Committee in 1983 when we last fixed the Social Security system, and I have to tell you that the Greenspan Commission did come up with this recommendation. But it was really through the leadership of then-Chairman Rostenkowski and Tip O'Neill and Jim Baker, the White House Chief of

Staff, that really put together the final deal because when Mr. Greenspan originally unveiled his plan, it was not well received. In fact, there was a lot of opposition to it. But it required congressional leadership working with the administration, the then-Reagan administration, to put this together. I hope that is the lesson that we all learned from 1983. Not the constant bickering that has been going on. This is a problem that is too serious.

Secretary RUBIN. Had I had a chance to respond to the Chairman's comments, Mr. Matsui, that is precisely what I would have said. Our model is precisely that which is that the administration and the leadership of Congress get together in precisely the fashion that they did there. In those days, I think that they met in Jim Baker's living room; I guess we can find some other locale. But they would get together and work through a set of decisions that we could then all coalesce around.

Mr. MATSUI. And I recall that Chairman Rostenkowski didn't attack. He was trying to come up with a solution.

I yield back.

Secretary RUBIN. But the President would expect that the administration would be exceedingly active in that process, but it would involve all of the participants working together. Precisely.

Chairman ARCHER. The Chair is constrained to have to comment on the colloquy.

Mr. MATSUI. You can, or you don't have to, Mr. Chairman. But you seem to comment every time a Member has a comment.

Chairman ARCHER. The Chair is the only person in this room who was a member of that commission. The only Member in this room who was a member of the commission. And, Mr. Secretary, what you said was not true. This was a bipartisan commission, not of Members of Congress and the White House. It included many people from the private sector who gave it a very different approach. In the end, the recommendation to the Congress was on a bipartisan basis, not dictated or participated in by Chairman Rostenkowski, but by many private citizens who were working with some Members of Congress who were in the Minority. So we tried to create that kind of commission last year with the opposition of the administration. The administration's approach now—I don't see any similarity to what happened with the Greenspan Commission.

Secretary RUBIN. Well, if I may say so, Mr. Chairman, I have actually spoken—it may be a difference with the history, and I think that that would actually be a worthwhile discussion to have at some—wherever you choose to have it. But I have spoken to a number of people involved with the Greenspan Commission, and the description that I have heard, in fact, quite a number of people involved, tracks with Mr. Matsui's description.

Chairman ARCHER. Mr. Secretary, I am not sure to whom you have spoke.

Secretary RUBIN. People on both sides.

Chairman ARCHER. But you are now speaking to a member of that commission, and the way that it was described is not accurate. I was there every moment, and the way that it has been described is not accurate. But the important thing is that the process today is very different than the process was back in 1982 and 1983, very different, and cannot be compared.

Secretary RUBIN. Well, I guess I would make two suggestions, Mr. Chairman. One is that I think it probably would be interesting, just as a guide to the future, to talk to various people who are involved. You obviously have a very different impression, and you were there, as you correctly say. On the other hand, I have spoken to people who were also there, because they were Members, and they had an impression more like Mr. Matsui's.

But I think that the key is what you said, in any event, which is how do we go forward, and the notion of how to go forward tracks, at least in our judgment, with what Mr. Matsui said. But we can have differences of views on that.

Chairman ARCHER. Mr. Secretary, we don't need to obfuscate this. There is no commission today. There are no private citizens who are working day after day, week after week, in order to develop a suggested plan to save Social Security within the confines of a commission along with Members of Congress. That does not exist. To try to compare what is happening today to what occurred then is just erroneous.

Secretary RUBIN. No, no. I agree that it doesn't exist, though, I think that you would agree that we have come an enormously long way from 1½ years ago with respect to Social Security. It has become a national priority. We have all agreed to put most of the surplus into it. And now the question is, how do we take the next step. I think that you should be pleased.

Chairman ARCHER. I am hopeful. The President has 2 years left in his term. I have 2 years left in the Congress, by my own announced retirement. I would like to get this solved.

Secretary RUBIN. As would he.

Chairman ARCHER. He would, too. We have discussed this personally on two or three occasions. I am very, very sincere in wanting to solve it. I don't know if it can be done. I don't think that it can be done internally within the Congress. That has never happened before.

Secretary RUBIN. But that is not what we are suggesting, as you know.

Chairman ARCHER. We need to develop a process by which we work to give ourselves the greatest opportunity to achieve success. And that is all that I am trying to get at.

Secretary RUBIN. And that, Mr. Chairman, I would agree with 100 percent.

Chairman ARCHER. OK, Mr. Houghton.

I am sorry, Mr. Shaw. I apologize.

Mr. SHAW. Thank you.

Mr. Secretary, you and I are of the same generation. In fact, we grew up in the same community. We had many of the same friends. For you and I, Social Security is going to be there for us. You know that, and I know that. It is there for my mother, whom I am lucky enough to still have, and I hope that you have some parents that are receiving Social Security.

But what we are concerned about is the next generation and their children, our grandchildren. Anyone who says that there is not a pending crisis in the Social Security system is either a damn fool or just doesn't care about the next generation. You and I agree on this.

We also agree, I would hope, that we do have a point in history, which is, indeed, historic, which gives us a good opportunity to solve this problem in a bipartisan way. I hope that it is done on the President's watch. I was very, very much delighted when I took the chair of the Social Security Subcommittee, but I did it with a great deal of thought and reservation. But I was delighted, and almost euphoric after the White House conference of last year when I got the President's promise to come forward. He did agree with us that it was his position to come forward with a plan. And he told us in just about these exact words, "I don't expect you Republicans to come up with a plan. I will come up with a plan."

But I want to look at the plan that he has come up with because it does create somewhat of a shellgame. By putting 62 percent of the surplus into the trust fund and investing one-fifth of that into equities, you take four-fifths of that and buy Government Treasury Bills, IOUs which are nothing more than a call on future tax dollars, and put the money back out into the Federal Government.

Now the problem that you have there is that you might on paper extend the life of the trust fund, but you do not extend the income of the trust fund, and that is a huge problem. Following your scenario——

Secretary RUBIN. That is not actually his plan.

Mr. SHAW. Let me finish, and then I am going to ask for your comments.

Following this scenario, you might as well put the entire surplus in there because all you are going to do is pump it out the other end and borrow money. Now, we have heard from Dr. Henry Aaron, who is generally friendly to the administration. He testified to us last Tuesday. He said that the President's proposal doesn't delay by 1 single day when Social Security's income is insufficient to cover benefits. Now, what we are looking at is our grandchildren having to commit up to 40 percent of their income in order to take care of their parents. That is disgraceful, and we need to do something about it. We need to do something substantively to extend the program.

And now I will yield to you.

Secretary RUBIN. Mr. Shaw, I think that there is just one slight difference, if I may, on what the President has proposed.

He has, as you correctly said, proposed we put 62 percent into the Social Security Trust Fund, and then he has proposed that 20 percent of that be put into equities. The other 80 percent would actually go into the reduction of the publicly held debt of the Federal Government. If you look at the entire program—and then, at the same time there would be——

Mr. SHAW. But you are taking it out of the public hands and putting it into the trust fund. The debt is still there. That is the problem.

Secretary RUBIN. No.

Mr. SHAW. By law it has to be invested in Treasury Bills.

Secretary RUBIN. Yes, but let me, if I just could finish this.

Mr. SHAW. I beg your pardon. I do want you to finish.

Secretary RUBIN. That is OK.

So, what you are doing is you are reducing, and in this case, very, very substantially reducing the publicly held debt of the Federal Government, the creditworthiness, if you will, or the ability of the Federal Government to access the capital markets will be vastly improved as a consequence.

What you are also doing is issuing first claims against the general fund, the general revenues of the U.S. Government with respect to meeting the already existing Social Security commitments. I think that the question that that poses—because I think that you are getting at a very important question—the question that that poses then is how secure are those claims. Though they do have the full faith and credit of the U.S. Government behind them.

If you take a look at the budget that we have submitted, that budget projects surpluses to at least 2039 on one set of assumptions and later on another, to at least 2039. So what that says is that not only do you have the full faith and credit of the U.S. Government behind these obligations, but these obligations are first claimed against general revenues in an environment.

Mr. SHAW. Which is a claim on the taxpayer, which is a claim on future taxes.

Secretary RUBIN. Well, yes, but it is not in an environment in which you would require an increase in taxes. Quite the contrary. It is an environment in which there will not have to be an increase in taxes because with the currently projected tax rates, there is actually a surplus in the unified budget until 2039.

Mr. SHAW. But Mr. Secretary, how do you pay those off?

Secretary RUBIN. You pay those off——

Mr. SHAW. You pay those off with tax dollars. That is where the revenue comes from.

Secretary RUBIN. Well, but you pay them off out of the general revenues of the Federal Government under the existing tax structure. You do not need any additional taxes. In fact, as I said a moment ago, when you get out in time, what you find is that not only can you meet all of the Social Security commitments, but you will still have a surplus left over.

Chairman ARCHER. The gentleman's time has expired.

Mr. Houghton? Is Mr. Houghton here? Mr. Houghton? Mr. Houghton, you are recognized.

Mr. HOUGHTON. Waiting in the wings here. Thank you very much, Mr. Chairman.

Mr. Secretary, good to see you here. It's strange, isn't it? I listen to this debate and there were contentious words when we had a deficit. I thought it would all be over when we had a surplus, and we are still in there battling.

But I have a different type of question. I was just down at the IRS yesterday, and we were talking about some of the things on which the Oversight Committee might be interested in. One of the things that concerns me is that you have got a wonderful Commissioner down there. He is trying to do a great job, and yet at the same time with all the things that are now on the table, his job gets more and more complicated rather than less and less. When you take a look at some of the President's tax proposals and these new targeted credits, I don't know how they are going to keep up with them. Literally, I don't. I just don't know what the answer is.

The President signed in July a tax simplification bill. The whole ethos is out there to try to make it plainer and simpler, more understandable, and here we are trying to confuse it again and laying on that agency, which is trying to get over terrible past problems, things which I am not sure they are going to be able to handle. Maybe you have a comment on that?

Secretary RUBIN. I think that, Mr. Houghton, that you are raising what is a very important question. It is one that we have taken into consideration. We have worked with Mr. Rosotti. I agree with you, I think that he is an outstanding choice. I think that he is doing an outstanding job as Commissioner. I think that there has been real progress at the IRS. If you take a look at the various indices of progress, telephone calls answered, refunds made and the time in which they have been made. All the different initiatives, electronic filing and so forth, all the different initiatives of movement and progress at the IRS, I think that a lot has been accomplished, though there is an enormous amount yet to do.

What we have tried to do in this case is to take into consideration not only the tax policy, if you will, aspects of our proposals, but also the very issues that you very correctly are raising which is the ability of the IRS to handle this. At least it is in our judgment that the degree of, that the proposals that we are proposing are proposals that they can handle in an orderly fashion.

We also, as you know, I think that it was last year or maybe it was 2 years ago, I have forgotten, no, I guess it was 1997, actually, had something like 40 tax simplification measures. Maybe it was 1998, 1997 or 1998, had 40 tax simplification measures passed. That was designed to try to make the Tax Code simpler, which is good for taxpayers and it is also good for the IRS. But let me assure you, because you raise a very important point, that we take into account the ability of the IRS to deal with the changes in the Tax Code as we design and propose these measures.

Mr. HOUGHTON. Right. Well, I guess we are trying to get at the same answer here. I guess the thing that worries me is that when you have all these different tax credits that the President mentioned, I don't know how many there are, there must be 10 or 15 or 20 of these things. I don't see us getting to where we want to get and what the President had originally stated in July of last year.

Let me just mention something. When I was on the Oversight Committee when J. Pickle was the Chairman of it, we had a field hearing. I don't know what the figure is now, but the figure at that point, as estimated by OMB, Office of Management and Budget, was that there was something like $197 billion in compliance costs with filling out the tax returns. And I am sure that it is higher now. And it goes on and on and on. And I just, I know that there is good will here, and I know that you are trying to do a good job, and I know that Mr. Rosotti is terrific, but I don't see us making any progress on this.

Secretary RUBIN. On the complexity of the Code?

Mr. HOUGHTON. Right.

Secretary RUBIN. Well, it is a balance between simplification measures and then the additional measures that are designed to advance various social and economic purposes. I think that all of us would agree, Mr. Houghton, that the simplification should be a very important objective with respect to Tax Code, and it is one that we certainly have pursued. But I think that one has to balance between the objectives of simplification and the objectives of things like long-term care tax credit and other kinds of social or economic objectives that are very important.

Mr. HOUGHTON. Well, I don't know why it isn't possible to either expand the brackets or lower the rates or do something rather than have all these different exceptions and all these different credits.

Secretary RUBIN. I might add incidentally, if I could, that we have been very—we have worked with Mr. Rosotti on the question of what the effective dates of all these measures should be so that he can effectively relate that to his Y2K conversion and the other kinds of issues that he is facing.

Mr. HOUGHTON. Thank you very much.

Chairman ARCHER. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Mr. Secretary, President Clinton and yourself and others in the administration have led us into a period of very strong economic growth, and that is a very positive thing for all of us. You alluded in your testimony to investment in people in the budget. I wonder if you could tell us a little bit more. Everyone is not participating in this vibrant economy.

There are many people that unfortunately are left behind and unable to get the economic opportunity that they would like to have. I was just wondering how your budget, the President's budget, addresses that, and particularly in light of the earlier discussion where you talked about the steel companies getting their net operating loss carrybacks. That is one thing. That will help steel companies. But what about the 10,000 steel workers who have lost their jobs as a result of the illegal dumping that we have experienced over this period of time? In addition to the people who have not participated in the growth of the economy, what does the budget do for those people?

Secretary RUBIN. Let me mention a couple of things, if I may, Mr. Coyne, because I think that the area that you are focused on, as you know, is an area that the President is very much focused on. We have had an extraordinary economy, and incomes are rising across all the quintiles of the income spectrum, but having said that, there are still too many people that are not participating in our economy, and then there are people who are suffering the dislocations that come with change. That is inevitable in a dynamic economy.

We have asked for full funding for the—for example, the CDFI fund which provides capital for distressed urban and rural communities. There is a, what we call a new markets tax incentive for investors to invest in entities that are investing in inner cities. We have increased funding in all sorts of programs that are directed toward distressed areas.

Let me ask Ms. Mathews if she would like to expand on that, though, because I think that this is an extremely important focus of our budget.

Ms. MATHEWS. I will keep my comments to just two specific areas, though it cuts across issues like crime and many other things. But I will address education and the economy and just give a few details there.

In the education area, one of the things that we have done in our school construction proposal is to try to target funding to needier schools. Additionally, I think that you have seen increases in money for afterschool programs, and that is for the less fortunate and those who aren't as able to do things like that.

A related issue is childcare for many who are not participating in the health of the economy, and that is an entire proposal.

Regarding the economy, let me mention a couple of things. One, is the EDA, the Economic Development Assistance Program, that is a part of the Department of Commerce and this gets to a couple of the questions that have been asked about dislocation. This year we have proposed a $20 million increase that is specifically targeted to places that are suffering from economic dislocation, much of that coming from trade. And I would just say, on the discretionary side, as the Secretary mentioned, the new markets initiative, there which is specifically focused at developing markets in the United States; ensuring that where it is a question of untapped markets, whether large companies and small entrepreneurs can do economic development in those areas.

So, that is both on the economic and education fronts.

Mr. COYNE. I wonder if you could touch on anything that may be in the for training for people who have been dislocated, who are not in preschool or grade school or high school?

Ms. MATHEWS. This is our most aggressive year in terms of focusing on the issues of training and related issues such as adult literacy, which is sometimes a problem for those in transition. We do focus on that and propose increases within the Labor Department.

In an effort to try to create a situation over time where there will be universal assistance, we believe what is needed is one-stop shopping, a place to go to learn about how you transition, or, number two, if you actually have transition needs in training, that we create a program over a period of years to address that universally.

Mr. COYNE. Thank you.

Chairman ARCHER. Mr. Herger.

Mr. HERGER. Thank you, Mr. Chairman.

Mr. Secretary, it is always a pleasure to have you with us. I have to admit that I have some very strong concerns on the budget that President Clinton and the administration has put forward. On one side I want to commend you. It must be a lot nicer sitting in your chair as Treasury Secretary today than it was back in 1994 back when we were projecting $200 billion budget deficits as far as the eye could see. I believe that our numbers are somewhere in the vicinity of $782 billion in projected surpluses over the next several years.

My concern has to do with, and I think was summed up pretty well in an editorial that was in one of our Washington papers here just a couple of days ago. The title of it was "Tax and Spend, Tax and Spend." It was referring to the President's budget. In it, it indicated that even though our surpluses are projected at $782 billion, we still see net tax increases proposed by the administration of $45.8 billion. In addition to that, the Cato Institute identified nearly $150 billion in new spending over the next 5 years.

I do want to commend you, there are a few tax credits that are in the President's budget. I am very concerned, however, that even though a major elimination of the marriage penalty was in our budget that went through last year that passed out of the House, that the President has excluded that from his budget. I think that is very wrong, and I hear this in all my townhall meetings, to somehow penalize our married families at the same time when their tax rates are lower if they happen to be single.

But I guess with all this in mind, it also concerns me just yesterday in the Budget Committee, which I also serve on, we had presented to us the budget for the United States, your Executive Office of the President's OMB budget. In it, with these projected surpluses, and even though the President has proposed major net tax increases, that the total debt, national debt, rather than going down at a time that we are having surpluses, are actually going up. And they are going up each and every year. This last year, 1998, our National debt, that is owed by every American taxpayer, but even more importantly owed by our children and our grandchildren, increases from $5.4 trillion to $5.5 trillion this year, to $5.7 trillion next year. Each and every year up and through 2004 to a net increase owed by our children and grandchildren of our National debt of $1.3 trillion at a time that we are projecting major surpluses.

Is there any explanation for this?

Secretary RUBIN. I think, if I may, that what one needs to do is distinguish, as you would in looking at any country's balance sheet, and as you know, I do this all the time and have done it for a long time in both the public and private sector, between publicly held debt which is the debt which is evaluated by capital markets when they look at a country, and the special government securities which are simply an internal claim within the unified budget and do not affect the creditworthiness of the U.S. Government one iota.

Mr. HERGER. But it is owed by our children and our grandchildren. Is that not correct?

Secretary RUBIN. It is——

Mr. HERGER. I heard this all day yesterday in the Budget Committee. This debt, held by the government which the administration attempts to make it seem like it is nothing is really real, and it is debt that is owed by our children and grandchildren. Is that not correct?

Secretary RUBIN. Let me make a suggestion, if I may.

Mr. HERGER. Is that not correct? Just yes or no. Is that debt not owed by our children and grandchildren?

Secretary RUBIN. The answer to the question is that there are existing Social Security commitments under existing law that are obligations of the U.S. Government. What this is is a first claim against the future general revenues of the Federal Government to meet the Social Security obligations.

Mr. HERGER. And is part of the debt held owed by our children and grandchildren? Would you just say yes or no on that?

Secretary RUBIN. Well, there isn't a yes or no answer to the question. The answer is that they are not a debt of the Federal Government that affects the creditworthiness of the Federal Government in the capital markets. And if you go to people——

Mr. HERGER. That is not the question that I asked because I agree with that answer.

Secretary RUBIN. Good.

Mr. HERGER. The question that I asked, which is different than the question——

Secretary RUBIN. Well, they are exactly what I just said. They are first claims within a unified budget——

Mr. HERGER. First claims owed by our children and grandchildren.

Secretary RUBIN. Well, they are first claims——

Chairman ARCHER. The gentleman's time has expired.

Secretary RUBIN. They are first claims to meet the Social Security benefits that are already obligated by law within the unified budget. And it was our judgment, which you can disagree with, that the Social Security benefits that are already committed to under law should have a first priority with respect to the claims against future general revenues.

Mr. HERGER. That's wonderful, but our debt goes up each and every year even while we are having surpluses to the tune of $1.3 trillion.

Secretary RUBIN. But the distinction that I am trying to make for you, and I really do think that it is the way that any analyst would look at the U.S. Government, is that is not debt. That is not publicly held debt.

Mr. HERGER. It is not debt.

Secretary RUBIN. Wait a minute. That is not publicly held debt that constitutes publicly held claims against the U.S. Government. What that is is an intragovernmental claim by the Social Security Trust Fund with respect to the general revenues of the U.S. Government.

Mr. HERGER. A shell game, but nonetheless our children——

Secretary RUBIN. No, no. It is not a shell game. It is actually not a shell game.

Chairman ARCHER. I don't think that the gentleman and the Secretary are ever going to get together on this. The gentleman's time has expired.

Mr. HERGER. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

Secretary RUBIN. Could I just say one thing, though, Mr. Chairman?

I think that the reason that others who have testified with respect to our budget, whatever their disagreements may be with other matters, view this as such a fiscally responsible budget. It is precisely on the issue of which we are now discussing which is it is reduction of publicly held debt of the U.S. Government.

Chairman ARCHER. Please don't let that go on Mr. McCrery's time.

Mr. McCrery.

Mr. MCCRERY. Thank you.

Now, Mr. Secretary, first of all, let me compliment the President and the administration for coming forward with the Social Security proposals that you have thus far. I think that they do move the process forward. I think reserving 62 percent is a good idea, and

I congratulate you on coming up with, I think, a realistic estimate of what it will cost us to transition to some new Social Security system or make refinements on the current system. Last year you were saying 100 percent, and I thought that was too much. Now you are saying 62 percent. I think that is a realistic estimate, and I think that is commendable that you have done that, that you have put that forward.

I also think that you are to be congratulated for suggesting that some moneys be invested in the stock market. Now, we may disagree on how that is done, but at least you have broached that question and come up with the right solution in terms of taking that risk for a higher rate of return on some of our money.

But even if all of your assumptions are correct, and everything works just like you say it will, you still only extend the life of the trust fund to 2055. So we still have a lot of work to do. And I think that you would agree that if we do everything you have proposed, that following 2055, if we do nothing else, the picture gets much darker very quickly. So, we really need to work together to propose some more fundamental reforms to the program if we are going to brighten that picture after 2055. But, I do think that it is important that we commend you on doing some positive things to move the process forward.

I want to just quickly, if I can, get back to Mr. Shaw's line of questioning and Mr. Herger's on the debt question. I too agree with you in terms of the capital markets and how they look at the Federal Government, they look at the publicly held debt primarily. But still, the internal debt is still a call on tax dollars. And as you say, in the Social Security Trust Fund it will be first call on the Federal treasury. So even though it is an internal debt, still we have to pay that with tax dollars. So there has got to be a plan, at some point to pay not only publicly held debt when it comes due, but the internal debt when it comes due.

Secretary RUBIN. But the point that I was trying to make, which I probably didn't articulate as clearly as I should have, is that plan already exists. All you need to do is look at the budget. Because what actually happens out in some outer year is that you start with the preexisting commitments, that is to pay Social Security. Then you have a first claim against the general revenues of the U.S. Government. Then you have to look at the general revenues as projected under this budget, and you have to see whether the claims that exist against the general revenues, in their totality, will exceed those revenues or be less than those revenues.

In this case, the claims will be less than those revenues, including, I might add, the payment of these first claims that go to meet the Social Security benefits. So that with the existing programs in place, you will have the revenues to both meet these Social Security commitments via, as you correctly say, via these first claims and leave a surplus. So there will still be a surplus in the year 2030, for example, or 2020, or whatever year you wish to choose.

So what you are not doing, and actually you are getting at it, at least in my judgment, in exactly the right way. What we are not doing is putting the Federal Government in a position when the year 2020 or some such year, in order to meet these first claims they would have to either raise taxes or cut spending because under the existing programs there will be a surplus in the unified budget.

Mr. MCCRERY. So you are saying that in the out years when we have to start redeeming those IOUs on the Social Security Trust Fund, that there will not—and even as late as 2045 or 2050, we won't have to raise taxes or cut other spending in order to pay those?

Secretary RUBIN. Well, under this budget, under the proposed budget, that is true out until 2039 at the very least. I don't remember the exact year, but I think that I am right in my recollection, 2039 at the very least and 2049, I think at the outer edge.

Mr. MCCRERY. OK. I would be real interested to see how we would reach that, but I will take your word for it now.

Let me just sneak in one last question about the total tax take of the Federal Government. Your budget assumes for the next several years that the percent of GDP, which will come to the Federal Government in the form of revenues, is over 20 percent. Does that, as an economist, give you any pause that the Federal Government takes that high of a percent of what we produce as a Nation?

Secretary RUBIN. Oh, I thought that you were actually going to ask a different question which is a very interesting and troubling question.

Oh this question in particular doesn't trouble me at all. It is a lot lower than it has been. Well, not a lot lower, but it is somewhat lower I believe than it has been a good number of years in the past. More to the point, I think, don't hold me to this, but I think that it is something like the third lowest tax. I apologize for not remembering the numbers, but I just saw it the other day in a totally different connection. It was a substantial list of countries that we are comparing our country to for a totally different purpose, and I think that we had the third lowest tax burden of about 15 or 20 countries, whatever number it was we were looking at.

Mr. MCCRERY. Well, if I can just interject here. My appreciation of the facts are that we are now at a peace time high in terms of the take.

Secretary RUBIN. On the Federal?

Mr. MCCRERY. Yes.

Secretary RUBIN. I am going to retract what I said before. In terms of spending, in terms of spending——

Mr. MCCRERY. No, no. I am talking about revenues.

Secretary RUBIN. Yes. In terms of spending I know that we have been lower than we have been historically.

Mr. MCCRERY. Yes, look. We have made a lot of progress on the spending side, and I congratulate you and us for that accomplishment. But I am talking about the revenue take.

Secretary RUBIN. We have moved somewhat up on the revenue side for the reasons that I said in my opening statement. It is because basically it's been driven by the stock market and the bonuses, the capital gains that's created and corporate profits.

But I think that we are still, as I said a moment ago, and I can get this for you and I'll send it to you, I just don't remember what it was. Within the universe that we were looking at, we are still, I think, the third lowest taxed country of that universe.

And working Americans, as I said in my opening remarks, have actually had their tax burdens come down substantially because of the work that the Congress did and the work that the administration did.

Chairman ARCHER. The gentleman's time has expired.

Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman.

And Mr. Secretary——

Secretary RUBIN. It was the 29 countries of the OECD, that was the universe.

Yes, go ahead. I'm sorry, Mr. Levin.

Mr. LEVIN. Thank you. That is an important subject, and we need to pursue it further. Why the tax revenues have gone up and whether that level will be sustained in view of the reasons for the increase.

But first, let me congratulate you on your accomplishments as Secretary and also for the dignity with which you conduct yourself. Also your insistence we look to the future. We can argue about the past, why a Social Security Commission wasn't created. There was resistance, Mr. Chairman, among Republicans in the Senate as well as from the White House and some of the Democrats here who thought that we should tackle this ourselves.

Also, about the emergency bill, the supplemental, I think as you were pointing out, after all, that it was accepted by the Majority Leadership in the House and in the Senate, and to simply say that it was the obstinate position of the White House, I think misses the point. As I remember it, many billions were inserted in that emergency provision at the insistence of the then-House leadership. So, keep looking to the future.

And let me just say a word about steel and the response to Mr. Coyne's question. I think that retraining workers is a very good idea, and we do it fairly well in this country. But I don't think that you can say to thousands and thousands of steel workers who are in their forties and fifties that we will simply retrain you and not worry about the impact of dumping on the industry. We have to balance these considerations, but we need an activist policy.

But let me just talk to you about the trust fund and the suggestion that there be public investment, because that became kind of the focal point of our discussion with Mr. Greenspan. Actually his opposition, as we later talked about it, I don't think was so stringent as was portrayed by some in the media. He later said, in response to a question, that the problems are mainly political and he would trust our judgment. But I want to ask you your judgment, because you have had some hesitation in the past.

Tell us what can be built into this so that there would not be the problems that you have worried about and some of us have worried about. Because we need to solve that issue if we are going to move ahead with Social Security efforts.

Secretary RUBIN. Yes, I have had reservations in the past, and I have reservations now. But I think that those reservations are meetable, and that was what I tried to say in my opening statement, Mr. Levin.

I don't know precisely what mechanisms we should create, but I would observe that we have an independent Federal Reserve

Board, and we have created a mechanism there. And through many presidencies, that independence has been respected, I think very much for the benefit of our country. I think that we need to find a mechanism that will be similarly independent and that we work to develop, develop with Congress, that will provide a totally apolitical investment process with respect to these funds.

I don't have a view at this time, Mr. Levin, as how best to do that. I note the Fed is a good example of success in this area, and it seems to me that this should be readily doable. I think that the best way to do it, so that we have the confidence of all, is to work with you all to develop that.

Mr. LEVIN. And this would involve independence from political inputs? It would involve private managers?

Secretary RUBIN. Oh, I think that the managers clearly should be private. I think that the money should be invested in some sort of broad-based index fund of some sort. I think that the choice of the managers should also be totally apolitical.

Mr. LEVIN. OK, thank you.

Chairman ARCHER. Mr. Johnson of Texas is next. He is not here. Which prompts me, Mr. Secretary, to ask you if you would be willing to accept written questions from Members whose time has run out or who cannot be here in order to verbally question you?

Secretary RUBIN. We would be pleased to, Mr. Chairman.

Chairman ARCHER. Thank you very much.

Is Ms. Dunn here?

Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

And thank you, Mr. Secretary, for the opportunity to question you on a couple of topics. I want to reiterate Mr. Rangel's initial comments complimenting you for your temperament and your tolerance. And I don't mean to test either of those here today.

I do want to raise a question with regard to steel that has not been covered so far. As you know, the domestic steel industry is reeling under a wave of unprecedented imports. Many of us, as you have heard today, have been disappointed by the administration's response, but I don't plan to revisit that as a broad policy. I am specifically interested in your proposal for extending the net or operating loss carryback period supposedly to help the industry. You project that this relief might inject $300 million into the steel industry. In the President's steel report this proposal was described as designed to provide timely and significant relief and to help stave off job losses.

I am wondering, because I have looked at this proposal, specifically did the Treasury or the administration check to determine which, if any, steel employers would benefit from this proposal?

Secretary RUBIN. I am sure, Mr. English, that the $300 million estimate was based on looking at specific companies and their financial situation, because I don't see how else you could arrive at the estimates. So the answer, by extrapolation, has to be yes, though I was not personally, specifically involved in the analysis.

Mr. ENGLISH. Do you know offhand, would this benefit, for example, U.S. Steel or National Steel?

Secretary RUBIN. I do not know who specifically would benefit, but we can certainly get back to you on that.

Mr. ENGLISH. OK.
[The following was subsequently received:]

According to our analysis, roughly 10% (by number) of all steel companies would benefit from the proposal. These would tend to be fairly small companies. Several large steel companies would not benefit because the longer tax carryback period would not reduce their taxes.

Mr. ENGLISH. I have a list here of the top ten manufacturers in the country representing the bulk of steel production in the United States. For your reference, and I hope this is helpful, my limited staff has contacted all of them and so far has found that none of them would benefit from the proposal put forward by the administration. For your reference, we did find one company in the Pittsburgh area, a small one called J and L Specialty Steel who support your provision and would benefit. They are owned by Usinor SA, a French company. But I do not know of any major, domestic steel company that would benefit from this provision. Can you enlighten us on this point and give us any indication of where this would benefit?

Secretary RUBIN. Can I make a suggestion, Mr. English?

Mr. ENGLISH. Surely.

Secretary RUBIN. Obviously the estimates of the $300 million have to have come from looking at companies, their P and Ls, their projected P and Ls and their past profits. My suggestion would be that we, because I don't know it offhand, that we get back to you.

Mr. ENGLISH. I would be delighted. I would like to review the specifics of your analysis, because as I have said, not one of the top ten steel producers would benefit from the proposal that you have outlined.

Secretary RUBIN. There is another possibility, it has just occurred to me. We look, obviously, at the publicly held data because that is what we have access to. It may be that they are looking at data that we don't have access to, or it may be that they are interpreting in ways different that we do.

But our primary thrust, as you know, Mr. English, because I responded to your letter, I don't know whether you received it yet, but——

Mr. ENGLISH. Absolutely.

Secretary RUBIN. This whole area has not been the net operating loss. Our primary response has been the one that I outlined before, and maybe it was in response to Mr. Coyne or maybe somebody else, I don't remember. We will also be limited in terms of our discussions with your staff by whatever restrictions exist with respect to our right to discuss specific companies. But we are doing the best we can to try to——

Mr. ENGLISH. I would like to follow up with one other unrelated question, though.

I noticed that the President in the State of the Union Address and then in his budget has proposed incentives similar to our Ticket to Work Act to bring people who are SSI recipients back into the work force. The President has also proposed an increase in the minimum wage. But the President, as far as I can see, has not proposed an increase in the SSI earnings limit and would leave people, under his budget, who are collecting SSI, who are not blind, limited to $500 a month in earnings or they would lose their benefits. I am very concerned about this.

With the additional minimum wage increase the President has proposed, and I have supported minimum wage increases in the past, many persons who are on SSI, who are disabled, would have a very limited opportunity to participate in the work force. As you know, I sent a letter to the President, ten of us signed on to it, asking him to include an increase in the earnings limitation in his budget. Is there any prospect that we can eventually agree on that?

Secretary RUBIN. That is a very thoughtful question. Let me ask Ms. Mathews if she would respond.

Ms. MATHEWS. This is a regulatory matter. It can be done through regulation. At OMB right now this very question is one we are examining.

Mr. ENGLISH. Well, I believe that it is under statute limited to $500 a month.

Ms. MATHEWS. We are working on it to see. I think that we agree that there is a problem in terms of trying to provide incentives to work. This is a place that we are looking at right now.

Mr. ENGLISH. But I am right, though, the President did not propose the increase from $500 a month, $6,000 a year, as part of his budget?

Ms. MATHEWS. I will have to go back and check if it is within the budget document that exists. This is something that I will get back to you on. It is something that we recognize, and I think that your letter has come through as something that is an issue that we need to address.

[At the time of printing, no responses had been received from Ms. Mathews.]

Mr. ENGLISH. Thank you so much for your testimony.

Chairman ARCHER. Mr. Weller.

Mr. WELLER. Thank you, Mr. Speaker, and good afternoon now, Mr. Secretary.

I have got a couple of observations. I have been taking some notes during your testimony and response to questions. Of course, when it comes to Social Security, of course I think that all of us appreciate the President's suggestion regarding setting aside 62 percent of the surplus tax revenue for saving Social Security, and, of course, we applaud that. I think that a minimum, I think that we certainly feel that we should do at least that.

I also want to note, of course, this Committee, just last year, just 2 months ago, passed and sent to the Senate legislation which would have set aside 90 percent of the surplus for saving Social Security. So clearly that is an area where I think that we can work together.

I also want to note that I salute the President in embracing repeal and elimination of the earnings limit on Social Security. Of course, our new Speaker of the House, Dennis Hastert, has led that fight over the last 2 years. It was part of the Contract With America, and clearly I applaud the President embracing Denny Hastert's idea because I think that is one area where we need to work together.

Secretary RUBIN. I am not quite sure how he relates to it, but in any event.

Mr. WELLER. But I do want to express concern, particularly with the over $80 billion in tax increases in the President's budget. I think that there are well over $40 billion in net tax increases, it is my understanding. I want to express concern about that. I think, as Mr. McCrery pointed out, the tax burden on our economy is at its highest level ever. Twenty-one percent of our economy goes to the Federal Government. In Illinois, the average family that I have the privilege of representing, sends about 40 percent of its income to government at the State and local level. The tax burden is at its highest level ever on Illinois families.

It is my understanding that since 1992 the total amount of tax revenue that your agency collects from individual taxpayers has gone up about 63 percent. So, clearly, the tax burden is pretty high. And when we are looking at a $2.3 trillion projected surplus of extra tax revenue, or the overpayment as a result of the balanced budget, I wonder why we need tax increases.

But also another issue which I think is important, and I am wondering why the administration did not include an initiative is the issue of the marriage tax penalty. As you know, 21 million married working couples pay, on average, about $1,400 more in higher taxes under our Tax Code just because they are married, if you compare that to a working couple with identical income living together outside of marriage.

The question that I have is not only why does the administration not embrace the elimination of the marriage penalty, but second, in studying the tax credits that the President proposes for long-term care and disabled tax credit, he creates an additional marriage tax penalty. I was just wondering if you can explain why he did not look into the impact on married couples when creating these new tax credits as well as why you do not support elimination of the marriage tax penalty in general.

Secretary RUBIN. Let me do this, if I may, Mr. Weller. You have raised a lot of questions, let me try to get as many of them as I can.

In terms of the marriage tax penalty, we have always been in favor of dealing with the marriage tax penalty. The question has always been a question of finding the money. Clearly, as you go back over the last 2 years, there has been a constant tension, if you will, between the question of taxing—in effect the 1996 presidential campaign was about this, I suppose—between tax cuts and fiscal discipline, and fiscal discipline is always a much tougher and in many ways a much less attractive path.

On the other hand, I don't personally think that there was any question but that the enormous change from deficits to surpluses that we have experienced over these last 6 years has been central to the tremendous increase in jobs, standards of living, and the rest that the American people have experienced. We, too believe, we agree with you, the marriage tax penalty should be dealt with. What we need to do is to work with Congress to find some way to fund it.

In terms of tax cuts, what we—and I am not quite sure what your $40 billion—are you referring to the offsets that we have in the discretionary account?

Mr. WELLER. My understanding is that your net tax increases are considered offsets, and that is still about $43 billion in net tax increases.

Secretary RUBIN. For what period of time?

Mr. WELLER. In your budget that you proposed.

Secretary RUBIN. No, but there are a lot of different time periods. If you are talking about the offsets that we have, if this is what you are talking about, the offsets that we have in the year 2000, we do believe that there should be a cigarette—that you cost that the Federal Government incurs because of smoking, and we do believe that they should be paid for by an excise tax.

Mr. WELLER. Mr. Secretary, once you subtract the tobacco tax, there is still a roughly what, $30 some billion in new taxes that you are left with on the business community and on the private sector.

Secretary RUBIN. No, no. Again, I am not quite sure what numbers you are talking about, but if you are talking about the $45 billion of offsets in the discretionary account, $34 billion of that is the tobacco tax, and $11 billion is other things, most of which, yes, virtually all of which I believe, or certainly most of which, are extensions of taxes that have existed and have expired.

Let me also say that if you put into place the President's program, you will be back into a net tax cut, in fact, a substantial net tax cut because you will have the USA accounts created.

Mr. WELLER. Mr. Secretary, just to quickly follow up. You had indicated that the administration has always supported eliminating the marriage tax penalty, but you have yet to propose your own ideas on solving it. Of course you took a position in opposition to legislation that we passed last year which would have eliminated the marriage tax penalty for a majority of those who suffer it.

Secretary RUBIN. No, our question on the marriage tax penalty——

Mr. WELLER. Also, Mr. Secretary, you did not answer my question on the long-term tax credit and the disabled care tax credit. You created a new marriage tax penalty, and if you are sensitive to this issue, I was wondering why you want to add one more marriage tax penalty to the Tax Code.

Secretary RUBIN. No, I think what I was saying, Mr. Weller, was that we have always been in favor of dealing—and by the way, I think that the long-term care tax credit is a very important credit, and I think that—we have always been in favor of dealing with the marriage tax penalty. I think that the question that you always have in these situations is what sorts of priorities do you have and what sorts of weighing and balancing you do of these things. If we can find room in the budget, Mr. Weller, it is something that we would be very happy to work with you on.

But I do think that if we are going to have the kind of economy in the future that we have had in the past, that we have to continue on a very disciplined road of fiscal discipline, and that is what our budget is directed to do. But we would be delighted to work with you to try to create room in the budget for a marriage tax fund, or rather for dealing with the marriage tax penalty. It is something that we are very much in favor of doing.

Chairman ARCHER. The gentleman's time has expired.

Mr. Secretary——

Secretary RUBIN. But you have to ask, what are you going to do instead of it.

Chairman ARCHER. Would you inform the Chair as to what your schedule constraints are for the rest of the day?

Secretary RUBIN. I have a couple of things in the afternoon, and I have a 7:30 dinner this evening, Mr. Chairman. [Laughter.]

Chairman ARCHER. I don't think that we will go that long, Mr. Secretary.

Secretary RUBIN. That is my schedule as I recollect it.

Chairman ARCHER. Let's say in the next hour.

Secretary RUBIN. I can think of no better place to spend the next hour than right here. [Laughter.]

Just like the last 2½ hours.

Chairman ARCHER. Would the Secretary like to take a break?

Secretary RUBIN. I think that a 5-minute stretch wouldn't be a bad thing.

Chairman ARCHER. All right.

Secretary RUBIN. Usually, because of your rules, that is not a problem, because you all have to run off and vote.

Chairman ARCHER. The Committee will stand in recess for 5 minutes.

[Recess.]

Chairman ARCHER. The Committee will come to order.

As soon as the Secretary returns, we will recommence the hearing. In the meantime, the Chair would invite guests and staff and Members to take their seats.

Mr. Cardin is recognized.

Mr. CARDIN. Thank you, Mr. Chairman.

First, Secretary Rubin, let me congratulate you as the principle architect of the fiscal policy that has been so successful in our country. I also really want to applaud you for the theme of your presentation today, which you have said over and over again, is to improve national savings, and the President's budget is aimed at improving national savings.

You have pointed out numerous times that we have gone from large deficits to projected surpluses. The unemployment rate is low. Interest rates are low. Inflation is low. But you have also pointed out that our National savings ratios are going in the wrong direction. We have actually been reducing the amount of money that we have put away for savings. So I really applaud you for proposing that we use the surplus to bolster our savings ratios for future economic growth in our Nation.

I want to call attention to a proposal that Congressman Portman and I are working on to improve existing retirement and savings plans that we have in our Nation to make them more effective for individuals putting more money away personally for savings. I also want to applaud your use of the surplus for creation of the USA accounts, because, as you point out, and I think it is worth underscoring, if we spend the surplus, whether on government spending or tax cuts, it is going to do little to improve national savings. But if we use it as a tax cut like the USA account, targeted to individuals putting money away for savings, then we have accomplished two major objectives. We have reduced taxes and we have increased national savings.

So, I just really wanted to just compliment you on that theme that you have brought forward.

Secretary RUBIN. Can I just say one thing, Mr. Cardin, because I think it has been somewhat understressed in the discussion that we have had this morning.

In my view, and I think that a lot of commentators who have no stake in this one way or the other have commented similarly, I think that in many ways the most significant thing that this budget does, and I must say that it is not something that I could not have imagined 6 years ago when I came to Federal Government, over 6 years ago when I came to the Federal Government, is to substantially reduce the Federal debt held by the public.

The Federal debt, as I think I mentioned in my opening remarks, and if I didn't I should have, as a percentage of the GDP was about 50 percent when the President was elected and is about 14 percent at the end of this program. That is a remarkable contribution to national savings, and also a remarkable improvement in terms of the ability of the Federal Government to access markets if need be. I think sometimes that gets lost a little bit in our discussion.

Mr. CARDIN. I think that your proposal also allows for the reduction of publicly held debt and still allowing for a very modest investment by the Social Security Trustees into private investments.

Secretary RUBIN. I think that I misspoke. In 2014, it will be 7 percent of the GDP.

Mr. CARDIN. That is even better.

Secretary RUBIN. That's even better.

Mr. CARDIN. If I have one suggestion on the proposal for private investments, I would say that you are too conservative. If you look at what private retirement plans do as far as investing in equities, they are over 60 percent. If you look at government retirement plans, State and local government, they are over 60 percent. You are suggesting, I believe, 15 percent. If you look at how large these accounts are. The State of California has well in excess of $100 billion in their accounts. The Fidelity investments are over $500 billion currently. So the dollars that you mentioned may seem large in absolute numbers, but relative to what is happening in the market, the chances of a concern about the Federal investment is so modest if you incorporate the type of protections that Congressman Levin mentioned and that you have mentioned in your presentation.

So I would encourage you that you have fiduciary responsibilities as Trustees of the Social Security Trust system. You need to look at it from the point of view of the future performance and ability of our Nation to pay Social Security benefits. That requires us to be a little bit bolder in looking how to get a better return for our seniors.

And last, let me just make a point on the surpluses. There has been a lot of talk about the use of the surplus in the last Congress. I don't want to belabor the point, but we complied with the budget rules. I would agree with the Chairman that the budget rules should be changed. It is interesting that I was the representative of this Committee on the Budget Committee last year along with Mr. Nussle, and we have come out with bipartisan recommendations that would adopt some of the Chairman's concerns by having us budget for the annual emergencies the best that we can. It still has the safeguard that if there are emergencies beyond what we project that we are able to go ahead and provide for that because you have to.

And it is interesting that if these new budget rules were in effect last year, the surplus would be about exactly the same as it is now because we allowed for the caps to increase in order to fund for emergencies.

So, I just really wanted to set the record straight. You complied with the budget rules. We saved the surplus for the Social Security system, and now we can talk about a proposal that can get bipartisan support, resolve the Social Security issues, and allow us to continue the high performance of our economy.

Secretary RUBIN. I agree, Mr. Cardin.

I might add that I thought that the work that you and Mr. Portman did last year under the aegis of the Chairman with respect to the Internal Revenue Service, in reforming the Internal Revenue Service, is a good example of how bipartisan work can really make progress and really contribute to our National well-being.

Mr. CARDIN. Thank you.

Chairman ARCHER. Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman, and Mr. Secretary. Thank you for sticking with us during this hearing today.

The gentleman from New York, the Ranking Minority Member, during his colloquy with you, I thought elicited from you a statement that I hope you will clarify, that the administration would not consider a tax cut until a Social Security proposal is proposed. Is that what I heard your statement to be?

Secretary RUBIN. Let me tell you where we are. I don't actually remember what I said to the Minority Member, not Minority Leader, Ranking Member.

Mr. RANGEL. All of those things. [Laughter.]

Secretary RUBIN. In any event, Mr. Rangel.

We have in our budget, fully paid for, give or take $34 billion of tax cuts, paid for with revenue raisers of one sort or another. Those tax cuts are part of the regular budget and obviously should proceed at pace.

With respect to tax cuts that are paid for out of the surplus, we propose one which is the USA accounts. We don't think that that should be enacted until Social Security has been addressed.

Mr. HULSHOF. Thank you for clarifying your earlier statement.

I want to focus a bit on what the Chairman opened the hearing with, and that is talking about what I think every Member desires of the Committee, that we do hope that children can attend school in a safe, secure environment. The Chairman talked about that in his opening statement.

You are familiar with the Taxpayer Relief Act of 1997. We, in fact, included a provision, the issuance of about $800 million of qualified zone, academy bond authority $400 million, I think, in

1998, $400 million in 1999. I recognize that the proposal of the administration is a little bit different, but there are some similarities. So let me ask you a couple of questions.

Can you tell the Committee, Mr. Secretary, how many schools have been improved under the qualified zone, academy bonding authority?

Secretary RUBIN. I do not know, but I certainly can get you the information, and we can get back to you.

[The following was subsequently received:]

Through January of 1999, issuances have been made to benefit two schools: one in Chicago, Illinois, and the other under joint control of school districts in Fresno and Clovis, California.

Mr. HULSHOF. Well, let me ask you. Last year's IRS reform legislation that you just complimented Mr. Cardin and Mr. Portman on also included a provision calling for complexity analysis to accompany any tax legislation before you bring it to Congress, especially before this Committee. Did the Treasury Department do a complexity analysis of either school bond proposal?

Secretary RUBIN. You mean of the school construction proposal that we are making right now?

Mr. HULSHOF. Yes, sir.

Secretary RUBIN. By the time we present you with legislation, we will obviously have it. Well, let me say that we strongly believe in having, and we will have a complexity analysis in accordance with the law. But we also, let me just say, believe in having complexity analysis.

Mr. HULSHOF. It is my understanding that the proposal that you are asking us to consider, again talking about the school——

Secretary RUBIN. You are talking about the school construction tax credit?

Mr. HULSHOF. Yes. That that proposal calls for the Department of Education actually approving a school district's plan to rehabilitate or construct public schools.

Secretary RUBIN. Yes, there is actually—my recollection of this is that, if I remember correctly, there is a formula allocation, and then the Department of Education gets involved, I believe.

Mr. HULSHOF. Can you tell us what expertise or experience the Department of Education brings to the table in regard to public finance?

Secretary RUBIN. Well, public finance, I don't know how much or how fully they are involved in public finance. But my recollection, I may be wrong in what I am going to say, but my recollection of the allocation was 50 percent of that was going to be allocated to the 100 largest school districts in the country as measured by the number of poor children that they had in them. I think that is right.

Mr. HULSHOF. Based on school lunch percentages?

Secretary RUBIN. Yes, however it was going to be determined, but it was the number of poor children. And then the second was the other 50 percent of them was going to go to localities to be allocated as they saw fit. That is my recollection of how that was supposed to work.

Mr. HULSHOF. Is there any truth to the reports that at least some of us have been receiving that the markets have been, to be kind, less than receptive regarding the qualified zone academy bonds?

Secretary RUBIN. I haven't spoken to anybody in the market. It is my own judgment, for whatever it is worth, that this is a good idea, but I can't tell you how markets have reacted.

Mr. HULSHOF. Specifically regarding the administration's proposal or the Chairman's proposal?

Secretary RUBIN. No, I am talking about our proposal. If you are asking me whether our proposal—we have a school construction bond proposal, and then we have the academy zone proposal. You are talking about those two proposals, right?

Mr. HULSHOF. Yes.

Secretary RUBIN. In my judgment, at least they are good proposals, and I think that they will be effective in the market.

Mr. HULSHOF. I would appreciate, and I know Ms. Mathews is probably jotting notes, that if the Treasury could provide us with some information.

Secretary RUBIN. Ms. Mathews might actually like to respond as well.

Ms. MATHEWS. The only thing that I would add is that on the qualified, those bonds are actually part of the school construction proposed. There is an increase in those as well.

Mr. HULSHOF. Would you be able to follow up, as my time has expired, of specific instances where qualified zone academy bonds have been used, because I think that number is probably not very many.

Secretary RUBIN. Well, we are involved in a new program, but I think that if we were to put in place the expansion of those plus the school construction bonds, at least my judgment, which could turn out to be wrong, is that I think you could actually see a very substantial contribution to school construction, which, as the Chairman said, is a very important national issue.

Mr. HULSHOF. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Lewis.

Mr. LEWIS of Kentucky. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for testifying today.

Just recently, as you know, we had Alan Greenspan here. Mr. Greenspan said that the best of all worlds would be to not spend the surplus. The second best thing would be tax relief for the American people. He said the worst thing of all would be more spending, more government spending.

Well the President's budget is in direct contradiction of Mr. Greenspan's testimony because there is more spending. There is $200 billion in more domestic spending, 40 new mandatory programs, and 80 new discretionary programs. There are $108 billion in new taxes and fees.

Secretary RUBIN. Are you talking about the year 2000 budget? Or the 5 years?

Mr. LEWIS of Kentucky. Over 5 years.

And there is no net tax reduction, no broad tax relief. So, none of this jives with Mr. Greenspan's testimony.

Secretary RUBIN. I actually don't agree with that, but go ahead.

Mr. LEWIS of Kentucky. And the other day, the President was speaking to a group of taxpayers, and he said, "You know, we could return some of this surplus money back to you, but if you don't spend it wisely then there could be a problem."

My question is, does the President or do you agree with that, that the American people, if we give them tax relief, really can't handle their own affairs and can't spend their own money wisely that they have worked very hard to earn?

Secretary RUBIN. But that, Mr. Lewis, was not the President's point. I think that the President's point was, and it is the same debate that we have had for over 6 years now within the Federal Government, to what extent should we have tax cuts, and to what extent should we focus on improving the fiscal position of the U.S. Government and increasing national savings. It has been our view for this whole 6 years plus now that if our objective was to promote jobs and to increase standards of living, that the best path toward that is also I will acknowledge the hardest path, which is fiscal discipline. That is precisely what this budget is about.

Eighty-nine percent of this surplus, if you enact the budget as proposed, will actually go to increase the national savings, which will be an extraordinary accomplishment for our country.

The President wasn't saying that the American people don't use their money wisely. He was saying that while all of us would like to have tax cuts, there is a harder path to tread which is to tread a path of fiscal discipline which has led us to where we have been over these 6 years, an extraordinary 6 years, and it is the harder, but in our judgment, the sounder path of going forward. That was basically where we are.

Mr. LEWIS of Kentucky. Don't you think that probably the reason that we are moving in the right direction in this country is because of tax relief to the American people, and the balanced budget, and the fiscal responsibility that we have tried to instill in the budget over the last years?

Secretary RUBIN. What I think?

Mr. LEWIS of Kentucky. Yes.

Secretary RUBIN. I think that the Nation changed fiscal direction in 1993. In 1992 there was a projected deficit of $290 billion. I remember exceedingly well during the transition when Dick Darmon came out with his projections going forward, and they were enormous. And we went to the President during the transition and said, "Mr. President, you've got to decide. You've got to make this your threshold issue." And he said, "I don't have a choice because we will never get this economy going again unless we get this deficit down."

And we put forth a budget in 1993. It was very controversial, as you probably remember. But what it did do, was it produced a lot of deficit reduction. That, in turn, created economic growth. The two interacted, and there is the path that we have been on ever since.

Mr. LEWIS of Kentucky. Then why did the President's projections for the next indefinite years would have been continued enormous deficits if the 1993 budget was supposed to solve the problem?

Secretary RUBIN. No, what the 1993—you are talking about the 1993?

Mr. LEWIS of Kentucky. You are speaking of the 1993 largest tax increase that was supposed to solve the problem. But the projections were that that was——

Secretary RUBIN. No, the 1993—my recollection, this is now 6 years, but my recollection is that the 1993 deficit reduction program was as a matter of policy designed to produce about $500 billion, I think it was, of deficit reduction, about half in spending cuts and half in tax increases. The actual number turned out to be much larger. I think that the reason that the turnout was larger was precisely because of the underlying theory that caused us to be there in the first place, which is the deficit reduction would generate economic growth and the two would interact.

Mr. LEWIS of Kentucky. Let me just ask a quick question. The 55 cent sales tax on tobacco.

Secretary RUBIN. I am sorry, I didn't hear you.

Mr. LEWIS of Kentucky. The 55 cent sales tax on tobacco. My tobacco farmers in Kentucky are going to be devastated. With the State lawsuits, you know there is going to be an increase already of 45 cents on a pack of cigarettes. The President requested and got a 15 cent increase in cigarette tax just a couple of years ago. Now a 55 cent tax, a Federal lawsuit against tobacco companies. This will absolutely destroy the small tobacco farmer in Kentucky.

Secretary RUBIN. Mr. Lewis, what the President has proposed is that we determine, and what we have done is to determine the costs generated. In fact, I think that there is a chart on this in the budget some place, the cost created for the Federal Government by smoking, and then to require that that be paid by virtue of an excise tax. That is where the tobacco tax comes from.

Mr. LEWIS of Kentucky. It seems like it is a law of diminishing returns.

Chairman ARCHER. The gentleman's time has expired.

Mr. Foley.

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

I just want to thank Secretary Rubin for his dedication to this country. You could clearly be in the private sector making quite a bit more money, and with the prosperity on Wall Street, I am certain that you yearn at times for that nice opportunity. I also want to thank you and encourage you in your hiring of Ray Kelly as Undersecretary of Treasury. He has done a wonderful job working with us on Coast Guard issues, Customs issues in Florida, and these are extremely important.

One thing that I do want to question is, back in the debate when we were advancing the notion of reducing capital gains tax rates in order to stimulate the economy, there was quite a notion by yourself and the administration that this was merely a tax cut for the rich and that we were not going to necessarily stimulate the economy and not, certainly, help the average American taxpayer. I think that over the years, we have noticed an increased trend by average consumers, baby boomers, and others, to invest in Wall

Street and to find an opportunity to have equities as part of their portfolio.

We changed the capital gains rate, and I think that clearly we have demonstrated that there have been significant gains made by Treasury as a result of that prudent policy. Has your reflection on the last several years since we adopted that policy changed your opinion at all? And would you also comment on the question, would reducing the holding period of an asset class from the 12-month period to a much less time period potentially increase opportunity?

Secretary RUBIN. I don't think, Mr. Foley, that I would agree with some of the posits of your question, if you will.

We did decrease the capital gains tax. At the time, I think that I said that it was my view and I think that there is a lot of academic literature to support this. Let me put it differently, that the academic literature predominantly suggests that that is unlikely to increase the national savings rate. I don't think that there is anything to suggest the contrary.

I spent 26 years on Wall Street. I never believed that a capital gains tax reduction would have much effect, if any, on savings within the framework of current tax structures. Obviously if you had 70 percent individual rates or something it would be a different situation. So, I am talking roughly speaking of the current framework.

There has been a very large increase in capital gains taxes paid, but I don't think that that has anything to do with capital gains taxes. In fact, I suspect that had capital gains taxes been higher we probably would have collected more. It has been a function of the stock market having done so well, and that stock market, for better or for worse, rightly or wrongly, and I am not saying that I believe it is rightly or wrongly or anything else. I am just saying that stock market was doing very well before the capital gains tax was enacted, and it has done very well since the capital gains tax was enacted.

Whether the market is at the right level or the wrong level is something that I am not commenting on, but I do think that the stock market basically responds to fundamentals over time. The key, it seems to me, with respect to our tax revenues is that we have had very good economic fundamentals in this country.

Mr. FOLEY. But don't you think, that having less of a tax burden on people will cause them to sell their securities, potentially then increasing income for all—the stock broker, the brokerage firms, transactional operations, and entities?

Secretary RUBIN. There may be, if you reduce the holding period. I don't know, and I would really have to speak to the estimators, whether that would increase the incidence of turnover. Whether it is desirable to increase the incidence of turnover is another question. As you know, there have been many economists hold that view that one of the problems in our country is a lack of patient capital, that our capital turns over—that the focus is to short-term rather than to long-term. So, I am not sure that would be desirable even if that were so.

Mr. FOLEY. It sometimes, though, seems arbitrary to me to trap people into an investment. If they see a gain and want to take advantage of the gain, an arbitrary capital gains tax burden on them would keep them from exercising their right to cash in and profit.

Secretary RUBIN. They can always cash in. The question is do they pay ordinary income tax rates.

Mr. FOLEY. But that may, in fact, affect their decision to sell.

Secretary RUBIN. Yes.

Mr. FOLEY. They might look at it and say that they would be better to hold it 12 months. But then if the gain evaporates over that 12-month arbitrary period, then you have locked yourself out of that profit.

Secretary RUBIN. I suppose that you have to start, Mr. Foley, with the basic question of whether you think having a preferential capital gains tax rate is desirable or undesirable. I at least think that it is pretty difficult to establish that it contributes to our National well-being. Now I know that the Chairman and many others have a very different view of that.

Mr. FOLEY. Let me ask one final question. Looking at the economy, particularly in Asia, Japan, and Latin America, there are a number of problems abroad that need our direct attention. I think that our own economic projections look quite rosy and optimistic. But you see any chance with these collapsing economies and currency fluctuations elsewhere that we really will not be able to meet the expectations of either side of the aisle on the budget?

Secretary RUBIN. Well, the actual assumptions on which the budget is based, I think are generally viewed as being pretty conservative. The CBO, I recollect, came out with a higher projected surplus than we did, didn't they?

Ms. MATHEWS. About $155 billion over the——

Secretary RUBIN. But having said that, I think that you are raising a very good question. There are lot of risks in the world, and life doesn't always go one way. I think that one reason why this budget is so important for the future of our country is that what it focuses on is fiscal discipline, paying down publicly held debt. So that if, in fact, conditions turn out to be worse than what I think are rather prudent, conservative assumptions, then the Federal Government will be in a far better position than it would be otherwise to access capital markets if need be, and national savings will be larger, which presumably will have generated greater economic growth than would otherwise be the case.

Mr. FOLEY. Thank you, Mr. Chairman.

Chairman ARCHER. Thank you.

Mr. Tanner.

Mr. TANNER. Thank you, Mr. Chairman, and Mr. Secretary, thank you. I will try not take all of my time.

I want to thank you, in starting off, for this budget document as it addressed the REIT problems that we talked about last year. I think that it is positive, and I appreciate that.

I want to talk about—we've heard of national savings rate, debt, deficits and so on. This is a new world. I came here 10 years ago, and at that time all I heard was people saying please do something to stop the deficits and please do something to pay off the national debt. It is too high, it is leaving our children and our grandchildren in a position where some substantial portion of the money that would be coming into the Treasury would be obligated in the form of interest payments, some say as much as 15, 16, 17, perhaps 18 cents on the dollar if we didn't do something about deficit spending and talk about debt.

Now as it relates to our National debt, there is publicly held debt represented by the Social Security Trust Fund, for example, investing in Treasury obligations with an interest factor there and inneragency publicly held debt, if one wishes to choose those words. There is also something called privately held debt, and that is held by individuals, held by foreign companies who have invested in our Treasury obligations in times gone by. It seems to me, in keeping with what Mr. Greenspan said when he was here a week to 10 days ago that his preference, and you may or may not agree, but his preference was to pay down the debt with the surplus, that that would leave the country's bank account in better shape, not only for all the good things that come with the government not hogging the money that is available for borrowing, but also leave us in a better position in the future if we were to use the surplus to pay down debt.

I would ask you to articulate on the difference between the inneragency publicly held debt, as it were, and that debt, which I understand it is about $2.6 or $2.7 trillion that is actually held and could be retired were we to use some of the surplus to pay that off. What would happen and how do you think that might affect our future economic potential as opposed to tax cuts or as opposed to any spending programs or anything that we have heard so far in this new world of surpluses.

Thank you. It is a long question.

Secretary RUBIN. No, but I think it is a very important question. I tried to address it to some extent in my opening remarks, but I used slightly different nomenclature than you did, though.

Debt that is held externally to—debt that is held by outside creditors of the U.S. Government, under this proposal, would be reduced to some 7 percent of the GDP in the 2014. That is a direct contribution, to, or increase of, if you will, national savings. What it basically—it's reverse crowding out. What it basically means is that the Federal Government would be making a much smaller claim on the available savings pool. The Federal Government is making a smaller claim on the national savings pool. What that means is that private investors will have more capital available or a larger percentage available to them, which both makes it more available and should lower interest rates, precisely what we have been trying to do over the last 6 years. And the lower interest rates will generate more economic growth, more jobs, higher standards of living, and the rest. And that is really the guts, if you will, of this budget.

In addition, it does, I guess it was Mr. Foley who raised the point, it does put the Federal Government in a stronger position to access markets in the future if, in fact, things turn out worse than we would hope and expect.

The claims within the unified budget have no effect on anything that we just discussed. They simply are claims against the general revenues, and then uses of the general revenues in the future years, and they have no impact at all on anything that we have just discussed.

Mr. TANNER. That was my thing. I believe that would be something that ought to be considered as a use of the surplus, and that is the paying down of this externally held debt, if one wants to use that nomenclature, because—am I correct in saying in so doing we directly save Social Security first, if that was what one wanted to relate to, how the obligations of the Federal Government in the future, however they are characterized, there is a finite out of money coming into the Treasury no matter what kind of tax this is called, whether it is payroll tax, capital gains taxes, income taxes, excise taxes, there is a finite amount of money coming to the Federal Treasury.

There is an obligation, under law, to Social Security, to several other entitlements as well as the things that we have to do from the discretionary side in terms of military preparedness and readiness and so on.

And so, how ever one characterizes what is going to happen in the future, it seems to me that the less money that we owe at that date, the stronger the country will be in terms of its financial integrity as it relates to that future date. Am I correct in——

Secretary RUBIN. That is correct.

Mr. TANNER. It is a simplistic notion.

Secretary RUBIN. No, but it is correct. I don't think that it is simplistic at all, but I think that it just goes to the heart of what this budget is about. And it also, as you said, and I don't think that this has actually come up at the hearing yet, it does strengthen Social Security by strengthening the ability of the Federal Government to access capital markets if need be, to meet Social Security commitments. So that is a point that did not come up yet, and it is correct.

Chairman ARCHER. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Thank you, Mr. Secretary.

I consider this whole episode as kind of like a game of checkers, and based on law, the administration at present had to move first in this checker game, and you are here to explain his move. We all know that his move basically could be defined as just in general terms and not in so many specifics as we get into Social Security and the other areas that you have discussed.

It kind of reminds me of the Baptist preacher who stepped out of the boat and walked toward shore. It looked like he was walking on water. Basically he just knew where the stumps were and didn't sink because of walking on the stumps. We walk on the stumps as we get passed the first move. And now it is our move.

You and I have discussed this before. I have read that you are a good budget person, an excellent budget person, but you are not very high on tax relief as you demonstrated just a few minutes ago with your position on capital gains. But in kind of a little takeoff from Mr. Tanner, he said that the less money that we owe the better off that we are. I consider that to be very true, but I also consider that whether it is privately held debt or publicly held securities.

But listening to Mr. Lew yesterday, he mentioned, and he had a chart that indicated that in the year 2014, the interest portion of the budget would be 3 percent of the budget based on national debt at the time. Do you agree with that?

Secretary RUBIN. I think that number is right. Yes, that is the right number, I believe. Let us check. One thing is to be sure, the interest portion would have been 27 percent, and it looks like it is 2 percent actually, as a percentage of——

Mr. COLLINS. Now, after we got into it, though, and he agreed, he stated that that interest didn't include the interest that would be owed on the portion that is held by the securities that are held by the trust fund.

Secretary RUBIN. Well, because I think that you get into the very same issue that we were just discussing.

Mr. COLLINS. Yes, but that is still debt whether you owe—well, he used publicly held, which we consider the private sector, or government held which would be the trust funds. But it is still debt, and if you continue to spend and the national debt increases year after year, as it is projected to do, then how do you redeem those securities to meet those Social Security benefits in those out years?

Secretary RUBIN. That is the right question. That is precisely I think the right question. How do you redeem the securities, that is I think precisely. I don't think it is debt in the sense, in fact I am sure it is not debt in the sense of the kind of external debt that Mr. Tanner was just talking about. The question I think is precisely—and it goes—the same question with respect to the interest as with respect to the principal: How do you redeem?

As we discussed a bit ago, if you look within the framework of the unified budget, what you will find is that you have, but what I am telling you you already know, but I will just repeat it if I may. You have existing Social Security commitments. Then, you have the judgment that we made which we could agree about or disagree about, that we should create a first claim against general revenues in the future to meet those Social Security payments.

And then the question is, how do you pay those first claims? The question is what will be available in the future to do that? If you look at this budget, what you will find until at least 2039, and there is some question after 2039, let's leave aside for the moment, that at least until 2039, you can make the—there is a surplus in the overall unified budget. Therefore, what is happening is that the cash is being transferred from the general revenues to the Social Security Trust Fund, to pay the Social Security benefits, all of which is done without a tax increase or a spending cut because the general revenues are sufficient to create a surplus.

Mr. COLLINS. I follow that pie in the sky.

Secretary RUBIN. No, no.

Mr. COLLINS. But wait a minute now. My light, yellow light is on already because I talk too slow. But you are spending the money. You are increasing the debt. And the money is owed. So in order to redeem those, you have got to reverse that pilot and go back to the public sector for borrowing the money.

Secretary RUBIN. No, Mr. Collins, could I say one thing?

Mr. COLLINS. Let me go over one other thing. One other thing now? Now, what?

Secretary RUBIN. Yes, actually, that is factually not true.

Mr. COLLINS. I want to say——

Secretary RUBIN. I will bet you——

Mr. COLLINS. I want to say one other thing.

Secretary RUBIN. I will bet you a bunch that I can, that if we get six people to listen independently to both of us making our case, that they will decide that that isn't the case.

Mr. COLLINS. You bet me right out of time. That is what you bet me out of.

Secretary RUBIN. Well, time is worth more than money or money is worth more than time. I don't know. Go ahead. [Laughter.]

Mr. COLLINS. We will talk about it on another day because there will have to be another day that you will sit before us and explain again one more move by the President. Thank you.

Secretary RUBIN. OK, thank you, Mr. Collins. Could we give Mr. Collins an extra moment here? I did waste his time. I didn't waste. I think I used——

Chairman ARCHER. Well, maybe you can do it privately, Mr. Secretary. We are really imposing on your time, and we have already gone through the lunch hour. But I sure don't need anything more to eat. I don't know about the rest of you all.

Mr. Hayworth.

Mr. HAYWORTH. How fitting you would call on me at lunchtime, Mr. Chairman. As we have said before, there is a preponderance of physical evidence that I can miss the midday meal and then some.

Mr. Secretary, thank you for joining us today. I listened with great interest to your efforts, as a historian, in evaluating the state of the economy when you told my colleague from Kentucky that what many of us I believe have accurately described as the largest tax increase in American history—what my good friend, the Democratic Senator from New York, described as the largest tax increase in the history of the world—that that tax increase is why we now experience such great prosperity and fiscal discipline. It is a very different outlook than many of us have.

I also noted, and not to review history, and obviously you were at a different role in the early days of this administration, when that almost Keynesian big government economic theory was at work, that $19-plus billion emergency stimulus package that many of us in the private sector at that time considered to be pork was wisely denied by then the liberal-controlled Congress. But good people can disagree on history and the cause and effect of a variety of different actions or inactions taken by the Federal Government.

Secretary RUBIN. I don't think though, Mr. Hayworth, there is a lot of disagreement anymore about the importance of the 1993 Deficit Reduction Program in terms of what has happened to this economy.

Mr. HAYWORTH. Oh, then I am sure you would join us in going on the record publicly regarding the effect of the change in the Congress of the United States and a return to true signals both to Wall Street and Main Street, that were serious.

Secretary RUBIN. True what? True what?

Mr. HAYWORTH. True signals and actions taken by the Federal Government, including a new approach to fiscal discipline by a conservative Congress, that that signaled to both Main Street and Wall Street we were serious about dealing both with the problem of the deficit. Followed by the very wise compromise to cut taxes on working Americans in our famous budget agreement, that we have been able to work things out. But, of course, there is credit enough to go around, and I won't quibble about history with you, Mr. Secretary.

But I would ask you again, because I was interested in your response to my colleague from Florida, and you noted a fundamental disagreement that a reduction in the capital gains rate, and this was not your term, but if I misunderstood, please correct me, has a negligible effect on our economy. To my understanding, according to figures released last spring by the Congressional Budget Office, some $11.1 trillion essentially sits dormant in our economy, for those who possess that capital have a disincentive to put it to work because of the current capital gains encumbrances.

Do you believe it is better to simply have that money inactive, if you will, or held in vaults rather than put to work for the American people, injected into the economy to create jobs and new economic enterprises?

Secretary RUBIN. I don't think, Mr. Hayworth, that—you are talking about the locking effect, because that is usually the way that is referred to. I don't think that you have a substantial impact on the mobility of capital as a result of the capital gains structure. In fact, people can do as they see fit with their capital. The only question is how they weigh the various factors that affect that. But I don't think that you are having a material impact on the mobility of capital.

And I do think that your capital gains preference, and this is the argument ordinarily made for capital gains preference, I do think it has relatively little effect on the national savings rate. That is sort of the core, as you know, of the arguments made by people who favor capital gains tax cuts.

Mr. HAYWORTH. Well, let's turn to a more micro, a personal level of impact of capital and budgeteering and family budgets. Again, I refer to the President's comments the day after, if memory serves, the day after the State of the Union Address, when he traveled to Buffalo, New York. And again relying on memory and the citation of my colleague from——

Secretary RUBIN. I might add if you want to put your argument just a slightly different way, which I think has a lot of—the question I think you are really asking is whether the allocation of resources in our economy is maximally efficient or whether that is being to some extent affected by the unwillingness of people to sell assets because they don't want to pay taxes.

Mr. HAYWORTH. Mr. Secretary, if you would suspend, I would simply, and I don't want to leave the purview of or the decorum of this process, and I know you are trying to be helpful. But I will reserve the right to ask the questions, rather than having them rephrased or taken in that tone.

Secretary RUBIN. I was just trying to——

Mr. HAYWORTH. I thank you very much for that. I would like to get back to the question I want to ask, which is, in lieu of, or in view of, the President's comments that when it comes to the surplus, we could give it back to you and hope that you would spend it in the right way. What is the official administration view of the way in which Americans should save, spend, or invest their money?

Do you have a conduct card now for the citizenry to suggest how they best spend or invest?

Secretary RUBIN. No, that was not the point of the President's comment. The point of the President's comment was that we always face within our society, the tension between the desire to have tax cuts and more money to use as we see fit, which he is very much in favor of. As you know, it is always good to cut taxes. And the much more difficult path, the politically much more difficult path, is fiscal discipline.

What he was saying is that the economic growth of the last 6 years, the increase in jobs, standard of living, and all the rest, has been contributed to enormously by taking that difficult path. He feels that we should stay on that path going forward in order to continue to have the kind of very strong economy in the years ahead that we had in the last 6 years. And that is all he was saying.

Mr. HAYWORTH. Again, a fundamental difference, it appears to me, that there seems to be this trust in government and under the guise of fiscal discipline choosing for the American people how best they save, spend, or invest.

Secretary RUBIN. No. What he wants to do with the surplus, I think 89 percent of it would actually go to just increasing savings, most of which would consist of paying down the Federal debt.

Chairman ARCHER. The gentleman's time has expired.

Mrs. Thurman.

Mrs. THURMAN. Mr. Secretary, we do thank you.

I want to just talk about a couple of things, and this is an opportunity because people may be listening to what is going on here today, and it is timely because people are talking about the President's proposal. They are talking about it in terms that they understand best. If you are an older person on Social Security and you remember the crash of the market, you become very concerned about what is being discussed up here. If you are a younger person who has watched the market balloon, and there has been a big return for them, they become less concerned about what could happen here.

Just one of the articles that was written within the last couple of days in the Citrus County paper, it actually has interviewed a couple of folks, and it is a very mixed review. One person noted that the government would have the best financial planners and forecasters. With that in mind, she said the plan could work. Previous to that, she had mentioned that she wasn't really sure. She was concerned because of what could happen.

Another one said, you know, I don't want to do my own investment decisions with Social Security. I am not familiar enough with the stock market. An investment person said, I might tell my clients to use the stock market as an investment, but I am leery about the government doing this. Another one said, I would rather be safe than sorry. I would rather get my 3 or 4 percent they give you.

So there is a mixed review going on out there, but with concerns of what could happen. So could you, in talking to the American people today, tell them why they should trust us on this particular issue of potentially putting 15 percent in stock markets or other places?

Secretary RUBIN. I think it is interesting, Mrs. Thurman, if you take those articles that you have just read, it seems to me they frame the issue exceedingly well.

Stocks do have risks. I think that sometimes is underfocused on when markets have been as good as they have been in the last some years. On the other hand, it is also true that historically stocks have had better returns than debt. It doesn't mean it will necessarily happen in the future, but it suggests that it probably will. I think we have sort of found the prudent balance by saying we would wind up with 15 percent of the trust fund in equities, and the money wouldn't be invested by us. It would be invested in broad-based indexed funds of some sorts, so that you wouldn't have individual stock picking. And you basically should perform with the market, whatever that index may be. This whole process would be conducted by private sector money managers, not by the government. That is sort of fundamentally how we approach this issue.

But I think your stress, I think you are stressing, at least some of those quotes are, the importance of being careful and being prudent is I think well taken.

Mrs. THURMAN. And I think that is a huge concern for some folks out there, because they have lived through different times, and they have seen different times, so they are concerned about it.

Let me ask you this. Mr. Greenspan had said, as one of our colleagues also said, OK, the first thing you should do is save the surplus. But if you are not going to do that, then you ought to give tax relief. Would you consider the USAs a tax relief?

Secretary RUBIN. That is a good question. They are a tax cut. They are refundable tax credits. But they also increase national saving, because that tax, that refundable tax cut goes into a savings account. If you look at what we have done with, or at least, we haven't done anything—what we propose to do with the surplus, we are proposing 89 percent of it will increase national savings, and that within that 89 percent, 12 over the 89, 12 percent of that within that 89 percent will be in the form of a tax cut that goes into a savings account.

Mrs. THURMAN. So it is then considered to be a tax cut?

Secretary RUBIN. Yes. Well it would be a tax cut, yes.

Mrs. THURMAN. OK. I am going to bring up a couple of issues that are probably more narrow—because they are issue that I have been involved with.

There is some part of the budget that is going to talk about crop insurance for some of our farmers, and especially with the debate we just had about emergency funds and things of that nature. There was a proposal, in a bipartisan manner that Mr. Hulshof and I did that actually dealt with having funds put aside in good times, and then used in bad times. I would just throw that out as maybe some conversation we can have later on. I would like to know if there is a way we could talk about this as being something important.

The Y2K issue, as far as it relates to small businesses, is another area that I would like to have some conversation about. And then, at some other time, I hope we will have a talk, dealing with

ESOPs. There is some concern about how the budget was put together and what it might do to those employee owned plans.

I know those are not very general, but I would like to have that opportunity.

Secretary RUBIN. We would be delighted.

Chairman ARCHER. Mr. Jefferson.

Mrs. THURMAN. OK, thank you.

Mr. JEFFERSON. Thank you, Mr. Chairman. At long last, Mr. Secretary, I get to thank you for your commitment and the President's commitment to the communities in our country. What you are doing with the new markets initiative, investment initiatives, tax credit programs, and your emphasis on the empowerment zone issues, and the capital formation matters, that we have been working on so closely for the last few years is very much appreciated.

I want to follow up a little bit on what Ben Cardin talked about and what Mrs. Thurman talked about a minute ago. When we started out with this Social Security debate, we had a paradigm. It had four legs to it. The first was that we could cut benefits. Nobody wants to do that. Second was we could raise payroll taxes. That was dismissed as out of hand. The third one was we could increase the yield that we now get from currently invested Social Security funds. And the last one was we could do something about holding more of the surplus to apply to help solve the problem.

Now, when Mr. Greenspan came to speak to us, he took issue with the equity investment aspect of the administration's plan, and he said for two reasons. One, he said that there would be inevitable political influence involved, which you have answered I believe in your response to Mr. Cardin's question. He said another thing, though, which bears some discussion. He said there would be inevitable inefficiencies in the allocation of capital in the marketplace. He used the State pension funds as evidence of that saying they were underyielding compared to private ones, or compared to the stock indexes that we talked about a minute ago.

But, as I examine this issue of the relative returns for the indexes versus the public pension funds, I find that there really isn't that much difference because the yield factors from these indexes take a hypothetical investor, over a period, who makes an investment which is measured over a certain period of time, during which he holds the stock for the entire time; and all the dividends are reinvested. There are no fees or commissions taken out, and so this constitutes this higher yield. When you examine it, there is not much difference there.

So I wonder whether our experience with State pension funds doesn't give us a very good model for what can happen here. Even if he were right about the lower yield, it is still a greater yield than we get under our present system. But I think that maybe there isn't very much difference there. And I think it is a strong argument, a powerful one for the fact that public institutions can make good decisions when they use broadly based indexes, like you talked about, and get a greater yield for the retirees.

Secretary RUBIN. I think you raise a good point, Mr. Jefferson. I don't see any reason, there is nothing inherent in employing this 15 percent in broad-based indexes that should result in an underperformance of any significance with respect to that index. So I guess I am basically agreeing with your point. I am not counting on State pension funds. That is a separate issue. I am not commenting on your analysis on that, though I presume, I am sure if you have done it, it is right.

But I am just saying there is nothing inherent in investing this in index funds that should result in a lesser performance than the rate of return on the index fund.

Mr. JEFFERSON. My whole point was that these two issues, you seem to have dealt with very well today, the one about we are not going to inevitably end up with political influence over the system. And no, the public system yields do not necessarily show that there is a lack of attention to return on capital or allocation.

I started out saying I appreciate what you are doing on the capital formation side. I hope that this commitment to our communities will be really pressed this time in the budget issues and that we will come out with most of what you have here, because that is so important. The job creation and wealth creation, this whole capital formation issue, and the idea of creating patient capital in those markets is the most important thing I think the administration can do to continue growth in the country.

Secretary RUBIN. Well, you have been involved with that issue for a long time, Mr. Jefferson. I think that is how I first met you 5 or 6 years ago. And I agree that it is a very important issue, and I think we have good proposals, in part, because of the input that you provided, particularly on the SSBICs.

Mr. JEFFERSON. Well, thank you, Mr. Secretary.

Chairman ARCHER. Mr. Becerra.

Mr. BECERRA. Thank you, Mr. Chairman, and Mr. Secretary and Director Mathews. Thank you for staying for such a long time. If you have got a few more minutes of voice left, I will ask you to address a couple of issues, because you have answered most of my questions. Perhaps I could ask you to concentrate a little bit on what my colleague, Mrs. Thurman, asked a bit about, and that is the USA accounts.

My understanding is that for quite some time we have had difficulty trying to persuade or provide an incentive for moderate income individuals to save, and they are usually the folks that most need it upon retirement. In fact, we find that they are the ones, once retired, are most reliant upon Social Security to provide them with the bulk of their income in retirement.

What does the USA account do for that population of America, the under $30,000 folks that, in your mind or in the President's mind, makes it beneficial?

Secretary RUBIN. I think you have gone to the heart of, well, to the very important part of what the USA accounts are about. By having a flat, nonrefundable tax credit, the same amount to everybody, it basically will be providing a tax cut going into a savings account for people who unfortunately, given their income levels, aren't able to save. Second, as an incentive for them to save further, there will be a match, I guess I should have mentioned this, maybe I didn't, the match will be higher, the lower your income. So it is again an attempt to provide incentive for low-income people to save.

Mr. BECERRA. So does that mean that if you are at, say, a $20,000, $25,000 income range that whatever we all come to agreement on would be the match, it would be greater than someone who is earning $75,000 or $100,000?

Secretary RUBIN. That is absolutely correct. In fact, yes, that answer is absolutely correct.

Mr. BECERRA. And I know within the Federal system that we have, the Thrift Savings system where, there is a matching incentive component that I know, at least I know I take advantage of it and I think others would as well, because it helps to push that dollar that you put in further along in savings.

Let me ask another question. It relates to some of the comments that were made earlier about the share of the money that the President would propose of the 60 percent of the surplus that would be used for Social Security. That one-fifth of that that would be used for investing in the private markets, in the equity markets. The President, you as well, seem to be very confident that having the government place those moneys into the equity market won't cause the intrusiveness or the difficulties that the private sector might fear in having the government have a substantial, although it is small compared to the relative size of the market, but a substantial investment into the private market. Give us, give me a sense of why you are so confident that there won't be any problems in having the Federal Government do that?

Secretary RUBIN. Because I think, Mr. Becerra, that what we can do and what we have to do is to develop some structure for doing this so that the investment process itself is conducted solely by the private sector. No government. Zero. And second, that there will be an apolitical oversight and selection of the managers, and I think I mentioned earlier in the hearing if you look at the independence of the Fed over many decades, it does suggest that it is possible in our system to create that kind of independence. I think we need to do precisely the same thing with respect to this investment.

Mr. BECERRA. And it is somewhat ironic that the Chairman of the Federal Reserve, an institution that has so much independence from the Federal Government, is somewhat critical of that type of an institution, when, in fact, you can show the independence can be had.

Secretary RUBIN. Well, he is raising what I think is a very legitimate concern. I guess the reason I feel comfortable where we are is I think we can meet the concern that he and others have raised.

Mr. BECERRA. Mr. Chairman, in respect of Mr. Secretary Rubin's and Director Mathews' patience and indulgence, I will yield back the balance of my time.

Chairman ARCHER. Thank you, Mr. Becerra. Mr. Secretary, thank you for being so generous with your time today, and I probably owe you a lunch. We will try to make that happen some time. But thank you for coming and being with us.

Secretary RUBIN. I would be delighted. Thank you, Mr. Chairman.

Chairman ARCHER. Also our gratitude to Ms. Mathews for her contribution.

May I, before you leave, ask one quick question? It is very short.

There was a lot of discussion about the steel situation, and we are all concerned about that. We are struggling to find the right way to approach it. There is a proposal before the House, sponsored by Representative Visclosky. Are you familiar with that, his approach?

Secretary RUBIN. I am not, Mr. Chairman.

Chairman ARCHER. OK. Well, if you're not, then I can't ask you the question.

Secretary RUBIN. If those are the quotas, I just didn't think of it in that term.

Chairman ARCHER. Yes, OK. Could you let me know whether you oppose or support that proposal?

Secretary RUBIN. Let me do two things if I may, Mr. Chairman. In responding to Mr. Crane, I tried to provide some, at least my personal view as to how to think about such an issue. Let me get back to you if I may, but I think——

Chairman ARCHER. OK, this is a specific proposal that we may well have to deal with, and I would really be benefited by knowing whether you are for it or against it.

Secretary RUBIN. Let me say, Mr. Chairman, as a general matter, as you know, we are on the one hand very concerned about the steel situation.

Chairman ARCHER. I understand.

Secretary RUBIN. On the other hand, we are strong supporters of open markets here and abroad.

Chairman ARCHER. I understand, and you and I are in general agreement on all that.

Secretary RUBIN. Yes, I suspect we are.

Chairman ARCHER. But we still have to deal with this specific thing.

Secretary RUBIN. Let us look at it, and we will get back to you.

Chairman ARCHER. All right. Thank you very much.

[The following was subsequently received:]

As the Administration indicated on March 16, 1999, we strongly opposed H.R. 975 because it was not in the Nation's economic interest and would have violated U.S. international obligations under the World Trade Organization. Because of these concerns, the President's senior advisors would have recommended that the President veto the bill.

Question received from Hon. Wally Herger, and Subsequent Response from Secretary Rubin

Mr. Secretary, I would like to take this opportunity to acknowledge the change that you have proposed in the definition of qualifying biomass for the Section 45 tax credit. It is my understanding that no one has ever claimed the current Section 45 tax credit for electricity produced from biomass because of its overly restrictive rules. The credit simply does not work. Your proposed definition, which I believe mirrors the bipartisan language I introduced along with Mr. Matsui last year as H.R. 4407, would provide substantial benefits both to the environment and to rural and agricultural communities across the country. Would you and your staff please work with me and Mr. Matsui in the weeks to come to continue to refine the proposal we introduced last year?

Yes.

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
February 5, 1999

Mr. Robert E. Rubin
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Ave., N.W.
Washington, D.C. 20220

Dear Secretary Rubin:

Thank you for testifying before the Committee on Ways and Means on the President's Fiscal Year 2000 Budget. Unfortunately, I was unable to ask you a number of important questions regarding the President's budget and specific actions on the Internal Revenue Service (IRS).

First, I am concerned about recent efforts by the IRS to require taxpayers to capitalize many costs that have previously been deducted without an IRS challenge. You may recall that I, together with nine of my colleagues on this Committee, wrote to you last June about a specific example of this action, involving sales commissions paid by cellular telephone service providers to sales agents for signing up new customers. We never received a reply from you. Rather, we got a letter from an Assistant Chief Counsel at the IRS.

Mr. Secretary, I believe the IRS is being overly aggressive in its treatment of these expenses. The direct result of these actions affects the competitive positions of these companies, many of which are on the cutting edge of innovative communications technology. The IRS position is contrary to current law. Moreover, it would appear inadministrable.

These are important tax policy issues. They should be decided by you, not an IRS Assistant Chief Counsel. I ask for your commitment to review them and respond to me, in writing, as soon as possible.

My second question concerns the President's policy on Social Security reform. It is my understanding he intends to transfer 62 percent of the surplus over 15 years to the Social Security system. Please elaborate as to what these funds consist of? Are they FICA taxes only or does it include interest on the trust fund? Does this transfer include funds from general revenue? Does the President really want future taxpayers to finance Social Security with their income taxes?

Finally, does the President's proposal guarantee that Social Security benefits will not be cut, the wage base increased or taxes raised to save Social Security?

Once again, thank you for your expedited consideration of these matters.

Sincerely,

SAM JOHNSON
Member of Congress

Question: First, I am concerned about the recent efforts by the IRS to require taxpayers to capitalize many costs that have previously been deducted without an IRS challenge... I believe the IRS is being overly aggressive in its treatment of these expenses... The IRS position is contrary to current law. Moreover, it would be appear inadministrable... I ask for your commitment to review them and respond to me, in writing, as soon as possible.

A: As you are probably aware, the heightened interest in capitalization issues began, in part, with the Supreme Court's 1992 decision in *INDOPCO*, 503 U.S. 79, in which the Court clarified that the creation or enhancement of a separate and distinct asset is not a prerequisite to capitalization. Rather, the Court held that a taxpayer's realization of significant benefits beyond the year in which the expenditure is incurred is important in determining whether an expenditure must be capitalized or may be deducted.

The Treasury and IRS have repeatedly reassured taxpayers that the *INDOPCO* decision did not change the fundamental legal principles for determining whether a particular expenditure can be deducted or must be capitalized. Since that decision, the Service has published eight revenue rulings, all holding that the particular expenditures at issue (such as advertising, repairs, training, certain environmental remediation, and Year 2000 costs) are deductible despite an incidental future benefit. We recognize that additional issues remain.

Because these capitalization issues are highly factual, they are best addressed on a case-by-case basis. The 1999 Treasury and IRS Priority Guidance Plan indicates Treasury's intent to aggressively study and publish formal guidance on capitalization issues during 1999. In particular, the Plan includes potential guidance regarding the treatment of sales commissions paid to obtain new customers, investigatory costs, ISO 9000 costs, the costs of removing property that is replaced with other property, cyclical maintenance costs, loan origination costs and mutual fund launch costs. We intend to continue to discuss the relevant facts and issues with potentially affected taxpayers and their representatives before proceeding further on these projects.

Question: My second question concerns the President's policy on Social Security reform. It is my understanding that he intends to transfer 62 percent of the surplus over 15 years to the Social Security system. Please elaborate as to what these funds consist of. Are they FICA taxes only or does it include interest on the trust fund? Does this transfer include funds from general revenue? Does the President really want future taxpayers financial Social Security with their income taxes?

Answer: The President's plan would transfer 62 percent of the projected surpluses over the next 15 years to Social Security and invest about a fifth of this amount in equities. These two actions will close a bit more than half of the long-term funding gap that is faced by Social Security today, and extend the life of the Social Security trust fund to 2055.

In essence, the President is proposing that we use the Social Security (and Medicare) trust fund as a "lock box" to assure that the bulk of surpluses projected over the next 15 years are secured for debt reduction. Using Social Security and Medicare in this way will have three effects. First, it will substantially raise the probability that we will actually use most of the projected surpluses to pay down debt held by the public. Second, it will strengthen significantly the financial condition of the Social Security and Medicare Trust Funds. Third, it will substantially increase national saving.

The transfers to the Social Security Trust Fund would earn interest just like any amounts added to the trust fund. Thus, the accumulation of the transfers in the trust fund would include interest payments.

Question: Does the President's proposal guarantee that Social Security benefits will not be cut, the wage base increased or taxes raised to save Social Security?

Answer: The President's plan envisions a bipartisan effort to close the remainder of the financing shortfall in order to restore 75-year actuarial balance to Social Security. That effort will require tough choices on benefits and Social Security income sources.

[Whereupon, at 1:31 p.m., the hearing was adjourned.]
[Submissions for the record follow:]

Statement of American Farm Bureau Federation

Preserve Integrity of Social Security

Farmers and ranchers support the preservation of the Social Security system as a safety net to provide workers and their families retirement income, disability protection or assistance because of the early death of a family wage earner. Farmers and ranchers are concerned, however, about the future and financial soundness of the Social Security system. Farm Bureau believes that reform is needed to preserve the integrity of Social Security for retirees and workers paying into the system.

The average age of farmers and ranchers is now 54 years. This means that almost half of them are at, or near, retirement age. They are very concerned about the return they will receive on a lifetime's worth of Social Security taxes. The current system is a major portion of their retirement program. They must be able to rely upon Social Security in their retirement years.

Ninety-nine percent of farms are operated by sole-proprietors and or by family partnerships. As self-employed individuals, agricultural producers pay the full 12.4 percent payroll tax, usually as one lump sum along with their income tax payment.

They are painfully aware of the high taxes needed to fund the current system and realize the urgency of saving the Social Security system.

CHOICE OF RETIREMENT SYSTEMS

While Farm Bureau supports preserving the Social Security system, we believe people should have the option of contributing to private retirement systems. For years we have recognized each individual's right to participate in pension plans in addition to Social Security. We believe that people should also be able to invest in private plans within the Social Security framework using the same deposit percentages and withdrawal age rules as the regular Social Security program. People should have the right to choose to stay in the standard Social Security program or shift to private retirement accounts.

PROGRAM FUNDING

We oppose an increase in Social Security taxes. Social Security, either the standard plan or new private retirement plans, should be funded by payroll taxes. We oppose any proposal to finance Social Security retirement income benefits out of general revenue. Social Security taxes should continue to appear as a separate deduction of Federal Insurance Contribution Act (FICA) taxes to make them clearly identifiable.

All employees, both in the private and public sector, should be included in the Social Security program. Employers and employees should continue to share equally in the payment of Social Security taxes. Low-income taxpayers should not be exempted from paying Social Security taxes because of their level of incomes.

THE TRUST FUND

Social Security taxes collected should be placed in a restricted interest-bearing fund to be used only for Social Security. Because we support placing Social Security funds in interest bearing accounts and private retirement accounts, we oppose government investment of Social Security Trust Fund money in stocks of private companies.

BENEFITS

Benefit levels should be preserved for retirees and those that are near retirement and, when in need of adjustment, should be changed based on a percentage of the annual decrease or increase in average wages. Benefits, both in the standard plan and in alternative private plans, should be based on an individual's contribution to the system. We oppose means testing as a way to limiting Social Security benefits for those that have contributed to the system. We oppose earned income restrictions for those receiving Social Security benefits.

SUMMARY

Farm Bureau supports reforms to the Social Security system. The integrity of the system must be maintained for retirees and near retirees while giving workers the opportunity to invest their Social Security taxes in private retirement accounts. We oppose tax increases and government investment of Social Security Trust Funds in equities markets.

Statement of Business Council for Sustainable Energy [1]

INTRODUCTION

The Council is pleased to offer testimony to the House Ways and Means Committee on our proposed incentives to encourage the expanded use of clean energy technologies throughout the nation.

The Council was formed in 1992 and is comprised of businesses and industry trade associations which share a commitment to pursue an energy path designed to realize our nation's economic, environmental and national security goals through the rapid deployment of efficient, low- and non-polluting natural gas, energy effi-

[1] Note: Where appropriate, the BCSE identifies legislation that was introduced in the 105th Congress which includes similar or identical language to that recommended here.

ciency, and renewable energy technologies. Our members range from Fortune 500 enterprises such as Enron, Maytag, and Sempra Energy, to medium-sized organizations such as Trigen and KeySpan Energy, to expanding entrepreneurial businesses such as Bergey Windpower, to national trade associations such as the Integrated Waste Services Association, the Hearth Products Association, and the American Gas Association. The following coalition consensus highlights the need for a tax proposal from the Committee which includes a broad array of clean energy technologies, which will enhance the nation's economic, environmental, and national security goals in the twenty-first century.

ENERGY EFFICIENT HOMES

Provide a Flat $2,000 Credit

The BCSE supports the adoption of a flat $2,000 credit which will ensure that all homes will be constructed or renovated to be energy efficient, not merely the most expensive models. With the implementation of this credit, builders will have an incentive to construct modestly-priced, energy efficient homes and low and middle-income homeowners will be encouraged to renovate their homes with new energy efficient technologies.

Offer New Home Credit to the Home Builder

Rather than provide an incentive directly to the new home buyer, the Council supports a flat $2,000 tax credit for the new home builder, who can pass it along to the buyer at closing. A tax credit to the builder will encourage the construction of a large number of new energy efficient homes, which will expand the percentage of energy efficient homes in the marketplace, thereby stimulating additional builder and consumer interest in these dwellings. A credit for the home builder will also reduce the financial burden of using existing technology to increase energy efficiency.

Offer Existing Home Credit to the Home Owner

The Council supports a tax credit for the owner of existing homes that have been upgraded by the home owner to be 30 percent or more efficient than the IECC. To achieve a 30 percent increase in energy efficiency will require a major effort by the homeowner, and the $2,000 credit will only cover a small percentage of the marginal cost of upgrading home energy efficiency, relative to the new home credit.

Employ 1998 International Energy Conservation Code

Instead of relying on the 1993 Model Energy Code as a measure of energy efficiency, the Council supports the 1998 IECC, given this measure's accuracy in accounting for the impact of seasonal and climatic variations on energy efficiency. This reduces the likelihood that one region of the country will have an advantage in the measurement of energy efficiency. The BCSE also supports other conservation tools which use total energy efficiency analysis.

Utilize Systems of Energy Efficient Technologies

Rather than provide incentives for specific technologies within new and existing energy efficient homes, the BCSE recognizes that a wide array of energy efficient natural gas, windows, insulation, lighting, geothermal, and photovoltaic technologies can be used in concert to enable new and existing homes to be 30 percent more efficient than the IECC. Examples of energy efficient technologies which could be used to achieve the 30 percent standard could include advanced natural gas water heaters, heat pumps, furnaces and cooling equipment, fiber glass, rock wool, slag wool and polyisocyanurate insulation, energy efficient exterior windows, geothermal heat pumps, and fluorescent and outdoor solar lighting.

ENERGY EFFICIENT BUILDING EQUIPMENT

The BCSE is pleased with the Administration's proposal which provides a 20 percent tax credit for fuel cells, natural gas heat pumps, high efficiency central air conditioners, and advanced natural gas water heaters (subject to a cap). However, the Council recognizes the need for incentives for energy efficient building technologies to be broadened for the benefit of consumers and the environment. The BCSE recommends consideration of a 20 percent tax credit for advanced natural gas water heaters with an energy factor (EF) of .65, a 20 percent tax credit for natural gas cooling equipment with a coefficient of performance of .6, and a 20 percent tax credit for advanced natural gas furnaces with an annual fuel utilization efficiency of 95 percent. Given the significant reduction in greenhouse gas emissions which can be achieved through the expanded use of small-scale distributed generation technologies, the BCSE supports a 20 percent tax credit for all fuel cells, *regardless of their minimum generating capacity.* Other technologies which could be included in a broadened tax incentive package include variable frequency drives and motors, building automation systems, and compressed air systems.

ALTERNATIVE FUEL VEHICLES

While the BCSE recognizes the Administration's efforts to provide tax incentives to encourage consumer demand for vehicles with two and three times the base fuel economy of vehicles on the road today, we are concerned that it has not provided an incentive for natural gas vehicle (NGV) technology. While NGVs are more expensive than gasoline and diesel vehicles, these technologies reduce CO emissions by 30 percent below that of gasoline vehicles currently on the road. The BCSE supports a 50 cent per gallon income tax credit for each "gasoline gallon equivalent" of natural gas, compressed natural gas, liquified natural gas, liquified petroleum gas, and any liquid with at least 85 percent methanol content used in a newly purchased alternative-fueled vehicle which meets applicable federal or state emissions standards. These tax incentives will increase demand for clean fuel vehicles, especially in fleet markets, accelerate production of NGVs, and lower the initial purchase cost of the technology.

WIND ENERGY

The BCSE supports the Administration's proposal to provide a straight 5-year extension (through July 1, 2004) of the existing wind energy production tax credit (PTC) provision providing a 1.5 cent per kilowatt hour tax credit (adjusted for inflation) for electricity generated by wind energy. An extension of the current credit prior to its expiration on June 30, 1999 will stimulate investments and current project planning that are now threatened due to the uncertainty surrounding the PTC's extension. In addition to the Administration's proposal, legislation was introduced during the 105th Congress (H.R. 1401/S. 1459) to provide a 5 year extension for the wind energy PTC. The Council also supports a 30 percent tax credit for small wind turbines with generating capacities of 50 kilowatts or less. (H.R. 2902) which was introduced during the 105th Congress. The goal of the new program is to stimulate the U.S. domestic market, increase production volumes and reduce production costs. Growing export markets for small wind turbines provide effective leverage of the federal investment in job creation.

BIOMASS

The BCSE supports the expansion of the biomass energy PTC from its current "closed loop" definition to include a 1.5 cent per kilowatt hour tax credit for electricity produced from landfill gas, wood waste agricultural residue, and municipal solid waste. In addition to offsetting greenhouse gas emissions, the use of biomass energy can address problems of landfill overcapacity, forest fires, and watershed contamination.

COMBINED HEAT AND POWER SYSTEMS

The following points should be added to the Administration's proposed investment tax credit for combined heat and power systems.

"The proposed definition of a qualified CHP system in the Administration's proposal is equipment used in the simultaneous or sequential production of electricity, thermal energy (including heating and cooling and/or mechanical power) and mechanical power."

Language in the current proposal could be construed to limit the credit solely to those taxpayers that produce mechanical power in conjunction with electric or thermal energy production. In addition, specificity is needed as to what "equipment" is included in the CHP definition. A better definition of a qualified CHP system is: equipment and related facilities used in the sequential production of electricity and/or mechanical power and thermal energy (including heating and cooling). Eligible equipment shall include all necessary and integral to the CHP process including prime movers (turbines, engines, boilers), heat recovery boilers, air and water filtration, pollution and noise control, and paralleling switchgear but may exclude buildings, fuel handling and storage and electrical transmission."

Items such as thermal insulation, controls, and steam traps should be included within tax incentives for CHP systems. Tax credits instituted from a systems standpoint will enhance the overall efficiency of CHP technologies.

BCSE supports the addition of language concerning thermal distributing networks to the CHP investment tax credit:

Distribution piping used to transport thermal energy including steam, hot water and/or chilled water as well as condensate return systems shall be included as part of a qualifying CHP system. Thermal distribution systems added to existing electricity-only energy facilities which then meet the definition of CHP facilities shall be eligible for the tax credit.

Furthermore, the BCSE supports the addition of the following language concerning backpressure steam turbines to the CHP investment tax credit:

"Backpressure steam turbines can be highly efficient generators of electricity and thermal energy. When used in distributed thermal energy systems to replace pressure reducing valves these turbines convert higher pressure thermal energy into lower pressure thermal energy along with electricity. Backpressure steam turbines with a capacity of between 50 kw and 3000 kw that reduce steam pressure and generate electricity qualify for the CHP Investment Tax Credit.

White Good Appliances

The BCSE supports a 25 percent tax credit for the purchase of Energy-Star®-certified white good appliances. Such a credit would give consumers an incentive to purchase the highest efficiency appliances, expanding the market for the technologies, and encouraging the manufacturer participation in this voluntary program. At a minimum, the Council would urge the Administration to adopt credits for the most energy efficient clothes washers and refrigerators which are in the market today.

Residential Biomass

Fuel pellets are a residential biomass technology used to heat residences throughout the U.S. The BCSE supports a 15 percent tax credit for fuel pellets used for residential home heaters and a 20 percent tax credit for fuel pellets used in residential and commercial water heaters, a market which is not as mature as the market for residential home heaters.

Research and Education

The BCSE supports a permanent extension of the research and education (R&E) tax credit. In response to a request by Council member Gas Research Institute, the Policy Economics Group of KPMG Peat Marwick examined the most recent economic evidence and official IRS statistical information to determine whether a permanent extension of the R&E tax credit was warranted. Conclusions were that the credit's effectiveness warranted a permanent extension, which may improve its effectiveness. The current short-term approach to subsidizing long-lasting research and development investments imposes unnecessary additional risks on R&D-performing companies, and does not best serve the country's long-term economic interests.

Residential Solar Technologies

The BCSE supports a tax credit equal to 15 percent of a qualified investment for neighborhood solar systems which enable energy consumers within multifamily dwellings, rented housing, and homes with roofs not suitable for direct photovoltaic (PV) installation to heat and cool their homes. The inclusion of tax incentives for neighborhood solar systems will reduce the cost of these investments while reducing overall greenhouse gas emissions. The Council also recommends a flat $400 credit for residential solar water heating or space heating systems certified by the Solar Rating and Certification Corporation or comparable agency. The credit could be added to the Administration's hot water efficiency credit. The BCSE also supports a $100 tax credit for pool heaters for family households with income under $85,000 or single households with income under $65,000.

Clean and Fuel Efficient Outdoor Power and Lighting Equipment

BCSE supports a tax credit for the purchase of clean and fuel efficient outdoor power and lighting equipment used in residential, commercial, and industrial applications. The credit would equal 10 percent of the purchase price of outdoor power and lighting equipment. Outdoor power equipment that meets Environmental Protection Agency Tier II emissions standards prior to their implementation or effective dates would be eligible for this tax credit. The creation of an analogous tax credit for manufacturers of these technologies could also result in substantial fuel savings and other environmental benefits.

Statement of Joint Industry Group

On behalf of the Joint Industry Group (JIG) and its membership, these comments are submitted to the House Committee on Ways & Means regarding the Clinton Administration's proposed US Treasury Department budget for fiscal year 2000.

JIG is a member-driven coalition of over one hundred-forty Fortune 500 companies, brokers, importers, exporters, trade associations, and law firms actively involved in international trade. We both examine and reflect the concerns of the business community relative to current and proposed international trade-related policies, actions, legislation, and regulations and undertake to improve them through dialogue with the Executive Branch and Congress. JIG membership represents more that $350 billion in trade.

The Joint Industry Group is appalled that the Clinton Administration has continued to be negligent in its federal budget decisions by allocating $0.00 for essential enhancements to Customs automated processing systems. Instead, the President proposes an additional "user fee" that industry will pay for the "privilege" of using Customs automated systems to process its commercial entries. To assuage opponents of this new tax on imports, the Administration proposes using $163 million of the monies collected from the tax to be used to offset the costs of modernizing Customs automated commercial operations and to develop Treasury's International Trade Data System (ITDS). Such a tax could collect hundreds of millions more than the $163 million proposed allocation for automation programs.

JIG and its members, who represent a wide cross-section of American industries, staunchly oppose any proposed new "user fee" or tax to continue funding Customs automation programs.

Since 1994, the Customs Service has collected $800 million annually through the Merchandise Processing Fee (MPF). The MPF is assessed on the value of the imported good at a rate of 0.21 percent ad valorem. The money collected through the MPF is supposed to fund Customs automation programs, but is deposited into the general treasury fund. Although the government claims the MPF is a "user fee" to finance Customs operations, it is simply another tax on imports. The money collected through the MPF could have been used to finance Customs automation and would have avoided the present automation crisis that currently exists.

Customs estimates that $1.2 billion is needed to fund the development of the Automated Commercial Environment (ACE) over a period of four years. ACE is the system that will replace the overburdened and aging Automated Commercial System (ACS), the automated system responsible for processing $900 billion in imports every year and collecting over $23 billion in taxes. Failure to replace ACS with ACE prior to its eventual collapse will shut down the import process and thereby harm all US importers and manufacturers, particularly those who rely on just-in-time delivery systems. Importers will be forced to file import entry information through a time consuming paper process rather than through quick and efficient electronic means. The loss of revenue to the government will be staggering.

Instead of creating a new tax, JIG supports the allocation of funds collected through the current MPF to fund ACE development. Other Customs operations should be fully funded in the FY2000 budget. We note media reports of the Treasury Department's intention to spend $1 billion over the next five years in replacing its internal communication systems. We believe that ACE funding is more important to US industry and the American people than the Treasury Department's internal communications system.

In previous policy statements, JIG has expressed its support for Treasury's ITDS program. JIG continues to support the concept for ITDS as the "front-end" interface that the government will use to gather and distribute a minimal amount of international trade data from industry. JIG is concerned, though, that too much emphasis is focused on ITDS development at the expense of ACE. As the "functional" part of the government's automated processing system, it is more important to develop ACE now rather than designing a data interface system. If no "functional" module operates, the development of the "front-end" interface is irrelevant.

More importantly, however, ITDS lacks trade community support because it is a program developed by the government and would only satisfy internal government needs for information. It will continue to delay the development of ACE, add to its costs, and provide few tangible benefits to its users—the trade community. Thus, ITDS is an unnecessary distraction from the more important issue of ACE development.

We are also concerned that the dividing of responsibilities for development of the import and export automated systems between the government agency responsible for the physical control and clearance of the goods and government agencies that have some regulatory responsibility for those goods is a mistake and will result in added costs to all parties.

Despite on-going criticisms of the Customs Service's plans for ACE development, particularly from the Government Accounting Office, we commend Customs for working with industry to develop automated processing systems that provide benefit for both government and trade. We believe that given the needed funding Customs will design and implement, with the assistance of outside contractors and consultants and its private sector customers, an automated system that will continue to promote the continued efficient processing of imports and will be able to adapt to future changes in government and private sector needs. This can only occur, however, if the Administration and Congress come to the realization that funds are currently available to develop ACE in a timely and efficient manner. Continued delays in appropriating this money only brings closer the day when Customs' archaic systems fail and the slowdown in US imports incurs a damaging effect to the strength of the US economy.

The Joint Industry Group and its members thank the House Committee on Ways & Means for its attention in considering our comments.

Statement of National Realty Committee

National Realty Committee[1] appreciates the opportunity to submit comments for the record of the February 4, 1999 hearing of the House Committee on Ways and Means regarding the revenue provisions of the Administration's fiscal year 2000 budget proposal.

BACKGROUND

The Administration's budget contains proposals that could significantly affect the real estate industry and we look forward to working with the Committee as it deliberates on these proposals. Although we welcome those proposals in the Administration's budget intended to be favorable to real estate, they do not represent a comprehensive and related approach to real estate tax policy. A comprehensive approach is preferable and in this testimony we will comment briefly on some of the real estate tax policies we believe the Committee should consider. If these tax policies were enacted, current tax impediments that otherwise discourage sound economic real estate decisions would be removed from the Internal Revenue Code and bring about fairer tax treatment and a more productive flow of real estate capital and credit.

Overall State of the Commercial Real Estate Industry

Real estate represents about 12 percent of America's gross domestic product and accounts for nearly 9 million jobs. About $293 billion in tax revenues is generated annually by real estate and almost 70 percent of all tax revenues raised by local governments come from real property taxes. Unquestionably, real estate is a direct, vital and major contributor to the nation's economy.

Today's real estate markets, as a whole, are in overall good health. Interest rates and inflation are low, availability of capital and credit is good; and demand for work and shopping space, in most regions, is relatively strong.

However, the financial crisis that erupted this summer in Japan and Russia demonstrated how quickly things can change in the credit markets. The international credit crisis led to a near shut-down of the commercial mortgage-backed security (CMBS) market as anxious investors stood on the sidelines forcing yield spreads to widen to the point that no debt placements were being made. This occurred despite the underlying fundamentals of real estate investment remaining strong. Clearly,

[1] National Realty Committee serves as Real Estate's Roundtable in Washington on national policy issues affecting real estate. As Real Estate's Roundtable in Washington, NRC works with federal lawmakers and regulatory officials to develop and implement appropriate and needed national policies affecting the commercial real estate industry. NRC members are top business leaders from more than 200 U.S. public and privately owned companies across all segments of the commercial real estate industry. They include owners, builders, lenders, managers, advisors and investors.

this was a financial crisis, not a real estate crisis, but real estate was nonetheless seriously affected.

Real estate is similarly sensitive to changes in tax treatment. The turmoil in the industry created by the whipsaw effect of the tax changes of the Economic Recovery Tax Act of 1981 and the Tax Reform Act of 1986 is evidence of this. Real estate tax policy changes should be implemented through a carefully thought through and deliberative course of action that brings about a rational relationship between the economics of a transaction and its taxation or the intended social or economic outcome.

National Realty Committee Tax Agenda

NRC recommends the Committee adopt, (in addition to those provisions in the President's budget we support) the following tax proposals:

10 year depreciation recovery period for leasehold improvements. Today's depreciation rules do not differentiate between the economic useful life of building improvements, (i.e. internal walls, ceilings, partitions, plumbing, lighting, floor coverings, electrical and communication outlets and computer data ports), and the life of the overall building structure. The result is that current tax law dictates a depreciable life for leasehold improvement of 39 years—the depreciable life of the entire building—even though most commercial lease terms average between 7–10 years.

As a result, the after-tax cost of reconfiguring or building out space to accommodate new tenants, modernize the space or upgrade technology is artificially high and out of step with the economics of the transaction. The tax implication of this could negatively impact decisions relating to leasehold improvements—particularly when extensive improvements are involved. Providing a depreciation life for leasehold improvements that more closely matches the lease terms, (typically about ten years) would more closely align the tax treatment for these assets and better reflect economic reality.

Current law provides a tax obstacle to reinvesting in existing properties. Without proper reinvestment, tenants will leave older buildings for more modern buildings that offer desired amenities and efficiencies. This will enhance new development demand and contribute to a deterioration of existing property. Last year, Representative E. Clay Shaw (FL) introduced H.R. 3500 that provides a 10-year depreciation period for leasehold improvements. The bill had bipartisan co-sponsorship and Mr. Shaw intends to reintroduce it this year.

Amortization of Demolition Costs. Current law (Code Section 280B) requires that demolition expense and the unrecovered basis of the demolished structure must be capitalized and added to the basis of the land rather than deducted. This tends to discourage the acquisition of land, including a structure which must be demolished in order to construct a more suitable property, because the costs of demolition are not recovered until the underlying land is disposed. A more appropriate tax result would permit these expenses to be added to the tax basis of the replacement structure and depreciated.

Expensing or Rapid Amortization of Environmental Cleanup Costs. Like demolition costs, costs to cleanup land purchased in a contaminated state must be capitalized and added to the basis of the non-depreciable land. These contaminated sites are known as "brownfields" and are less toxic than Superfund sites but still must be remediated prior to redevelopment. The U.S. Conference of Mayors estimates that there are approximately 400,000 brownfield properties across the country. The 1997 Taxpayer Relief Act provided immediate expensing of brownfield cleanup costs in empowerment zones and other high poverty targeted areas. This tax treatment should be extended to non-targeted areas as well. If not immediate deductibility, then a rapid amortization period such as 60 months would be appropriate. As with demolition costs, requiring that these costs be capitalized to the basis of the land is a disincentive to acquisition and redevelopment.

Update the Placed in Service Date for Properties Eligible for the Rehabilitation Tax Credit. The 1986 Tax Reform Act provided that the only properties eligible for the rehabilitation tax credit are those placed in service before 1936. Prior to 1986, a 10% tax credit was allowed for rehabilitation of properties placed in service at least 20 years prior to the rehabilitation activity. Qualifying a building for the rehabilitation credit based on its age, rather than a fixed placed in service date, is a preferable approach because it continually adds buildings to the credit eligibility pool as they reached the required age. The pre-1936 placed in service requirement excludes all buildings placed in service from 1936 on—regardless of age. Allowing buildings of a minimum age to be eligible for the credit would update the pool of eligible buildings and help achieve the social, economic and aesthetic goals brought about by rehabilitating and preserving older structures.

At-Risk Rules: Repeal the "at-risk" rules for real estate. Given the significant changes to real estate taxation designed to eliminate tax shelters (such as the passive activity loss limitation rules and 39 year straight line depreciation), the application of the at-risk rules are redundant and unnecessary. Meaningful tax simplification would be achieved by repealing these rules.

We believe the above-proposed policies, except the repeal of the at-risk rules which is a simplification issue, comprise a related package of tax changes aimed at promoting smart growth through redevelopment. In communities across the nation, rapid land development—often called "sprawl"—is having unwanted side effects such as traffic congestion, higher taxes, loss of open spaces and parks and overcrowded schools. Although the problems and solutions are primarily at the state and local level, the Federal government can help provide solutions, particularly through tax policy.

Current federal tax law discourages redevelopment of existing property through its uneconomic tax treatment of leasehold improvement depreciation, demolition costs and brownfield cleanup expenses. Enacting the changes proposed above would mitigate these tax impediments and level the tax implications associated with *new* versus *re* development decisions, thus making redevelopment more viable. Breathing viability into the rehabilitation tax credit by allowing more buildings to be eligible also serves to make redevelopment more viable and in turn ease pressure to develop new space. We look forward to working with the Committee to shape and implement these real estate tax policies.

Revenue Increases in President's Budget Proposal

Real Estate Investment Trust (REIT) Proposals

Similar to last year, the President's budget contains proposal affecting the formation, operation and management of REITs. The securitization of real estate through REITs that has occurred in the 1990s has been an important factor in the recovery of the real estate industry which itself is making a significant contribution to the strength of the overall economy.

One of the primary catalysts in real estate's recovery in the 1990s has been the emergence of the REIT as a broad-based public ownership entity. The REIT, along with the development and growth of the commercial mortgage-backed securities market, has provided real estate with access to much-needed funding via the public debt and equity markets. Such access to capital enabled billions of dollars of real estate to be recapitalized—thus stabilizing asset values nationwide and easing the tremendous negative pressure being placed on lenders' portfolios. These positive actions contributed significantly toward setting the nation on a course of job-creating economic growth.

Over the years, REIT tax laws have been modified and refined by Congress and the Treasury Department to ensure that REITs are able effectively to fulfill their mission in a changing economic and business environment. Federal tax policy should continue to provide this type of flexibility and reflect an understanding of the benefits REITs provide to the vitality of today's real estate markets and the overall economy.

Congress, and notably this Committee, has avoided any dramatic policy shifts affecting REITs, particularly during their recent proliferation and expansion. Your approach toward REIT policy has been measured and thoughtful, as evidenced by: (i) the liberalization of the independent contractor requirement by the Tax Reform Act of 1986, which enabled REITs to avoid the unnecessary expense of hiring independent contractors for routine management functions; (ii) the amendment of the closely held rules, in the Revenue Reconciliation Act of 1993, to allow a "look through" for pension funds investing in REITs; and (iii) the enactment of the REIT simplification provisions as part of the Taxpayer Relief Act of 1997. Collectively, these changes modernized the REIT tax regime, resulting in enhanced ability to raise capital, more efficient organization and improved flexibility to provide services to tenants, thereby maintaining the overall competitiveness of REITs.

This carefully thought-through and deliberative course of action should be continued. Our recommendations concerning the Administration's specific proposals follow.

President's Budget REIT Related Proposals

Taxable REIT Subsidiary/Preferred Stock Subsidiary Proposal. The Administration is proposing to modify the current REIT rules by: (1) authorizing a REIT to form taxable subsidiaries that can provide non-customary services to REIT tenants and services to third parties and; (2) requiring REITs with preferred stock subsidiaries to convert those entities to taxable REIT subsidiaries. It also proposes that the ownership restriction for preferred stock subsidiaries be amended so that REITs could not hold stock in a subsidiary representing more than 10 percent of the voting rights or value of the corporation. The proposal would be effective on date of enactment. There would be a currently unspecified transition period for preferred stock subsidiaries to convert.

Recommendation:

We support the concept of allowing REITs to form taxable REIT subsidiaries for purposes of providing services to tenants and third parties. REITs are evolving into a customer-oriented service business and require the flexibility to be able to respond to changing economic and market conditions the same as any other real estate entity. Many of the services that would be provided by the taxable subsidiary are natural outgrowths of traditional REIT operations, such as third party management and development businesses. A properly formed taxable REIT subsidiary would allow REITs additional operating flexibility and ensure that income generated by the subsidiary is appropriately subject to corporate level taxation. It would also ensure that REITs remain focused on owning and operating income producing real estate.

The Administration's proposal provides that the value of all the REIT's subsidiaries cannot represent more than 15 percent of the REIT's total asset value with the "qualified independent contractor" subsidiary not being able to have value in excess of 5 percent of the total value of all REIT assets. Currently, preferred stock subsidiaries cannot exceed 25 percent of REIT total asset value. The Administration's proposal does not explain why it reduces the 25 percent value threshold to a 15 percent value and imposes the additional 5 percent limitation. We believe this issue needs further examination and, lacking compelling rationale for the 15 percent value limitation, should be restored to 25 percent.

Also, the subsidiary would not be allowed to deduct any interest incurred on debt provided by the REIT, whereas current preferred stock subsidiaries can. This approach is overly restrictive. REITs should be allowed to lend to their subsidiary so long as adequate earnings stripping provisions are enacted to prevent the subsidiary from shifting its taxable income to the REIT by incurring excessive deductible payments to the REIT.

If enacted into law, the proposal would require existing preferred stock subsidiaries to convert to a taxable subsidiary within a yet to be specified conversion period. This could be problematic depending on the asset value of the preferred stock subsidiary (i.e. whether it fits within the 15/5 percent limitations) and whether there are any financing arrangements between it and the REIT. The better approach would be to allow existing preferred stock subsidiaries the election of converting to a taxable subsidiary or remaining in its current form. The 10 percent vote or value stock ownership limitation, if warranted, should only apply prospectively.

We would emphasize that there are a number of provisions already existing in the Internal Revenue Code that effectively prevent REITs from using these preferred stock subsidiaries in ways that avoid taxation on the subsidiary's earnings. Some of these provisions include: the rules under Section 482 affecting the allocation of income and deductions among taxpayers; Section 269 disallowing deductions or credits relating to acquisitions made to evade or avoid taxation; and the requirements under Section 162 for deduction of rental payments and business expenses. Further, although now discontinued, the IRS, beginning in 1988, issued favorable rulings on these subsidiaries. Congress also has been aware of these subsidiaries and found no reason to act upon them even though it recently enacted a number of REIT reforms.

National Realty Committee looks forward to working with the Committee and the Administration on the taxable REIT subsidiary and preferred stock subsidiary issues.

Modify the treatment of closely held REITs. Under this—proposal—which would constitute an additional requirement for REIT qualification—any "person" (that is, corporation, partnership or trust) would be prevented from owning stock in a REIT if the person controls 50 percent or more of the total combined voting power of all classes of voting stock or 50 percent or more of the total value of shares of all classes of stock.

Recommendation:

It is fundamental to the concept of REITs that they be widely held entities, easily and economically accessible by small investors. National Realty Committee is in full agreement with this. The Administration's enunciated reason for proposing the additional qualification requirement is a concern about possible tax avoidance transactions involving the use of closely held REITs. However, the Administration's explanation of the proposal provides little description of the transactions at issue. Before National Realty Committee can constructively comment on this provision, and certainly before Congress should consider the proposal, further clarification should be provided as to the perceived abuses targeted by the proposal. We agree with the Administration' intent to close potential tax abuses but its proposal appears to be overly broad.

We are pleased that this year's version of this proposal, unlike last year's, would not apply to ownership by a REIT of 50 percent or more of the stock (vote or value) of another REIT. Further, we believe pass-through entities such as partnerships, and mutual funds should not be counted as one entity for purposes for the "5 or 50" rule. The partners or shareholders should be considered the "persons" owning the REIT for purposes of limits on investor ownership.

Finally, so called "incubator REITs" sometimes have a majority shareholder corporation for a transition period in order to prepare the REIT for going public by allowing it to develop a track record. Corporate majority shareholders of private REITs are also used for legitimate state and local income and real property tax planning purposes and as a vehicle for legitimate foreign investment in real estate. We do not believe these structures lend themselves to tax abuse, and any proposal on this issue should clarify the same.

National Realty Committee believes that before this Committee takes any action, the tax avoidance transactions involving the use of closely held REITs generally referred to in the Administration's proposal need to be more clearly and specifically set forth. This will help qualify the issue and quantify the extent, if any, remedial action is needed. Also, it would help insure that legitimate transactions important to real estate capital formation not be unduly affected.

Repeal tax-free conversions of C corporations to S corporations (or REITs). Under current law, (Section 1374 of the Code), a C corporation that converts or merges into an S corporation does not pay tax on "built-in" gains, (the excess of asset value at such time over tax basis), unless the asset is sold within 10 years of the conversion or merger. The Administration proposes repealing Section 1374 for large corporations (valued at over $5 million), so that a converting or merging corporation would, immediately thereupon, pay tax as if it had sold its assets and distributed the proceeds to its shareholders, producing an immediate second level of tax. The Administration's proposal also would apply to C corporations that convert into or merge with REITs.

Recommendation:

National Realty Committee, together with a broad coalition of industry and small business organizations, opposed this proposal when it was put forth by the Administration in each of the last two budget proposals. Our position is unchanged—the proposal should be rejected. The current rules taxing the "built-in" gain of assets sold within a 10-year period of electing S corporation or REIT status is a fair standard that effectively prevents tax avoidance. Imposing two levels of tax on built-in gains likely would affect the economics of most transactions so significantly that they simply would not go forward. Thus, many C corporations would be precluded from converting or merging into an S corporation or REIT. The effect would be to negate the revenue-raising impact of the provision and to impede the continuing recapitalization of commercial real estate through the access to public capital markets that REITs provide.

Finally, if such a proposal were enacted, at a minimum, the effective date should be amended to allow fiscal year taxpayers the same amount of time to wind up pending conversions as calendar year taxpayers. As currently proposed, calendar year taxpayers have until December 31, 1999. A fiscal year taxpayer with a tax year ending, for example July 31, will have only until the end of its fiscal year in 1999 to complete a conversion. There appears to be no rational reason for this discrimination against fiscal year taxpayers—and the proposal should be, if not rejected out of hand, amended to allow an equivalent amount of wind up time before the provision becomes effective.

Other Real Estate-Related Revenue Provisions

Eliminate non-business valuation discounts (for family limited partnerships). The budget proposal asserts that family limited partnerships are being used to take "illusory" valuation discounts on marketable assets. The proposal contends that taxpayers are making contributions of these assets to limited partnerships, gifting minority interests in the partnerships to family members, and then claiming valuation discounts based on the interest being a minority interest of a non-publicly traded business. The proposal would eliminate such valuation discounts except as they apply to "active" businesses.

Recommendation:

National Realty Committee opposes this proposal in concept because it increases the estate tax burden and specifically because it defines non-business assets as including "real property." The reference to real property, which lacks any elaboration, could be interpreted broadly to include much of the nation's directly or indirectly family-owned real estate. In all events, further clarification by the Administration is needed to determine the definition of "real property" and whether it is considered part of an active business.

Nevertheless, National Realty Committee does not believe that real property or interests in real property should be included in a proposal targeted at truly passive investments, such as publicly traded stocks and bonds. We applaud the Committee for its continuing effort to reduce the estate and gift tax burden. This proposal would take a number of steps backward and increase the estate tax burden. As a result, successors in family-owned real estate businesses could be faced with the troubling scenario of having to sell real property in the estate (often at distressed value prices) in order to pay death taxes.

Disallow interest on debt allocable to tax-exempt investments. The President's proposal would expand the definition of "financial institution" in Section 265(b) of the Code to include "any person engaged in the active conduct of banking, financing, or similar business, such as securities dealers and other financial intermediaries." As a result, a "financial institution" that invests in tax-exempt obligations would not be allowed to deduct a portion of its interest expense in proportion to its tax-exempt investments. Under current law, (Revenue Procedure 72–18) taxpayers, other than financial institutions, are not subject to such limitations provided the average amount of the tax exempt obligations does not exceed 2 percent of the average total assets of the taxpayer.

Recommendation:

National Realty Committee opposed a similar proposal last year and opposes this proposal because it would reduce corporate demand for tax-exempt securities, such as industrial development and housing bonds. Reducing corporate demand for these important investment vehicles would increase the borrowing costs of municipalities throughout the country—thus, hindering urban reinvestment activity—and it would discourage corporate investment in state and local housing bonds issued to finance housing for low and middle income families.

Limit Inappropriate Tax Benefits For Lessors of Tax Exempt Use Property. Under current law, certain property leased to governments, tax-exempt organizations, or foreign persons is considered to be "tax-exempt use property." There are a number of restrictions on the ability of lessors of tax-exempt use property to claim tax benefits from transactions related to the property. For example, such property must be depreciated using the straight-line method over a period equal to the greater of the property's class life (40 years for non-residential real property) or 125 percent of the lease term. The Administration contends that certain leasing transactions involving tax-exempt use property are being used to generate inappropriate tax benefits by creating mismatches of the timing of reported income and expenses. Therefore, the budget proposes to apply principles similar to the passive loss rules to leasing of tax-exempt use property. As a result, a lessor of tax-exempt use property would not be able to recognize a net loss from a leasing transaction involving tax-exempt use property during the lease term.

Recommendation:

We believe that applying principles similar to the passive loss limitation rules to transactions involving the sale and leaseback of real property of tax-exempt organizations is overly broad and heavy-handed. The depreciation treatment of such transactions substantially removes the tax shelter motivation and effectiveness of most transactions. Any losses that result from principally from such unfavorable depreciation treatment could hardly be considered uneconomic losses in need of limitation.

Modify Basis Adjustment Rules for Partnership Distributions. The Administration has put forth the following five coordinated proposals relating to gain recognition and basis adjustments upon the distribution of cash or property by a partnership: (1) A mandatory basis adjustment of undistributed partnership property upon a distribution of other property. (2) Modification of basis allocation rules for liquidating distributions to prevent shifting of basis from non-depreciable assets to depreciable assets. (3) Modification of rules for partial liquidations of a partnership interests to prevent a partner from obtaining an inflated basis in partnership property that would inappropriately defer gain. (4) Repeal Section 751(b) relating to distributions treated as sales or exchanges with respect to unrealized receivables and inventory items. (5) Require certain basis adjustments when a partnership distributes certain stock to a corporate partner that controls the corporation in order to prevent inappropriate deferral of gain. All provisions would be effective for partnership distributions made on or after the date of enactment.

Recommendation:

The basis rules for partnership distributions are among the most complex rules in the Code. The Administration's proposals would enhance their complexity significantly. While it make the case that the current rules allow for some potential abuse, the Administration does not provide compelling evidence that the rules are being abused to an extent that would require the proposed substantial modifications. As with other proposals addressed in this testimony, we believe the Administration's proposals may be overly broad and perhaps unnecessary. If the Committee decides it wants to take action in this area, we strongly recommend that hearings be held so that leading tax professionals and interested organizations, such as National Realty Committee, can provide input into the process.

TAX INCENTIVES IN THE BUDGET PROPOSAL

Tax credit for energy-efficient building equipment. The Administration's budget proposes a 20 percent tax credit for the purchase of certain highly-efficient building equipment, including fuel cells, electric heat pump water heaters, advanced natural gas and residential size electric heat pumps, and advanced central air conditioners. Specific technology criteria would have to be met to be eligible for the credit. The credit would apply to purchases made after December 31, 1999 and before January 1, 2004.

Recommendation:

National Realty Committee believes the immediate objective of this proposal—encouraging energy efficiency in buildings—is appropriate. In preparing for the 21st century, the real estate industry, like other major industries, is looking for ways to improve its overall performance from an economic and environmental perspective. National Realty Committee has taken notice of statistics from the Department of Energy identifying office buildings as consuming about 27% of the nation's electrical supply. If this is an accurate assessment, we are surprised that, of the six specific tax credit proposals for energy efficient building equipment, only one (fuel cells) has any practical application to commercial office buildings. More specifically on the matter of the fuel cell credit, while the amount of the incentive is not insignificant, it is not yet sufficient to encourage the use of this technology except in limited circumstances.

Furthermore, because of the December 31, 1999 effective date, the credit provides no incentive to taxpayers considering making energy efficient building equipment decisions this year. Optimally, the credit should be available for purchases made in 1999. Postponing the credit until 2000 could affect negatively decisions to purchase certain energy efficient building equipment this year resulting in a missed opportunity for the new building stock coming on line.

Expensing of brownfield remediation costs. The Administration proposes to make permanent the deduction for brownfield remediation costs. This deduction was enacted as part of last year's budget and tax law and is scheduled to expire after December 31, 2000.

Recommendation:

National Realty Committee supports this proposal. However, the deductibility of clean-up expenses applies only to brownfields in specifically targeted areas, such as empowerment zones. We understand the social and economic policy goals intended to be furthered by this targeted clean-up provision. However, there are almost 400,000 brownfields across the nation, most of which are outside of these targeted areas. Allowing some type of deductibility or amortization of clean-up costs for all of these brownfields would help restore brownfields across America to viable and productive use.

Low-income housing tax credit expansion. The budget proposes a major expansion of the low-income housing tax credit, which could facilitate the construction of 150,000–180,000 new affordable housing units over five years. Under the Administration's proposal, the annual state low-income housing credit limitation would be raised from $1.25 per capita to $1.75 per capita, beginning after 1999.

Recommendation:

National Realty Committee supports this proposal. We also support related legislation, H.R. 175 introduced by Representative Nancy Johnson (CT) and cosponsored by several other Members of the Committee on a bipartisan basis. We are encouraged by the consensus developing between the Administration and key Members of Congress on the need for increasing the amount of low income housing tax credits allocated to the states.

Tax credits for holders of Better America Bonds. The Administration is proposing a tax credit for holders of certain bonds issued by state and local governments for the purpose of protecting open spaces; creating forest preserves near urban areas; rehabilitating brownfields; improving parks and reestablishing wetlands.

Recommendation:

Although we have no specific comment on how the Better America Bonds would or should function from a tax perspective, we believe the Committee should consider tax policies that would improve the livability of our communities by encouraging redevelopment, protection of open spaces and clean up of contaminated sites. The NRC tax agenda described in this testimony is intended to achieve a similar goal and we welcome the opportunity to work with the Committee on these proposals.

Conclusion

Again, we thank Chairman Archer and the Committee for the opportunity to comment regarding the revenue proposals in the President's fiscal 2000 budget. We are encouraged by the proposals to increase the low income housing tax credit, make permanent the deductibility of brownfield clean-up costs and implement credits for energy-efficient improvements for buildings. We agree with the intent of the Administration's taxable REIT subsidiary proposal but are concerned about their what is proposed for preferred stock subsidiaries, closely held REITs and C corporation conversions and mergers.

We look forward to working with the Committee to ensure that the provisions of the Code dealing with REITs do not lead to abuses, yet allow REITs effectively to fulfill their mission in a continually changing economic and business environment.

Finally, while we object to the proposal to eliminate realistic valuation discounts in the non-business, family limited partnership situation, we strongly believe that, in all events, including real property in such proposal is ill-advised and should be dropped from any further consideration.

Statement of North Dakota Public Service Commission, Bismarck, ND, Bruce Hagen

I support President Clinton's proposal to set aside 62 percent of the budget surpluses over 15 years for Social Security's cash reserves. I also believe it makes sense to consider creating individual retirement accounts as well as putting some of the surplus into Medicare.

I am very concerned regarding the efforts of some interests for tax cuts. I believe there is a stronger message to start paying off the national debt.

The national debt is now over $5.6 trillion. The fact is both the Republican and Democratic Parties share a responsibility for creating this debt. The record shows, for example, as I understand it, over 60 percent was created under Republican presidents who proposed unbalanced budgets, which Congress eventually passed. So, today, we have "defeated the evil empire" Russia, but we have a huge debt that comes, in part, from some of those high-spending years to defeat the Russian bear, as well as from other costs.

It seems to me to be responsible, we should make a strong effort with both Republican and Democratic Party's endorsement and support, to pay down the national debt. When times are good and our budgets are in the black, we should systematically pay down our national debt. If we do this, it helps everybody by reducing the interest we pay on loans, because the U.S. Government will not be borrowing money to pay its bills.

I appreciate the tough job Congress has, but I do hope you will seriously consider my views.