THE PRESIDENT'S BUDGET FOR FISCAL YEAR 2001

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BEFORE THE

COMMITTEE ON THE BUDGET HOUSE OF REPRESENTATIVES

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THE PRESIDENT'S BUDGET FOR FISCAL YEAR 2001

TUESDAY, FEBRUARY 8, 2000

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to call, at 10:10 a.m. in room 210, Cannon House Office Building, Hon. John R. Kasich (chairman of the committee) presiding.

Members present: Representatives Kasich, Chambliss, Shays, Herger, Smith, Nussle, Hoekstra, Radanovich, Hilleary, Sununu, Pitts, Knollenberg, Thornberry, Collins, Green, Fletcher, Ryan of Wisconsin, Toomey, Spratt, Rivers, Thompson, Minge, Bentsen, Davis, Clayton, Price, Markey, Clement, Moran, Hooley, Lucas, Holt, Hoeffel, and Baldwin.

Chairman KASICH. OK. I want to welcome Jack Lew to the—I haven't thought about this—first budget hearing of the new millennium, and I would observe that the Director is somebody who—I mean, not unlike the Staff Director on this committee, Wayne Struble, you know, labored for many years in the vineyard; and it is always good to see somebody who does the work ultimately appointed to the position of authority.

So I want to congratulate you, Jack, for the fact that you hold this position, and I think it is great that you had an opportunity not just to do the background work, but now you have a chance, you know, to be heard a little bit more and to be appreciated a little bit more. So I want to welcome you here.

Let me just say a couple things. First of all, it would be easy, but I think frankly a little bit too partisan to come in and bemoan where we are today or predict dire circumstances in the future, because we have a very strong economy, and the great thing about a strong economy and the longer it stays strong, the better people, who really struggle, do. I don't at all feel badly—in fact, I feel great—that the people who are the investors and the movers and the shakers are doing well in this economy because the better they do, the more investment that occurs and the better that everybody does.

The fact is, though, that with a strong economy it is just a wonderful thing for families, and we may be on the edge of really what is the idea revolution which really may cement these incredible productivity gains which result in a lot more money for everyone; and when people are more productive, that means they get higher pay, and that is what we have seen happening.

You have got to go back, John, about a hundred years to take a look at what this period represents, and it is interesting historically. It seems as though there are giant technological advancements about every 100 years, and what results from it, from what I can tell, is that industries—you get basic industries. For example, you know the steel industry got created over 100 years ago, and then you saw industries flow from that industry, and that is what brought on the great industrial boom.

In some sense, that is what we are seeing today with the incredible improvements in biotechnology and, obviously, the computer and the Internet; and you are beginning to see industries that flow from those major creations which leads one to believe that this is not something that is temporary, but rather something that is permanent in terms of the long-term strength of this economy.

I think we need to celebrate the 1997 budget agreement. I remember the days when we passed it, and I remember trying to sell it inside the Republican Conference, and I can remember a number of the conservative publications having a lot of fun bashing some of us, including me, about what a mistake it was. I think it helped.

I don't think it is the end all. I think the fact that the Berlin Wall came down and international trade has been expanded and the fact that technology has grown have been huge, huge reasons for this strong economy; but I think if you talk to Alan Greenspan, he will tell you that the ability of the Congress to indicate some sense of financial and fiscal responsibility also allowed him to pursue a path regarding interest rates that allowed this economy to grow. So I think that is what we ought to celebrate.

I got a great opportunity to work with John Spratt on that 1997 agreement, and since then, of course, now that we are running these huge surpluses, we have had profound disagreements. I mean, we had that one year, I have been here 18 years, and we had one year when we could cobble together and get it done, and that was 1997; but in 1998 and 1999 we have essentially been in gridlock, and as you all know, I will be out of politics in less than a year. I will be a private citizen, and as a private citizen, I celebrate gridlock because that means things don't get done down here; because I don't think the answers to our problems lie in more government, and as a result of that gridlock, we have been able to pay down debt.

Now, we have not had the tax relief that I would have liked to see, and I believe the 1997 capital gains tax cut was a huge part of what has spurred this economy, but nevertheless, we have paid down debt; and of course, the great news is we have not spent any of the Social Security surplus, something that many people thought we would do, and we did not do it, which has made space for the ultimate solution related to Social Security.

At the same time, however, I have to tell you that I am not happy with the amount of government that has grown up since 1997, and I know the argument is that we are a smaller percentage of GDP. Frankly, we are kind of stabilizing in relation to the size of the economy, but I am familiar with a number of businesses that in high profit times started celebrating by building more offices, more overhead, only to find themselves in deep trouble with the need to go back and cut that overhead. I believe that we have not been good stewards here in the good times, prioritizing programs and going back to fundamental governmental reform.

This committee is going to have a hearing in the next couple of weeks on the issue of government reform, and I can tell you that in the areas of Medicare and Medicaid and food stamps and earned income credit, HUD, there has been virtually no improvement. Many of these systems are out of control, no accountability. We got off the reform agenda. We need to be on that reform agenda, because as Joseph in the Bible told the great king, in the good times it is a time to store, to stock the barns, to prepare for what happens in bad times, because over the time I have been in government, people say you don't need to reduce your overhead or control spending in good times. And then when you go into bad times, people say, well, my God, there is no way you can save money; in bad times the people need it. So the fact is, I think we have spent too much.

Secondly, I think we have failed to do the basic kind of reform efforts that need to be done in the area of education. I do believe that education, without proper resources, will not work, but I don't believe that just spending money on education will fix it, and I think more and more of our children are falling farther and farther behind, and I am very disappointed that we have not done more in the area of education.

But, Jack, I guess my greatest disappointment beyond the fact that you have got a net tax increase in your first year of the budget that you have passed out, distributed money to almost virtually every sector of the economy. You know, where we are today, as far as I can see it, it is an approach of Santa Claus. You just give every single group in America that could ask you for any spending, you give them some money, and people may support that, but what you get as a result of it is you get less tax cuts.

You get more top-down rather than bottom-up in America, and you don't pay down the debt that you ought to pay down. That is what is so wrong about expanding the size of government; not just that, of course, but also the issue of a growing intrusion in the area of our liberties.

But what has really astounded me—I can't figure this out, and I don't say it as I said it yesterday with a whole degree of anger or partisanship or whatever—but what I can't figure out is how you can be in the eighth year of your term as President and you virtually do nothing in the areas of Social Security and Medicare.

Now, almost all the people that are sitting out here this morning are baby boomers. We talk about paying down debt over the next 10 or 15 years. We don't have 10 or 15 years to fix Social Security and Medicare. Medicare is in the emergency room right now. I hope to come up with a Medicare reform plan that isn't going to be a whole lot about good news.

In the area of Social Security, we have a little bit more time, but it is going to require some really innovative and dramatic proposals, and the fact is that the President in the eighth year of his term—I mean, this business about putting more bonds in the fund, I mean, that is just more of a demand on every one of these people's and all of our pocketbooks. It doesn't solve the problem. There are no programmatic changes.

How could you punt on Medicare and Social Security?

I was saying this morning, it is almost like you are going to make your last tour around the major league baseball parks and you tell the coach at every city you go to, I am not going to play today. I mean, I don't understand how you could be in the eighth year of a presidency and ignore Social Security and Medicare reform and use a little political capital to move that reform agenda down the road before it swallows up the baby boomers and their children; and that is the biggest disappointment for me in the budget.

We are going to offer our budget. It will pay down more debt. It will promise genuine tax relief and tax reform. I am hopeful we will have a provision that will say that if we pass a tax cut bill in the Congress and the President vetoes it, that money will go into a lock box; it will not be used for more spending, but will be used to pay down more debt.

And I hope Republicans will set some priorities on defense and in streamlining education and improving health care. And finally, I hope that, at least in this committee, we can revive the reform agenda, not designed to point fingers necessarily at this administration, because this is a continuation of mismanagement in the Federal Government, to let people know that there is so much to be done, so much to be reformed, so much to be streamlined which would make people a little less frustrated.

So, Jack, I am glad you are here today, and we are going to have a good round of questions for you, and there are some things we can really celebrate, but there are some things we can anticipate and some disappointments we have, but as we go down this year, 2000, getting ready for another President, let us work together as much as we can and see what we can get accomplished.

Mr. Spratt.

Mr. SPRATT. Mr. Chairman, since we last met something significant has happened in the Kasich household, the arrival of twin girls, I believe, and I would just like to say on behalf of all of us, we are happy for you. We really are.

Chairman KASICH. Well, I don't know—they are only 3 weeks old, but I will bet they are watching this morning. Their names are Emma and Reese, and they are doing well. They have got a little virus right now, but they are doing well.

Mr. SPRATT. The question is not how they are doing. How are you doing?

Chairman KASICH. I have eaten more words in the last 3 weeks than I ever thought I would, but you know, I want to—I guess this is an opportunity to thank so many of the doctors and nurses that we worked with in the hospital. I didn't have a chance. They were born in Ohio State University Hospital and, you know, just the doctors, the nurses, their dedication is just awesome; and then beyond that, I have never had so much joy in my life and people you know sharing in my joy, and my friends, Ed Markey, for example, sent me two little Teddy bears from Vermont with a note that says, "This is one surplus we Democrats can't take credit for," which I thought was great.

But I just want to thank everybody and tell all of you that, you know, I am beginning to believe in life that you don't really know anything unless you experience it, and John, with his daughters, they have done so well, and I shared a little bit in that joy, but now having my own kids, I can now really celebrate it.

So it's a transformation, and I am thrilled, and this is my Achilles heel. Thank you very, very much.

Mr. SPRATT. Mr. Chairman, you took us back 100 years. I would like to go back just 8 years, to 1992, the last year of the Bush administration. We have come a long way. We have come from a budget that was $290 billion in deficit to a budget that was $176 billion in surplus. On this administration's watch, we have moved the budget $466 billion in the right direction. This budget continues that trend. It is the fourth surplus budget in a row for the Clinton administration.

You know, Mr. Chairman, the year after Mr. Reagan came to office, the government's debt, owed to the public, stood at $920 billion. When Mr. Bush left office 12 years later, the government's debt held by the public had risen to the sum, the mountainous sum, of $3.2 trillion. I am not blaming them. We all have some responsibility for that. You and I were both here during that period of time, but on this administration's watch, by the end of this year, we will have retired $297 billion of that debt. It is a matter of record; and if we take the path proposed by this budget, we can repay over $2.5 trillion in debt held by the public by the year 2010. It is not that far away, and if we stay that course—this is phenomenal—we can retire the entire debt held by the public by the year 2013. Now that is phenomenal.

But what is most notable about this budget is that it pays down the public debt, and at the same time it lays down a basis for extended Medicare solvency to 2025; that is what the transfer of the $300 billion will do. And it also lays the basis for extending the solvency of Social Security to 2050; that is what the eradication of net debt service will do to the overall prospects for Social Security. And it does both of these things while addressing a number of other priorities, and let me highlight a few because I don't think these are Santa Claus distributions:

Prescription drug coverage for Medicare. I don't think anybody would design Medicare today and leave out prescription drug benefits. This budget fills that gaping omission in Medicare coverage, and it does it in a framework of a budget that stays in surplus and pays off public debt.

Defense. This budget will take defense spending to $306 billion. In nominal dollars, that is the most ever since the Second World War, and it is $24.4 billion, Mr. Chairman, above the level that we put in the baseline for defense in the Balanced Budget Agreement of 1997, $24.4 billion more than we provided for defense in 2001 when we did the BBA just 3 years ago, and it is $12.2 billion more than we budgeted for defense this year. That is a substantial plus-up in defense.

You will probably want to match us and raise us one; you have in the past. You don't want to be one-upped on defense by the administration.

Veterans. Closely aligned with defense are those veterans who have stood on the ramparts during the Cold War and won the Cold War and provided our defense. We made promises to them about health care; this budget keeps those promises. This budget increases veterans' health care discretionary funding by $1.5 million. That is the biggest single year increase in veterans' health care in history.

Education. I have been out and about among teachers and parents since we broke last November, and I have yet to meet a parent or a teacher who didn't think that reducing class sizes in primary grades to 18 kids is a great idea.

I ran into a third grade class in Ladson, SC, and I asked the teacher—she had had 32 kids the year before, she had 18 this year—I said, what kind of a difference does this make, and she said night and day. Well, this budget extends the teacher/class size initiative. It expands the after-school program. It increases Head Start. It helps schools afford the cost of new school construction and old school renovation. It has $4.5 billion in discretionary education funds. If we can do $12 billion for the military, surely we can find a third that much for education.

Farm safety net. Commodity prices are still low. They are at the lowest level since the 1970's. We had to help farmers on the brink of bankruptcy last year. This budget provides $11 billion over the next couple of years for new safety nets and deficiency-type payments and better crop insurance until Freedom to Farm expires and is replaced with a farm program that really works.

NIH. You mentioned the scientific breakthroughs that are occurring today that are truly phenomenal. We are on the cusp of some that could change the way that we live. A few years ago the Clinton administration dramatically proposed that we increase funding for NIH by 50 percent. The Senate, Republican majority, said, that is not good enough. They wanted double-funding for NIH over 5 years. Well, this budget fulfills that commitment. It doesn't do it the way you did it last year. It doesn't say to NIH, here is more money, but you can only spend $7 billion of this increase after September the 29th, 2000. No gimmicks. This is a real plus-up.

Mr. Kasich, you yesterday were decrying these initiatives and just now said this is sort of a return to the era of big government, and you would rather have smaller government.

You also mentioned the fact that typically when you make that argument you are confronted with some numbers, namely the ratio of government spending to the size of our economy, our gross domestic product. Let me put this budget in context. Now, this, the last year of the Clinton administration, government spending will equal 18.7 percent of our gross domestic product—GDP, 18.7 percent. For comparison, let us go back to 1983, the second year of the Reagan administration, because in that year, 1983, government spending peaked at 23.5 percent of GDP.

When Mr. Clinton came to office, spending had tapered off a bit. It was 22.5 percent of GDP. Not only have the Clinton budgets brought the deficit down every year for 8 years in a row, but every year the budget as a percentage of GDP has gone down, too, so much so that today it is 3.7 percentage points of GDP below the Bush years and 4.8 percentage points below peak spending during the Reagan years. I am talking about 4.8 percent of nearly $10 trillion, $500 billion less government spending than would have been the case if we were running the government at the levels of the

Bush administration or the Reagan administration. If the path plotted by this budget is followed for the next 10 years, government spending will decline to 16.7 percent of GDP by the year 2010. That is 7 percentage points lower than it was at its peak in the Reagan years.

Now, these ratios show irrefutably that this budget downsizes government. Yet this budget also shows how we can provide more coverage for the health care of older Americans, drug coverage, more teachers for the education of younger Americans, more defense to keep our Nation strong, more for veterans, more for medical research and still pay down the debt and plus-up national savings by nearly $3 trillion.

I have heard statements that this budget spends a large portion of the surplus. In truth, this budget begins, thank goodness, on a realistic note. The beginning point of any budget this year has to be a realistic projection of discretionary spending. CBO's report takes where we are right now and says, we don't know where we go from here, we will give you three choices. This year's budget is ridden with gimmicks because the discretionary spending caps have become so unrealistic that they don't know where to start and how to project into the future.

They make three different assumptions. There is only one of these that is realistic. It is not realistic to assume that we will take discretionary spending from today's level down to the caps that we set in 1997. That would require a reduction in outlays this year and next year of $30 to $35 billion and a reduction in budget authority of probably $50 billion. You know and I know that is not going to happen; all it will do is invite more gimmicks.

Nor is it realistic to assume that we are going to have discretionary spending frozen at this year's level for 10 years. I have been here for 17 years. I have heard freezes discussed continually during that period of time. I have never seen one that lasted for any period of time, not a true freeze. And you and I know, in the face of the mounting surpluses, we are not going to have a 10-year freeze in discretionary spending.

It is totally unrealistic. It would mean if we held defense harmless against inflation, let it increase with inflation, that at the end of that 10-year period of time what we provide for medical research and education and environment would be 40 percent less in real purchasing power than it is today. That is not going to happen.

The only realistic baseline, the place where we should begin our budget, and we do under Mr. Lew and President Clinton, we begin by realistically assuming that discretionary spending will roughly grow with inflation. Zero real growth, no real addition, simply holding harmless discretionary spending against inflation.

By Jack Lew's calculation, that gives us a surplus of somewhere around $750 billion. By CBO's calculation, we get a surplus of around $838 billion. That is how much money we have to talk about, and in truth, we don't have that much in available surplus because if we spend it or tax-cut it away, we have to make an adjustment for debt service of about $125 billion. We are really talking about, over 10 years, $700 billion; and 80 percent of that surplus—80 percent of that surplus occurs in the second 5 years of that 10-year period of time.

So all of this is to counsel caution; let us not plunge ahead with something dramatic. What we have got before us, I am sure we will disagree about. I don't embrace this budget entirely myself. I am not going to vote for additional tobacco taxes, additional net new taxes this year; and you are proposing once again user fees that have been around the track again and again and again and gone nowhere in the Congress. Maybe one day we will see the wisdom in it, but I don't think it is going to happen this year.

So we are not going to embrace this budget in its entirety, but it is a good budget to build upon, and if we want to get away from the gimmick-ridden budget that we have got, get back to reality and get down to programs that really matter—saving Social Security, making it solvent, adding prescription drug coverage, putting money into accountable education programs—this budget gives us a great basis to begin upon.

Thank you, Mr. Chairman. And, Mr. Lew, I look forward to your testimony.

Chairman KASICH. Mr. Lew, it is now your turn.

STATEMENT OF HON. JACOB J. LEW, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. LEW. Thank you, Mr. Chairman, Congressman Spratt. I would like to thank you for the very kind and generous introduction and to join in extending my congratulations to you, Mr. Chairman, on entering this most exciting part of life.

It is really a pleasure to be here with the committee today.

After turning around large and expanding deficits that threatened our economy, we face a new challenge: maintaining sound fiscal policy during a period of surplus.

Budget surpluses and debt reduction are no longer projections. They are real accomplishments. In 1998 we ran a $69 billion surplus and didn't spend it. In 1999 we ran a $124 billion surplus and didn't spend it. By the time this fiscal year ends we will have an even larger surplus, and between 1998 and 2000, we will have paid off $297 billion of the public debt.

After 12 years of spiraling debt, we are now paying it off, and by 2013 the United States will be effectively debt free for the first time since 1835 when Andrew Jackson was President. We must now continue a policy of fiscal discipline that is working.

Our new challenge boils down to relying on realistic assumptions and baselines, setting priorities and making choices to maintain a balanced program. It requires that we begin by addressing our existing commitments. The President's budget relies on realistic assumptions and reflects balanced priorities.

I think it is useful to begin by reviewing the state of our economy, because it shows how much is at stake. While the private sector is the engine for economic progress, fiscal policy can encourage or discourage growth. As this chart shows, fiscal discipline has helped achieve rapid growth of business investment, because the Federal Government has stopped draining the Nation's pool of capital, accommodating lower interest rates and reducing fears of inflation. Businesses have better access to capital and are better able to invest and innovate. Under this administration we have enjoyed the best sustained growth of business investment since the 1960's.

Economic progress has reached almost every facet of our economic life, raising living standards for most Americans. The economy has 20.8 million new jobs since 1993. Unemployment is at its lowest in 30 years, and African-American and Hispanic unemployment rates are at the lowest level since we started keeping those statistics 25 years ago. Work pays more, reversing a two-decade decline in real wages, and 7.2 million people have moved off the welfare rolls. The number of poor people has declined by 4.8 million and a record number of Americans now own the homes they live in.

When President Clinton took office 7 years ago, the budget deficit was $290 billion, the largest in history. Between 1980 and 1992, the debt had quadrupled, from about $700 billion to $3 trillion. Without a change in policy, the 1998 deficit was projected to be $390 billion, rising to $639 billion by 2003. Nothing indicated that the vicious cycle would abate.

Reversing these adverse trends required tough policy choices in 1993 and, on a bipartisan basis, in 1997. These tough policy choices worked. From 1994 through 1998, deficit reduction more than doubled over prior estimates and deficits fell by $1.2 trillion.

As a percentage of GDP, spending in every year for which President Clinton has submitted budgets has been lower than during either of the preceding two administrations, declining from 22 percent in 1992 to 18.7 percent in 2000, the smallest share of the economy since 1966. This year we are proposing to spend 18.3 percent of GDP, which is still lower. Thanks to the strong economy, receipts have grown beyond expectations while income tax rates on typical households are actually the lowest since the 1970's.

A typical family of four with a median income of about $55,000, will have lower income and payroll taxes this year than at any other time in a quarter century. A family with income at one-half the median level will pay the lowest share of income taxes since 1965. Even a family of twice the median income level, over $100,000, will pay less in income tax as a percentage of income than at any time since 1973.

The bipartisan Balanced Budget Agreement of 1997 reinforced expectations of Federal fiscal responsibility. To continue our strong economic performance, we must continue along the path of fiscal discipline and prudent investments.

From 1993 to 1999, almost 75 percent of the dollar increase, the nominal increase in spending, is attributable to honoring long-term commitments, Social Security, Medicare, Medicaid and interest on the debt. All other spending has actually declined in inflation-adjusted dollars.

With a growing economy and a growing population, the Federal Government must continue to accomplish important missions. We need to maintain critical functions like air safety, law enforcement, the administration of Medicare and national security, both defense and diplomacy. Realistic projections also need to accommodate investments in education, families, protecting the environment, and research and development, all necessary to assure a better future.

CBO served the policy process well this year by illustrating three potential discretionary baselines, only one of which I believe is realistic. A discretionary baseline at the 1997 spending caps is not realistic. Congress appropriated above those caps by tens of billions of dollars in both 1999 and 2000. To bring spending down to the caps in 2001 would require an unachievable 1-year reduction from 2000 program levels of almost $70 billion, 11 percent.

Likewise, a discretionary budget freeze over 10 years is unrealistic. The Congress increased discretionary budget authority by 7 percent in 1999 and 3½ percent in 2000. A nominal freeze in 2001 would require a reduction from 2000 program levels of 3 percent. Extending such a freeze for 10 years would require program level cuts of 23 percent by 2010, and this assumes that defense would be frozen along with nondefense.

If defense spending increases within an overall freeze, the implications for all other spending would be far more severe. Within an overall freeze, appropriating the President's request for 2001 for defense would turn a freeze into a 9 percent cut from 2000 levels for all nondefense programs. Any addition to the President's request would make the effect on nondefense programs even worse. By 2005 the reduction would be 25 percent, and by 2010 the reduction would be over 40 percent. This is just not realistic.

Our budget is based on the third CBO scenario, the most realistic. The discretionary baseline would not shrink in real dollars. It also would eliminate the gimmicks used in recent years to mask spending over the caps. A budget based on unrealistic assumptions is unlikely to stop unnecessary spending. What ultimately would suffer is fiscal discipline and the commitment to protect the Social Security surplus.

If the surplus is exaggerated to make room for either tax cuts or spending increases, when discretionary spending cuts do not materialize, as I do not believe they will, the non-Social Security surplus disappears. This means that both fiscal discipline and the Social Security surplus would be jeopardized. Moreover, any perception that the fiscal discipline in Washington is on the decline would undermine our unprecedented economic progress.

Our projection of the non-Social Security surplus of $746 billion over 10 years provides substantial resources for a balanced program in the context of realistic assumptions. The President's budget continues the fiscal discipline that since 1993 has fostered this era of prosperity and surplus. It uses conservative economic assumptions and a realistic baseline for discretionary spending and reflects balanced priorities. It eliminates the national debt, extends the solvency of Social Security and Medicare, and provides a tax cut and funds essential investments in our future.

The President's budget projects a total surplus of $2.9 trillion over the next 10 years. Of that, $2.2 trillion is from the Social Security surplus, and we put it into a solvency lock box to retire the Nation's publicly held debt.

Beginning in 2011, interest savings will be used to extend Social Security solvency to 2054. These interest savings are substantial. In 1993 we projected that in 2010 interest would consume 23 cents out of every Federal dollar. Today, we project that interest will consume 3 cents out of every dollar in 2010. These savings permit the extension of Social Security solvency.

The remaining on-budget surplus is $746 billion. Overall, $432 billion is allocated to Medicare; $299 billion is contributed to the

Medicare Trust Fund to extend its solvency for 10 years to 2025, $98 million is used for Medicare prescription drug benefits and to permit uninsured older workers to buy into Medicare coverage, and $35 billion is reserved to augment the President's proposal for prescription drug coverage to provide catastrophic coverage for the elderly. Another $91 billion of the surplus is allocated to the President's initiative to expand health care coverage under the existing State Children's Health Insurance Program and to extend coverage to the uninsured parents of those children.

The President's proposed tax cuts would help low-income working families support child care, reduce the marriage penalty, reduce the burdens of the alternative minimum tax, encourage savings for retirement, make higher education more affordable, aid in school construction and renovation, help those with long-term health care needs, and extend health insurance coverage. It would also promote philanthropy, encourage energy efficiency and protect the environment.Overall, these tax proposals would use $256 billion of the projected surplus.

The balance of the President's policies yields a small net savings, and these policies include proposals to restore the farm safety net and have the budget savings that are associated with our tobacco policy. Discretionary spending is actually below the baseline, and net interest costs is part of this as well.

A balanced approach requires that each element be properly sized. If a tax cut grows within the bounds of a realistic surplus projection, it precludes strengthening Medicare and extending health care coverage through the Child Health Insurance Program.

Overall, the President's budget proposes a balanced set of investments in the context of fiscal discipline. It would reduce the size of government to the lowest level since 1966, and it would pay off our debt by 2013.

It is a pleasure to be here, and I would be delighted to answer any questions that you have, Mr. Chairman.

[The prepared statement of Jacob J. Lew follows:]

PREPARED STATEMENT OF HON. JACOB J. LEW, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

WE MUST MAINTAIN SOUND FISCAL POLICY IN AN ERA OF SURPLUS

For 3 years now, we—the administration and the Congress—have faced a new challenge: maintaining a sound fiscal policy in an era of surplus. Having fought our way back from large and expanding deficits that threatened our economy, we now continue the fiscal discipline that has brought us the strongest economy in memory.

Budget surpluses and debt reduction are no longer just projections. We ran a $69 billion surplus in fiscal year 1998, and did not spend it. We ran a $124 billion surplus in 1999, and did not spend it. Eight short months from now, we will have an even larger surplus in fiscal year 2000. From 1998 through the end of 2000, we will pay off $297 billion worth of publicly held debt. It should be clear by now that we can run surpluses and pay down our public debt—if we create the right processes and policies to maintain that fiscal discipline.

We must now continue a fiscal policy that is working. Our new challenge boils down to relying on realistic assumptions and baselines, setting priorities, and making choices to maintain a balanced program. It requires addressing our existing commitments before we make new ones.

The President's budget relies on realistic assumptions and reflects balanced priorities.

ECONOMIC PERFORMANCE REFLECTS FISCAL POLICY

It is useful to begin by reviewing the state of our economy, because it shows how much is at stake. Though the private sector is the engine for economic progress, fiscal policy can encourage or discourage growth.

Our fiscal discipline has helped achieve a rapid growth of business investment, because the Federal Government has stopped draining the Nation's pool of capital. This has helped to accommodate lower interest rates, and has reduced fears of inflation. Businesses have better access to capital and are better able to invest and innovate.

Under this administration, we have enjoyed the best sustained growth of business investment since the 1960's. We have seven consecutive years of double-digit inflation- adjusted growth of business equipment investment—which is unprecedented.

Economic progress has reached almost every facet of our economic life, raising living standards for most Americans.

• The economy has created 20.8 million jobs since 1993, nearly all of them in the private sector—most of them full-time and in high-paying industries.

• The unemployment rate is the lowest it has been in 30 years; for African Americans and Hispanics, unemployment is lower than at any time in the quarter-century for which statistics have been kept. A record percentage of adults are employed.

• Work has begun to pay more, reversing a two-decade trend of declining real wages and boosting household incomes throughout the economy. Cumulatively, since the beginning of the Clinton administration, real wages have increased by 6.6 percent.

• After two decades of decline and stagnation, Americans at the lower end of the income scale—those in the poorest 20 percent of households—have seen a rise in their real incomes. From 1993 to 1998, their incomes have risen by nearly $900 per household in 1998 dollars, a 10 percent increase. The median family's income has grown by 12 percent.

• In the past 7 years, 7.2 million people have left the welfare rolls, a 51 percent decline. Welfare recipients now account for the lowest percentage of the U.S. population since 1967. Meanwhile, 1.5 million people who were on welfare in 1997 are now working, and every State has met the overall work requirements mandated by the 1996 welfare reform law.

• From 1993 to 1998, the number of poor people in America declined by 4.8 million, and the number of poor children by 2.1 million. The poverty rate has declined sharply from 15.1 percent to 12.7 percent, the lowest it has been in over two decades.

• Crime rates are at the lowest level in over 25 years.

• A record number of Americans now own their own homes, which was made possible by lower real interest rates and larger real incomes. The number of households that are homeowners increased by more than eight million since the President took office.

The President helped to set off this virtuous economic cycle with his 1993 economic plan.

WE HAVE MADE ENORMOUS, UNPRECEDENTED FISCAL PROGRESS

In 1998 and 1999, we had the first consecutive balanced budgets since 1957. We expect a larger surplus in 2000, and we propose a still-larger surplus in 2001. The 1999 surplus was the largest as a percentage of the economy since 1951. And the proposed 2001 surplus would be the ninth consecutive year of fiscal improvement—the first time ever.

After 12 years of spiraling debt threatening to expand beyond control, we are now paying off the debt. By 2013, the United States will be effectively debt-free—for the first time since 1835, when Andrew Jackson was President. By the end of this year, the Treasury expects to have reduced our debt held by the public by about $300 billion from where it was 3 years ago. Under the President's fiscal policy, debt held by the public by the end of 2004 will decline to the lowest ratio of our GDP since 1974—completely undoing the debt buildup of the 1980's. And by the end of 2007, the public debt will fall to its lowest share of the GDP since before the United States entered World War I.

HOW WE ACHIEVED THIS UNPRECEDENTED ECONOMIC AND FISCAL PROGRESS

When President Clinton took office 7 years ago, the budget deficit was $290 billion, the largest in the Nation's history. Between 1980 and 1992, publicly held debt quadrupled, from about $700 billion to $3 trillion. It also doubled as a share of GDP, from about 25 percent to about 50 percent.

Both CBO and OMB projected that these adverse trends would accelerate without changes in fiscal policy. OMB forecast the 1998 deficit, in the absence of policy change, at $390 billion; by 2003, we expected the deficit to be $639 billion. Nothing indicated that the vicious cycle would abate.

Reversing these adverse trends required tough policy choices, which the administration and the Congress took in 1993 and 1997.

The President's initial economic plan cut spending and increased revenues in equal amounts. From 1994 through 1998, deficit reduction more than doubled prior estimates—instead of the projected cumulative $505 billion, deficits fell by $1.2 trillion.

This administration has controlled Federal spending well beyond the record of its predecessors.

- In 1999, spending declined to its smallest share of the GDP since 1966.
- As a percentage of GDP, spending in every year for which President Clinton submitted a budget has been lower than in any year of the two preceding administrations.

In 2001, our policy would further reduce spending to 18.3 percent of GDP. And thanks to the strong economy, receipts have grown beyond expectations, even though income tax rates on typical households are the lowest since the 1970's.

- A typical family of four with the median family income will pay a lower share of its income in income and payroll taxes this year than at any other time in a quarter century. Its income tax payment considered alone will be the lowest share of income since 1966.
- A family with income at one-half of the median level will pay the lowest share of its income in income and payroll taxes since 1965. It will receive money back from the Federal Government because of the earned income tax credit.
- Even a family at twice the median income level will pay less in income tax as a percentage of income than at any time since 1973.

The historic bipartisan Balanced Budget Agreement of 1997 has reinforced expectations of Federal fiscal responsibility. This has had a positive impact on interest rates and has helped spur economic growth.

In the last 7 years, we have enjoyed extraordinary economic performance in part due to sound fiscal policy. To continue our strong economic performance, we must continue along the path of fiscal discipline and prudent investments.

WE NEED A REALISTIC BASELINE, WITH ADEQUATE RESOURCES FOR A STRONG DEFENSE AND CRITICAL INVESTMENTS IN THE FUTURE

Since 1993, discretionary spending has declined in inflation-adjusted dollars. The Federal Government must continue to accomplish the missions assigned to it in a growing economy with a growing population. We often take for granted the need to maintain critical functions like air safety, law enforcement, the administration of Social Security and Medicare, and national security—both defense and diplomacy. We need realistic budget projections to provide funding for these essential functions that the Nation has a right to expect its government to perform well.

Realistic projections also needed to accommodate investments in education, families, protecting the environment, research and development and national security—all necessary to assure a better future. CBO served the policy process well this year by illustrating three potential discretionary baselines—only one of which I believe is realistic.

A discretionary budget baseline that would retain the 1997 spending caps is not realistic. Congress appropriated above those caps by tens of billions of dollars in both 1999 and 2000. To bring spending down to the caps in 2001 would require an unachievable 1-year reduction from 2000 program levels of almost $70 billion of budget authority—11 percent.

Likewise, a discretionary budget freeze over 10 years is unrealistic. The Congress increased discretionary budget authority by 7.0 percent in 1999, and 3.5 percent in 2000. A nominal freeze in 2001 would require a budget authority reduction from 2000 program levels of 3 percent. Extending such a freeze for 10 years would require program level cuts of 23 percent by 2010—assuming that defense would be frozen along with non-defense. Such reductions should not, and I believe would not happen.

If defense spending increases within the overall freeze, the implications for all other spending would be even more severe. Within an overall freeze, appropriating the President's 2001 defense request would turn a hard freeze into a 9 percent cut from 2000 levels for all non- defense programs. Any addition to the President's defense request would make the effect on non-defense programs even worse. This is just not realistic.

In contrast, a baseline that maintains the program levels enacted by the Congress last year would provide a sound basis to plan for the future. It would allow for continued investments in key program areas and for the maintenance of vital government functions.

A budget based on unrealistic assumptions is unlikely to stop necessary spending. What ultimately would suffer are fiscal discipline and the commitment to protect the Social Security surplus. If the surplus is exaggerated to make room for either tax cuts or spending increases, when discretionary spending cuts do not materialize, the non-Social Security surplus disappears. This means that both fiscal discipline and the Social Security surplus would be jeopardized. Moreover, any perception that fiscal discipline in Washington is on the decline would undermine our unprecedented economic progress.

Our projection of the non-Social Security surplus of $746 billion over 10 years provides substantial resources for a balanced program, in the context of realistic assumptions. The President's budget continues the fiscal discipline that since 1993 has fostered this era of prosperity and surplus. It uses conservative economic assumptions and a realistic baseline for discretionary spending. To stay on our successful budget track, we urge the Congress to consider this approach, and the President's specific policy choices as well.

THE PRESIDENT'S BUDGET FRAMEWORK RELIES ON A BALANCED APPROACH

The President's budget relies on a balanced approach, which maintains fiscal discipline, eliminates the national debt, extends the solvency of Social Security and Medicare, provides a tax cut and funds essential investments for our future.

- The President's budget projects a total surplus of $2.9 trillion over the next 10 years. Of that, $2.2 trillion is the surplus from Social Security, which is put in a Social Security solvency lock box and used to retire the Nation's publicly held debt. Beginning in 2011, interest savings because of the Social Security surplus will be transferred from the on-budget surplus to the trust fund, to extend Social Security solvency to 2054. These interest savings are substantial. In 1993, we projected that in 2010 interest would consume 23 cents out of every Federal dollar. Today we project that only three cents out of every dollar will go to interest. These savings permit the extension of Social Security solvency.
- The remaining on-budget surplus is $746 billion.
- Overall, $432 billion is allocated to Medicare: (1) $299 billion is contributed to the Medicare trust fund to extend its solvency for 10 years, to 2025; (2) $98 million is used for Medicare prescription drug policy along with several other health initiatives (including allowing uninsured older workers to buy into Medicare); and (3) $35 billion is reserved to augment the President's proposal for prescription drug coverage under Medicare, to provide for catastrophic costs to the elderly. Pending enactment of that policy, this sum, too, retires debt. (This debt reduction, combined with the Social Security surplus, allows the President to make the Nation effectively debt-free by 2013.)
- Another $91 billion of the surplus is allocated to the President's initiative to expand health-care coverage under the existing State Children's Health Insurance Program (SCHIP) and extend coverage to the uninsured parents of those children.
- The President's proposed tax cuts—to help low-income working families with children, to reduce the marriage penalty and the burden of the Alternative Minimum Tax (AMT), to encourage saving for retirement, to make higher education more affordable, to aid in school construction and renovation, to help those with long-term health care needs and to extend health insurance coverage, to promote philanthropy, and encourage energy efficiency and protect the environment—use $256 billion of the surplus. (The tax cuts alone total $351 billion, but they are partially offset by proposals to limit the benefits of corporate tax shelter transactions, and end other unwarranted tax benefits.)
- The balance of the President's framework policies yields a small net savings. These policies include the President's proposals to restore the farm safety net, the net interest cost of all of these initiatives, and the budget savings that result from the President's tobacco policy.

A balanced approach requires that each element be properly sized. If a tax cut grows within the bounds of a realistic surplus projection, it precludes strengthening Medicare and extending health care coverage through the Children's Health Insurance Program (CHIP).

The following discussion explains the various elements of the President's framework in more detail.

THE PRESIDENT'S BUDGET ELIMINATES THE DEBT

The President's plan will eliminate the publicly held national debt by 2013. That would be the first time our nation has been debt-free since 1835—when Andrew Jackson was President. The President's successful policy of fiscal discipline and deficit reduction has already allowed us to pay off $150 billion in debt, increasing to about $300 billion by the end of the current fiscal year. If we maintain our fiscal discipline, and eliminate the public debt, we can devote the savings from debt reduction to Social Security. Last year, the government paid $230 billion in interest costs to finance the national debt—payments that, under the President's plan, will become unnecessary.

THE PRESIDENT'S BUDGET STRENGTHENS SOCIAL SECURITY

The President's commitment to Social Security has resulted in general acceptance of the need to protect the Social Security surplus. Now, we must meet the next challenge by strengthening Social Security for the future. The President's framework transfers part of the on- budget surplus—$100 billion in 2011, rising to $211 billion in 2020 through 2050—to Social Security, to extend its solvency to 2050 (2054 with the President's proposed investment in equities). The President's plan to pay down and eliminate the national debt results in savings in interest costs, which fully justify these transfers for the solvency of Social Security.

THE PRESIDENT'S BUDGET STRENGTHENS MEDICARE

The President's framework extends the solvency of Medicare until 2025, with transfers of part of the on-budget surplus—$299 billion from 2001 to 2010, and further transfers in the next 5 years.

The framework also modernizes Medicare with a needed prescription drug benefit. This plan ensures that seniors get the drugs they need, as prescription drugs are now more central to medical treatment than they were when Medicare was established thirty-five years ago. Prescription drugs can save money by obviating the need for more-expensive subsequent in- patient treatment. Most elderly lack comprehensive and reliable prescription drug coverage. The budget expands access to preventive benefits, and improves Medicare management.

THE PRESIDENT'S BUDGET EXPANDS HEALTH-CARE COVERAGE

The President's budget framework addresses other health-care needs as well. For example, the budget expands the successful health insurance program (State Children's Health Insurance Program) for low-income children, and extends it to their working parents. Established with bipartisan support as part of the 1997 Balanced Budget Act, SCHIP has already enrolled two million children of working low-income parents.

THE PRESIDENT'S BUDGET ADDRESSES NEEDS IN FARM COUNTRY

The budget also provides a comprehensive farm aid package of $11 billion over the next 2 years, until the next farm bill is enacted. The President's package includes income assistance that responds to falling crop prices; a major farm conservation program; and targeted assistance to certain segments of the farm and rural communities.

THE PRESIDENT'S BUDGET HAS FAIR MIDDLE-CLASS TAX CUTS

The President's plan proposes $350 billion for tax cuts ($250 billion in net tax cuts) for America's working families.

- It reduces the marriage penalty for two-earner couples, by increasing the standard deduction and introducing an exclusion for part of the earnings of a second working spouse.
- It expands the Earned Income Tax Credit, to help America's hard-working low income families, especially larger families which are more likely to be poor than families with only one or two children.
- It helps families finance higher education, child care and long-term care, as well as expanding health insurance options for those facing unique barriers to coverage.
- The President's plan also establishes Retirement Savings Accounts, to give 76 million Americans the opportunity to build wealth and save for their retirement.

THE BUDGET CONTINUES THE PRESIDENT'S POLICY OF INVESTMENT

Education, in our competitive global economy, has become the dividing line between those who are able to move ahead and those who lag behind. Over the last

7 years, we have worked hard to ensure that every boy and girl is prepared to learn, that our schools focus on high standards and achievement, that anyone who wants to go to college can get the financial help to attend, and that those who need another chance at education or to improve or learn new skills can do so. The budget builds on the sustained commitment to make college more affordable by increasing the tax credit than funds higher education and increasing Pell grants and other college scholarships from the current record levels. It reduces class size by recruiting and preparing thousands more teachers and building thousands more new classrooms, as well as providing for urgent and essential repairs.

The budget expands access to after-school learning opportunities to help children, especially in the poorest communities. It recruits teachers in high-poverty areas and encourages school districts to pay teachers more through peer review. It ends social promotion by expanding after school learning hours to help students to earn advancement. The budget funds monetary awards to the highest-performing schools that serve low-income students, and helps States to identify and change the least successful schools. It invests in programs targeted to Hispanic students. It narrows the digital divide through technology centers in low income areas.

The budget promotes early learning by significantly increasing 21st Century Learning Community Centers. It makes child care more affordable by expanding tax credits for middle- income families, and establishes a tax credit for businesses to establish child care. It assists parents who attend college to meet their child care needs, as well as parents who choose to stay at home to raise a young child, and makes the Child and Dependent Care Tax Credit refundable. The budget proposes an expansion of the Early Learning Fund and builds on the expansion of the successful Head Start program to help meet the goal of serving one million children by 2002. It increases funding for the Child Care and Development Block Grant for poor and near-poor children.

Supporting families. The budget promotes responsible fatherhood by enforcing child support, and aiding the employment and training of low-income parents. The budget allows low-income working families, who need transportation to work, to own a modest vehicle and retain food stamp eligibility. And it provides health care to legal immigrant children, and restores Supplemental Security Income benefits to legal immigrants with disabilities and to legal immigrants in families with eligible children.

Extending prosperity to all of America. The New Markets Initiative provides tax credit and loan guarantee incentives to stimulate billions in new private investment in distressed rural and urban areas. It builds a network of private investment institutions to funnel credit, equity, and technical assistance into businesses in America's untapped markets, to target small businesses and help them to grow. The budget increases the number of Empowerment Zones and Enterprise Communities, which provide tax incentives and direct spending to encourage private investment, and provides more capital to the Community Development Financial Institutions program. The budget also includes significant funding increases for Native American communities, for enforcement of the Nation's civil rights laws, and for the partnership we have begun with the District of Columbia.

Fighting crime. The budget adds funds to hire 500 new ATF agents and 1,000 State and local gun prosecutors. It funds smart gun technology development. The budget also provides funds to prevent violence against women, and to address the growing law enforcement crisis on Indian lands. The budget strengthens border enforcement in the South and West. It combats illegal drug use, particularly among young people, through treatment and prevention, law enforcement, international assistance, and interdiction.

Research. The budget introduces a Science and Technology Initiative for high-priority long-term basic research, including nanotechnology—the manipulation of matter at the atomic and molecular level, offering the promise that medical science may one day be able to detect cancerous tumors when they comprise only a few cells. The budget also increases the Information Technology Initiative to invest in long-term research in computing and communications. It will accelerate development of extremely fast supercomputers to support civilian research, enabling scientists to develop life-savings drugs, provide earlier tornado warnings, and design more fuel-efficient, safer automobiles. The budget provides strong support for the Nation's two largest funders of civilian basic research at universities: the National Science Foundation and the National Institutes of Health.

Environment. The Nation does not have to choose between a strong economy and a clean environment. The past 7 years are proof that we can have both. The budget establishes dedicated funding and increases resources for the historic interagency Lands Legacy initiative to preserve the Nation's natural and historic treasures. The budget also supports the Clean Energy initiative, to reduce the threat of global warming, and Greening the Globe, to save tropical and other forests around the world. It supports farm conservation to upgrade water quality, the Clean Water Action plan to clean up polluted waterways, climate-change technology to increase energy-efficiency, and renewable energy to strengthen our economy while reducing greenhouse gases.

National security—diplomacy and defense. Our Nation now has the greatest opportunity in its history to advance American interests and values while building a better and more peaceful world. However, doing so requires leadership and engagement. This budget supports a democratic society and stronger economy in Kosovo. It proposes increased funding to ensure the continued protection of American embassies, consulates and other facilities, and the valuable employees who work there. It supports significant increases in funding for State Department programs to address the threats posed by weapons of mass destruction. In a fiscal year 2000 emergency supplemental, the budget provides critical assistance to the Government of Colombia in its fight against narcotics traffickers. It proposes funding to promote international family planning, contain the global spread of AIDS, and promote debt forgiveness for the world's poorest countries. The budget also increases programs that support U.S. manufacturing exports and continues our long-standing policy of opening foreign markets.

This budget builds upon our major commitment last year to maintain our military readiness. It provides additional resources to ensure that the military services can recruit and retain quality personnel, meet training standards, procure new equipment and spare parts, and maintain equipment in top condition. In addition, this budget provides resources for the Department of Defense and other agencies to combat emerging threats—including terrorism, weapons of mass destruction, and cybercrime against critical infrastructure. It supports counternarcotics efforts, including a 2000 supplemental to increase assistance to the Government of Colombia in their fight against narco-traffickers. It also provides additional funding for contingency operations in Kosovo.

THE BUDGET CONTINUES THE PRESIDENT'S DRIVE FOR BETTER MANAGEMENT

This administration set out to create a government that works better, costs less and gets results Americans care about. We have streamlined Government, cutting the civilian Federal work force by 377,000, giving us the smallest work force in 39 years. While we have made real progress, there is still much work to do. We have set a list of the highest priorities: 24 Priority Management Objectives are listed in this budget. It is a mark of our success that in early 2000, we were able to remove last year's number one objective from the list: Manage the Year 2000 (Y2K) Computer Problem. We will continue to address other priorities, including modernizing student aid delivery and completing the restructuring of the Internal Revenue Service. The steps we have taken to change and improve the way government works have also changed the way Americans view their government, increasing the confidence and trust of the American public.

WE MUST CHOOSE NOW TO MAINTAIN FISCAL DISCIPLINE

The President has recognized the need to maintain the fiscal discipline that has brought us not only unprecedented budgetary progress, but also the strongest economy in memory.

Under the President's leadership, we have maintained the surplus for the last 3 years. We can do it again. In the face of the demographic pressures that will begin to burden the budget in less than a decade, we must stay on this course—and create the right processes and policies to maintain that fiscal discipline.

Again, the President has measured the future in realistic terms, set his priorities, and made balanced choices. We are proud of our budget, and we commend it to your consideration.

Chairman KASICH. Thank you. Let me just ask you really two questions.

The first thing is, last year we had a vote on the Clinton budget up here in the House of Representatives, not much different than the budget you have presented to us today, and Mr. Spratt said the tobacco increase, additional fees, these loophole closings. I think the vote in the House last year was 425, no, and two, yes; and you sent us just about the same bill that you sent us last year.

So why would you do that? Why wouldn't you attempt to go back to the drawing board and send us something that has some chance of being enacted or some chance of making some progress? Maybe you will get four or six votes this year, I don't know. We will see. We are certainly going to have a vote at some point.

Why not change course? Why send us something that virtually has no support even among your Members?

Mr. LEW. Mr. Chairman, my recollection of last September, October and November is a little bit different. I recall negotiations where we prevailed on many important priorities in education, research and development, many, many areas. I think the President's budget last year and the year before served as the basis for much of the work the Congress accomplished, and we worked together on a bipartisan basis to reach agreements. I am quite confident that that will happen again this year.

We feel that the record we have had over the last number of years establishes that our budget is a good starting point, and our success in the end establishes that we prevail quite well. I think that we might not agree today and we may not agree over the next few days, but I am confident that by the time we come to September we will actually agree on many of the things in this budget; and I look forward to working on a bipartisan basis to get a lot of things done this year.

Chairman KASICH. Let me ask you about the Social Security and Medicare. What you essentially do in Social Security and Medicare is to put IOUs in these accounts, which represent a claim on future taxpayers. In other words, we as Americans owe the Social Security fund or the Medicare fund more dollars. So that extends the life of the program; it doesn't change the program. It doesn't reform the program.

We know by, I think, 2012 Medicare runs out of money. We know that soon after that we are going to be faced with Social Security—if we wait that long. I don't think we will. I think somebody will step up to the plate and show some leadership. How could you duck Medicare and Social Security another year?

Mr. LEW. I think we have actually done quite the opposite. We have proposed a budget that tackles many of the important issues regarding Social Security and Medicare.

Chairman KASICH. Such as?

Mr. LEW. In the case of Medicare, the President has proposed substantial reforms in the Medicare program to modernize the program, to increase competition that would partially offset the cost of the prescription drug benefit program. We think the prescription drug benefit ought to go hand in hand with modernizing the program and achieving some realistic and prudent savings.

Chairman KASICH. Jack, let me ask you, the extension of the life of Medicare is based on paying down debt and putting IOUs in the Medicare Trust Fund. What programmatic improvement or reforms have you put in place that extend the life of Medicare?

Mr. LEW. We have obviously taken the savings associated with the reforms and modernization and used them to offset the cost of the prescription drugs.

Chairman KASICH. That's not an answer.

Mr. LEW. It is an answer. We could have presented a budget that showed those savings extending solvency. The money can go either way. We have real reforms, we have real savings, we have real modernization.

Chairman KASICH. Which of those reforms have extended the life of Medicare?

Mr. LEW. On their own, the proposals that would promote competition on the fee-for-service side of Medicare, the proposals that would extend modest cost constraints after the expiration of the Balanced Budget Act beyond the life of the current provisions would all extend solvency.

Chairman KASICH. Aren't those savings spent?

Mr. LEW. They reduce spending of the trust fund. We separately have proposed the prescription drug benefit, and net, the combination of surplus dollars committed plus the savings, extend solvency to 2025.

Chairman KASICH. That is because you just put more IOUs in the fund. All of the programmatic savings that you make you use up in more spending.

Let us not argue then. We can go round and round for weeks. Let us go to Social Security.

What programmatic changes have you made in Social Security that has extended the life of Social Security?

Mr. LEW. I think if you look at the proposal that we have made to take the interest associated with paying down the debt and dedicating it to Social Security, there are two important things to point out. First of all, the interest reduction is coming as a result of taking the Social Security surplus and not spending it for any other purpose. No lock box will do any good for Social Security solvency unless it extends solvency by putting money back into the trust fund. We think that is an appropriate thing to do.

Chairman KASICH. IOUs. There is no money put in, correct?

Mr. LEW. The commitments are current law commitments to Social Security. There is nothing about our policy that does anything to increase a penny of commitments to Social Security. Unless one wants to advocate cutting Social Security benefits, those commitments are there. What we are saying is, before we undertake new commitments—and I don't personally care in terms of the analysis whether it is for tax cuts or for spending—you have to put the resources in keeping the commitments to Social Security, and that is what we have done. We have run a fiscal policy that produces surpluses. If we don't spend the money twice, if we don't spend it on a tax cut or on other new programs, we can put money aside for Social Security.

I think the reduction in interest payments is so dramatic that it bears repetition. When we started doing budgets in 1993, we expected to be spending 23 cents out of every dollar in 2010 to pay interest on the debt held by the public. When we reduced that 23 cents down to 3 cents, the question is what do you do with the remaining 20 cents. We are saying we should use that to extend Social Security solvency.

We are making a second proposal. We are saying that, of that money we put into the trust fund, half of it should go toward equity investment, half of it should go toward Treasury bonds, up until the point when equity totals 15 percent of the trust fund. We believe that is an important reform in Social Security financing. It is one that we look forward to a debate on.

Now, I can't challenge your proposition that there is a need for other policy changes. The President has spoken to that. He has spoken to the need for it to be undertaken on a bipartisan basis. We remain prepared to work with the Congress on a bipartisan basis toward those kinds of program reforms; but I think realistically we have to assess the year before us, and if we can take the first step of taking the interest savings associated with not spending the Social Security surplus, and we can dedicate that to extending solvency, we will have accomplished something very important.

Chairman KASICH. Well, Jack, then essentially there are no programmatic changes in either of these programs where the people who estimate the life of these programs will give you one nanosecond worth of extension of these programs. The fact is, Mr. Stenholm and Mr. Kolbe have a Social Security proposal, Mr. Archer has a Social Security proposal, I have a Social Security proposal, Mr. Smith has a Social Security proposal that deals with comprehensively creating private accounts—in my case, saying the baby boomers in the short run will have to give something up for their children in the long run.

The President doesn't have one single plan on that, not one single proposal. He has done nothing other than put more IOUs that everybody in this room owes the government without making one change in the outflow of dollars, not one single dime worth of change. And I have got to tell you, if I were the budget director—and I wouldn't have that job.

If I were the budget director and my President didn't want to be in a position to tackle the two biggest challenges that we have in the country—I would just tell you, we are all going to get out of this business and we are going to meet one day and maybe have a cold beer and kind of look back, and I think you are going to regret the fact that you really didn't have the courage on these programs. Oh, yeah, we paid down some debt, thank God we did. We are the ones who told you to keep your mitts off Social Security, let us not forget that.

The fact is, politicians today don't want to deal with these issues; some do, but most don't. Some on a bipartisan basis do, but we are punting on Social Security and Medicare; and it is tragic because what it is going to mean is, right now, if we got on it, we could do it, we could handle it, but every day you wait you get yourself deeper and deeper in a hole.

And I am disappointed that you have done it, that you have done this, and I guess we will turn it over to the next administration and kind of duck it again this year. We will get back to it because we will be forced to.

Mr. Spratt is recognized.

Mr. SPRATT. Mr. Lew, basically what we are doing is allowing Social Security to not only keep the $2.2 trillion that will accumulate over the next 10 years, but by not otherwise spending it, by paying down corresponding public debt, we are adding to net national savings——

Mr. LEW. That is correct.

Mr. SPRATT [continuing]. In the same amount of money.

Now, nobody has tried to estimate the impact on our economy because it invites a lot of very judgmental decisions about exactly what that will do to the economy, but surely $2.2 trillion in additional savings over the next 10 years, $3 trillion before we begin to really experience the onslaught of the baby boomers, is bound to have a solid impact on the growth of the economy, bound to be a boost. Wouldn't you agree?

Mr. LEW. Yes, I would agree; and I would also point out that by using conservative economic assumptions, we have not taken credit for any of those kind of effects.

Mr. SPRATT. I understand and you shouldn't.

Mr. LEW. I don't believe we should.

Mr. SPRATT. And secondly, if we do follow the path that you have plotted, we will go from 18.7 percent of GDP in government spending to 16.7 percent. Instead of being at 23 percent as we were at the peak of the Reagan years, we will be 7 percentage points lower; and if we have to raise money from the economy to meet obligations of Social Security and Medicare, we will be far better positioned in the Treasury to do it because we have taken these steps now.

Mr. LEW. I would actually go a step beyond that, Mr. Spratt. We do long-term projections, and the long-term projections that we currently have show that we are running unified budget surpluses until I am roughly 100. That, to me, is the definition of a pretty sound fiscal forecast. We are not looking at going back into deficits anytime soon, and we factored in paying all of the bills we owe—all the bills to Medicare, all the bills to Social Security.

The only thing that could jeopardize that is if we make other commitments that make the resources not be available. If we have too large a tax cut or too large a set of new programmatic initiatives that throw those projections off, then the question would arise, can we pay the bills.

I think one of the things that we need to do as prudent fiscal stewards is take a look ahead and make sure that everything fits, without putting us back into a deficit; and if that is the case, we have actually done quite a bit we can be proud of in terms of managing the budget and our fiscal affairs.

Mr. SPRATT. Let me turn to the other end of the budget, nonentitlement spending, discretionary spending. I think you would agree in the budget equation this year that is the biggest variable.

Mr. LEW. I think in terms of where we begin it is certainly the biggest variable, and I am proud we are presenting a budget that invites the kind of honest decision making where we all look at each other and ask, what is and is not possible. I tried in my opening remarks to point this out, but if I could just underscore, the notion that we would sit here today with the kind of surplus we are looking at and make cuts that would reduce our ability in the country either to provide for our national defense or invest in our children for the future is just not realistic.

On the other hand, we do not believe that discretionary spending should be unconstrained. We have proposed extending discretionary caps for 10 years, but at realistic levels, levels that we can all live with and levels that give us the ability to make balanced judgments on the other part of the budget.

Mr. SPRATT. Specifically, how much of an increase in discretionary spending are you talking about between this year, 2000, and next year, 2001, and then over the 10-year period of time?

Mr. LEW. Well, over the 10-year period of time we are actually projecting growth at slightly below the current service's inflation level. So we would save $33 billion over 10 years compared to a simple inflated baseline. That obviously over 10 years is pretty close to the no-real-growth projection.

In the first year, our outlays are actually below the no-real-growth level, and our budget authority is a little bit above. The reason is largely defense. Our defense path, as you noted in your opening remarks, had very significant increases from 2000 and 2001. We have stuck to that level of defense policy. We have provided additional funding in defense for unforeseen circumstances in last year's budget, in particular Kosovo and fuel price increases. So we think that the best way to look at the budget is over the 10-year period.

Mr. SPRATT. Let me ask you about one other aspect and I will turn it over to other Members.

Tax cuts. Your budget provides for spending increases that would keep discretionary spending pretty consistent with inflation, zero real growth over a 10-year period of time. It also provides for returning some of the surplus to the American taxpayer.

What sort of tax cut are you seeking? How much is it? What is the gross amount? What is the net amount? And who benefits from it?

Mr. LEW. Well, the net tax cut, the amount of the tax cut that we financed from the surplus is $256 billion. The design of the tax cut, as the President made clear in the State of the Union, and as I have tried to make clear in my remarks today, is really to target working families, to take care of the needs that working families have to provide for child care, health care, to provide communities the resources to invest in a clean environment and new schools; and they are not a kind of across-the-board tax cut. We have a marriage penalty provision which we think is properly sized, and we have tried to come up with a balanced approach.

The alternative of a much larger tax cut, we think forces one to make judgments about how to allocate the existing resources. We think that if the tax cut grows much larger than $256 billion net in terms of the draw on the surplus, then it puts in real question whether one could finance the increases in Medicare for prescription drugs or in the child health program so the kids and their parents could be covered. These are the kinds of priorities we ought to be debating this year.

We think we have the right balance. We think we have the right priorities. It is not a question of who is for or against a tax cut. It is a question of how big it can be and what it squeezes out.

Mr. SPRATT. One final question: You estimate the net surplus that you provide for discretionary, roughly the rate of inflation, as $746 billion over 10 years. CBO, using basically the same baseline for discretionary spending, comes out with $838 billion. Will a surplus in that range sustain a tax cut of $400 or $500 billion over the next 5 years?

Mr. LEW. I don't believe it would, Mr. Spratt. The projection that we have of $746 billion and the projection that CBO has of $838 billion are really quite comparable. Over 10 years it is rare for forecasters to come out that close.

I think that is a realistic range. If we were in a debate over that range of difference, I think we would be at a good, fiscally prudent starting point. Within that box there just isn't room for a $500 billion tax cut without completely eliminating the opportunity to invest in other important things like Medicare, prescription drugs and child health and parents' coverage.

I think that to go outside of the box puts at risk our fiscal policy. I don't believe the savings will materialize, and I think we would end up spending more money than we really have. I think if we are in a debate of $750 to $800 billion, we are in the right range of surplus to be talking about. If we are talking about $1.8 or $1.9 trillion, I think that is not realistic.

Mr. SPRATT. Thank you very much.

Chairman KASICH. Mr. Chambliss is recognized for 5 minutes.

Mr. CHAMBLISS. Thank you, Mr. Chairman, and I know you referred to this budget as being the first budget of the new millennium, but I have to be honest with you, I look at this budget as being, more importantly, the last budget of the Kasich era. You know, we have been through some very difficult times over the last 5 years, and I think it goes without saying that this administration—and, Mr. Lew, you obviously were a part of it back then—was under the public commitment that the budget of this country could not be balanced over a 5-year period.

Thank goodness for John Kasich, who led this committee down the path of believing that the budget could be balanced in 5 years; and after a severe fight in 1995 and another one in 1996, another one in 1997, John, you did magnanimous work in getting us to a balanced budget that nobody in the administration really thought we could accomplish.

Mr. Spratt has already stolen my thunder about little Emma and Reese, but I think their legacy is what this is all about, because we talk a lot about what we are going to do for our children and grandchildren. But, John, you have certainly lived up to your word in trying to make sure that your children are not left with a huge deficit out there that we have been spending for all these years.

And I guess I am not surprised to hear you say, Mr. Lew, that you don't think that holding down spending is realistic. I am not surprised at that statement because it is very obvious, looking at—every single budget that this administration has presented since I have been in office has called for an increase in spending every single year, and this year is certainly no exception, but you know, we can't continue to go down that path. And what really disappoints me with this budget is that instead of looking at some way to reduce Federal spending and to make reforms and programs, this administration thinks that the answer to the problems out there are to continue down that road of increasing spending.

Now, there are real reforms that can be made in every single agency in the Federal Government. We all know that. We say it over and over again, but this is the real opportunity that we have to insist that every agency examine themselves and make real reforms; and if we don't do that, then what we are going to do is take the attitude that this administration has of solving problems simply by throwing money at it. Now that is not going to work.

Now, there are two particular areas that I have an interest in, and that is defense and agriculture, and even though I am the biggest defense hawk in America—there you go, John—and I am certainly a strong advocate for farmers all across America, and I believe that we have got to look out for those folks, at the same time I have a strong recognition of the fact that there is waste, fraud and abuse going on at the Department of Defense, and there is waste, fraud and abuse going on in the Department of Agriculture, and we are going to look at some of those issues and some of those areas in the coming weeks.

But, you know, when you look at the budget that the President has come forward with this year, the defense budget, it is obvious to me that there is a clear admission on the part of the administration that they have been wrong for 7 years and the Republicans have been right, and that they have not been spending enough money on defense. You have made admission after admission in this budget that recruiting is down, retention is down, purchase of weapons systems is not what it should have been, spare part inventory is not what it should have been. We have got too much cannibalization going on out there. We are not flying airplanes that ought to be flying, we are not sailing ships that ought to be sailing, and we have not done a good job with defense.

With respect to agriculture, I think you have done the same thing. You have not looked at reform of programs like crop insurance. You have simply thrown money at the problem, and I will have to tell you, Mr. Lew, that our farmers don't want handouts. Our farmers want a fair market in which to sell their goods, and if you travel down the path of trying to create a fair market for our farmers, then you will go a long ways toward solving the problem that we have in agriculture today as opposed to simply throwing more and more money at the problem.

There is not one single aspect of this budget that deals with the issue of regulatory reform that will save our farmers money. There is not one single aspect of this budget that looks at trade so that we drop some of the barriers out there to try to improve trade so that our farmers can sell their products at a fair price across the world. So, very honestly, I am disappointed in this budget.

You may be right that at the end of the day, next fall when you come back, there will be tax increases in here, there will be more spending in here; but I just guarantee you today, Mr. Lew, this Member of Congress is not going to vote for your tax increases. I am not going to vote for your increase in additional spending that is going to be a burden upon my children and my grandchildren.

Thank you, Mr. Chairman.

Chairman KASICH. Mr. Minge is recognized for 5 minutes.

Mr. MINGE. Thank you, Mr. Chairman.

I would like to join in welcoming you, Mr. Lew. We certainly appreciate the care that you have gone to to work with our committee and to present in a very lucid fashion the budget proposals from the administration over the last several years.

I would also like to thank the chairman of the committee for the leadership and the challenge that he has issued to us continuously, not that we have always agreed with the nature of the challenge but certainly it has made all of us think very carefully about our responsibilities here in Congress.

I would like to turn to two factors which I believe have been emphasized in this budget proposal which I think are important for our country. The first factor is paying down on the national debt. This has become a mantra that people on both sides of the aisle have embraced. And, secondly, dealing responsibly with the other opportunities that we then have to reduce taxes and to strengthen programs.

I would like to sort of have you put in framework the debt reduction piece of this effort and tax reduction, because, as I understand it, we are apt to have on the floor within a week a fairly significant tax reduction proposal which would cost close to $200 billion. I am wondering, can we fit this type of a tax reduction proposal into our budget efforts and still expect to pay down on the debt and achieve the savings in interest rates and other things which I understand are a very important dividend for the American people?

Mr. LEW. Congressman Minge, I don't believe that if the tax cuts total a very large number, whether that is $500 billion or a trillion, whatever they add up to, you can accommodate the kind of fiscal policy we are talking about. The bill that has moved out of the Ways and Means committee is just one element of it. It is just the first installment. It is a policy that I think we all agree on, that there ought to be action taken to address the marriage penalty. But the size of it, $182 billion, suggests that when you get done adding each of the other pieces that it will just be an enormous package.

What we keep emphasizing is not whether one is for or against a marriage penalty provision, because I think we agree that we all want to address the marriage penalty. The question is, how big should that be as part of an overall balanced tax package and as part of an overall balanced economic program?

I think that you look at the substance of that bill, and in fact many of the dollars go not to people who pay a marriage penalty but people who actually get a marriage bonus. So I don't think it's a terribly well-crafted proposal, and the size of it is just not compatible with other tax proposals and other spending priorities. That is why Secretary Summers sent a letter to the Congress last week, and we've indicated that we have very, very serious problems with it.

I think that the notion of tax relief being part of the balanced use of the surplus is a given. We have put $256 billion of the surplus into tax relief. We think that is the right size. We think that one can address a variety of very legitimate needs for tax relief while addressing Medicare and health care coverage.

If I could just go back one moment to something Mr. Chambliss said, to correct something, we have not proposed increased spending. The chart that I have up there shows we proposed lower spending every year as a percentage of the economy from when we came in. I think the question is, how do you take all of the different pieces and keep them together in a balanced way? I think we have done that. I think there is a real danger if you go piece by piece and let the pieces at the front end get very large, that it just won't add up.

Times of surplus require that we exercise fiscal discipline just as times of deficit do. It is actually in a funny way more difficult. Because when there is a surplus, it seems like everything is possible. When there was a deficit, everyone was focused on getting to zero and we worked together. I am very proud of having worked with the chairman and the ranking member in 1997 on a bipartisan basis to take some very important steps. We may have to work together on a bipartisan basis with the surplus but to have a realistic balanced use of it, we must be prudent in terms of how we do it.

Mr. MINGE. I certainly feel it is a slap in the face at this committee to have a very large and actually in some respects a very attractive tax reduction proposal come to the floor without at least considering how we craft a budget first. We are putting the cart before the horse. I know it is Valentine's Day. We all would like to give a valentine to people contemplating marriage. Certainly this is something we should try to work on.

Thank you very much.

Chairman KASICH. Mr. Shays is recognized for 5 minutes.

Mr. SHAYS. Thank you, Jack. It is nice to have you here.

I do agree in the end we can find some common ground and work on a bipartisan basis, but there will clearly have to be some changes from what the President has proposed to ultimately what we agree on. I would like to know, how many Federal programs does your budget propose eliminating or reforming?

Mr. LEW. I can't give you a count of programs. We proposed very different funding levels for every different Federal program. We have some things that we have reduced substantially.

I can give you some examples, and we may not agree on them, but things like local law enforcement block grants, we have proposed lower funding levels, eliminating some things. We put more money into our COPS program. We think that is the right way to make priorities. In the area of EPA, we have reduced funding for the State revolving funds because we have reached a level of capitalization. We no longer need the same level of contributions. We have removed funding for many earmarks because we think that is not the highest and best use. I haven't done a count of them, but we have gone through the budget item by item making case-by-case judgments—what should go up, what should go down.

Mr. SHAYS. But, by your count, how many new programs have been established?

Mr. LEW. I haven't done a count. We tried very hard to design a budget that would, to the minimum extent, require new authorizing legislation, very conscious of the time pressures this year. We have tried to do everything within existing authorizations. There may be a few exceptions to that. But in general we were very conscious of the fact that we wanted to be able to work through the appropriations process to fund our priorities.

Mr. SHAYS. Last year you set aside 62 percent of the unified budget to pay down the debt of Social Security. How much do you set aside this year?

Mr. LEW. We have taken the entire Social Security surplus and set it aside in a lockbox. It is $2.2 trillion out of a 10-year total of $2.9 trillion. I haven't done the percentage, but it is $2.2 trillion out of $2.9 trillion.

Mr. SHAYS. With defense, have you identified any wasteful programs that you could eliminate?

Mr. LEW. In defense, we have worked with the Defense Department very, very hard to design a budget that would meet the needs of the policy set forth last year. That means some things go up and some things go down. I think that we are very proud of the management reforms that the Department of Defense has undertaken in the areas of procurement, in the way it manages many aspects of the day-to-day business.

Mr. SHAYS. But the bottom line is there is no major program that——

Mr. LEW. We have reduced funding for things that weren't requested in prior years. We have provided resources to pay for the cost of operations that we couldn't expect. Like every other aspect of the budget, we worked with the Defense Department item by item.

Mr. SHAYS. I only have 5 minutes. I need you to be a lot more punctual here.

With the Japanese, they pay over $3 billion, 75 percent of it nonsalaried costs of our troops in the Pacific theater. The Europeans have 100,000 troops. The Japanese have about 40. The Europeans pay less than $200 million. Have you made any effort to do the same kind of burden-sharing in Europe that we require of the Japanese?

Mr. LEW. Congressman Shays, I can't address the specifics of burden-sharing in Europe. I can tell you that with the Pentagon and the State Department——

Mr. SHAYS. Let me get to taxes then.

Mr. LEW. If I could just give you half a minute of an answer. We have worked very hard to try and keep burden-sharing in mind because we know that we have to improve burden-sharing.

Mr. SHAYS. We have the highest level of tax revenue coming into the Federal Government. Basically, it was 20.4 percent of GNP in 1945. We are now at 20.7 percent. Your tax cut—your net tax cut when you add fees in the next 10 years is only $77 billion. It is only $28 billion net tax cut in 5 years. Why so little?

Mr. LEW. I don't think I would do the calculation the way you did. I think you are adding together things that we don't think appropriately should be added in figuring out the net tax cut.

Mr. SHAYS. Even if you take out fees you are only cutting in 10 years $146 billion.

Mr. LEW. You are counting our tobacco policy as a tax increase. I would argue very strongly that our tobacco policy is, first and foremost, an effort to stop youth smoking in this country, if you take away the profits associated with selling cigarettes in general.

Mr. SHAYS. My time is up. The bottom line is it is a tax increase. Please don't come here and say you are not increasing taxes.

Mr. LEW. We have designed a youth penalty to make it not be profitable to sell cigarettes——

Mr. SHAYS. But is it not a tax increase?

Mr. LEW. It is receipts to the government. Whether or not it is a tax increase is something we could debate.

Mr. SHAYS. I don't think we could debate it. It is a tax increase.

Chairman KASICH. Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman.

First of all, let me just say, Mr. Lew, I think the budget here today—there are really two budgets. There is the macrobudget that lays out the Nation's fiscal policy as the administration would like to see it, and I think—I appreciate the fact that you have put such great emphasis in paying down the debt.

I would remind my colleagues on the committee, last year when we marked up the budget in this committee, the budget that ultimately failed, I offered an amendment that would have extended the paygo rules, would have extended the spending caps forward and would have committed all of the surplus to paying down the debt. Needless to say, that amendment was defeated overwhelmingly by this committee.

Now, my colleagues have decided that maybe something along those lines isn't such a bad idea, so maybe I am smarter than I think I am. I appreciate what you have done there.

I think the second part of your budget is the micro part of the budget where you talk about new ideas. Some of them are good, and some of them aren't. But I have a little bit of problem when my colleagues stand up and say, well, you gave every special interest something in this budget.

I have got a young woman who lives in my district named Carolyn Rawley who has juvenile diabetes. Her outlook is not particularly that great. I have two kids, two daughters. I am fortunate that they don't have that problem. They don't have to take insulin every day. This budget increases NIH. My colleagues have come a long way on that. They weren't for that in 1995, and they have come a long way on that.

This budget addresses the problem of kids who should be in the Medicaid program but can't get in there because the States have made it so hard to sign up. The State of Texas—and we all hear a lot about the great State of Texas where I am from—the State of Texas has the highest number of children who are Medicaid eligible and not enrolled in the program, 800,000. That number has been going up over the last couple of years. That is a national tragedy. Who pays for that? The taxpayers in my district through the public health system, the public hospitals.

The Republican county judge has just announced that they are going to raise taxes in Harris County to pay for indigent care because these kids aren't signed up for Medicaid. So you address that. The woman who needs treatment for breast cancer is addressed in this budget. Those are things that are on target. I think it makes sense.

The clinical trials, I have introduced legislation on that. I met a woman whose insurance company wouldn't pay for the clinical trials. She is in Medicare, has an HMO. Her last chance is through a clinical trial at M.D. Anderson Hospital in my district.

Those are good things. Yeah, there are things in Medicare that I don't care about, but the other thing, I would remind my colleagues, it is not do as I say, not as I do.

My colleagues, the chairman talks about no Social Security plan. I think paying down the debt is one of the best things we can do for Social Security from an economic perspective. The fact is, what happened to the Archer-Shaw plan? You are in the majority. Bring it to the floor. But you didn't bring it to the floor. The fact is that you have put ideas in here. Some of these are good and some that aren't.

I also want to ask about the funding issue. Because my colleague, Mr. Chambliss, made the point there are two issues that he cares a lot about, defense and agriculture, two areas where we increased spending last year, $17 billion in defense and about 7 or $8 billion in agriculture, over what the caps were that we set in 1997. It is Congress who makes these laws. The President sends up the budget, it gets beat around, and Congress ultimately makes the laws. All my colleagues understand that or should understand that. That is why you ran for this office.

If you go around the horn here, every Member will raise their hand and say what program they think needs to be funded, that you have to put more money in. The problem is you get to the end and it tends to be more than caps. Can you tell us what the historical annual growth rate in discretionary spending, both defense and nondefense, has been since 1995 when the Republicans took control of the Congress? And also can you tell us are you eliminating the spending caps and paygo rules in this budget or are you maintaining fiscal discipline in this budget?

Mr. LEW. The increases in spending have been present on a year-to-year basis every year. The numbers I can give you off the top of my head, 1998 to 1999 through the present. 1998 to 1999 it went up 7 percent, 1999 to 2000 it went up 3.5 percent. We are proposing for 2001 that we go up 3.9 percent, so that it is roughly last year's levels, far below the 1998 to 1999 level.

I think that you have put your finger on what the real definition of realistic discretionary levels are. If no one is willing to advocate what it would take to reduce spending for veterans, for health care, for education, as I don't believe they should have to where we are right now, then we ought not to assume that in the aggregate we are going to spend less. The burden is really on those coming forward with lower levels I think to say what it is they would reduce. I think we have come up with balanced priorities, but reasonable people could disagree. We would welcome a discussion on that.

In terms of the caps, what we have done is we have looked ahead not to getting rid of the caps but to having realistic caps that could actually be in force from year to year. Caps do more good if you use them as a planning tool and an enforcement tool than if you spend most of the year trying to figure out how to get around them.

Last year and the year before, it taxed all of our creativity to understand what we were doing to get around the caps. I have got to tell you, sitting down to do this year's budget, it was a challenge just to figure out what happened in 2000. That is not the right way to do budgets. It is not the right way to enforce fiscal discipline. We have tried to get back on a clean slate. I am not sure we got all the way there. It was very complicated. But I think we made a very, very big step. We would like to work together to try to get all the way there.

Mr. BENTSEN. Thank you, Mr. Chairman.

Chairman KASICH. Mr. Nussle.

Mr. NUSSLE. Thank you, Mr. Chairman.

What a difference a few years makes. As late as last year the President submitted a budget that wasn't balanced, spent the Social Security Trust Fund and broke the spending caps. Now, all of a sudden the President rushes in in here in his final year as President and took 8 years to get to this point but finally proposes the first balanced budget, proposes not to touch the Social Security Trust Fund and offers a tax cut.

You are not good at it yet, but you have finally come around to our way of thinking. We want to appreciate you for that. We think we can help you with your goals about keeping the budget balanced and paying down the debt and Social Security, keeping your mitts off of that and providing the tax cut. We are going to introduce a budget that can do just that. You are not used to it yet.

After 8 years of trying, you have, as I say, finally come around to a way of thinking that I think this committee, in a majority sense, appreciates. We do have to commend you for that. But I think we also have to look at whether or not your budget is realistic, even within that framework.

First of all—I guess the first question I have that I would ask my constituents, is this a time when we ought to be raising taxes? Well, most of my folks back home tell me that, no, if anything they are taxed enough or they are taxed too much. But I don't think anyone is suggesting back home that they are not taxed enough.

So then the next question I would ask is should we add about 85 new programs? I know there is a cute little thing in here, is there anything that needs to be newly authorized? You and I both know that is a game that they may not understand back home in Iowa, but there are 85 new programs that we have found so far, since you have submitted your budget, and we are still looking. Eighty-five new programs and proposals. Is that a time we ought to be doing that here in this country?

Most of my constituents think that government in Washington is probably already big, spends too much, and the government back—closer to Manchester, IA, and Des Moines, IA, and Iowa in general and across our country at our State and local level is probably better government.

So then the third question I would ask my constituents back home is, is this a time when we finally have gotten to a surplus that we ought to tackle big issues such as Social Security, such as Medicare reform, such as paying down the national debt? And to a one in my town meetings that I held during the month of January they said exactly, this is time to focus in on paying down the national debt, not more government spending. This is the time that we ought to focus in on Social Security reform, not this gimmick of IOUs. You can IOU yourself to death out here with all of this banter you had with the chairman.

The fact of the matter is, it is still paper. It is not money that is available for future generations. There are kids and grandkids that came to my town meetings that said now is the time to focus in on that.

Finally, Medicare reform. Not one thing in here for rural health concerns of Medicare where most of our seniors are located right now. And there are hospitals closing across our country, having a difficult time making ends meet. Not one scintilla of reform for those hospitals, for those providers that are on the front lines of providing quality health care in rural America. Not one bit—except for more IOUs and a prescription drug benefit that doesn't even phase in for 4 years.

Now, I think we ought to have five proposals or five principles. We ought to first balance the budget and pay down as much national debt as we can, we ought to continue to protect Social Security, and we ought to look at some of these proposals that are out there for reforming Social Security. We need to provide tax relief, not tax increases, but not just relief for the sake of relief. It has to be fairness.

I think the marriage penalty is unfair. You can talk about it in terms of numbers, but when it comes right down to it these are people that are dealing with it as married couples.

There ought to be a real prescription drug benefit, not one that is put in there on the backs of rural America in particular because you don't have real reform in Medicare.

Finally, we ought to continue our commitment to education and national defense. The increase that you have in here with a 40 percent mandate for special education is almost criminal. The reason our folks back home in education are having a difficult time building schools and repairing schools and buying textbooks is because you keep forcing down a mandate on special education without proposing the kind of increases that the Republicans did last year. We are going to continue that commitment.

Those five principles I think are the ones that we should focus on, Mr. Chairman, as we write our budget. Thank you.

Chairman KASICH. Mr. Davis.

Mr. LEW. May I respond?

Chairman KASICH. If you want.

Mr. LEW. Mr. Chairman, Congressman, I would respond, first of all, by saying that we have presented the first two balanced budgets in a row since the 1950's. So we consider this a reprise, not the first balanced budget.

Mr. NUSSLE. You used the Social Security Trust Fund last year, did you not?

Mr. LEW. We balanced the budget without using the Social Security surplus. This is the first time——

Mr. NUSSLE. This year.

Mr. LEW. Last year we accomplished it.

Mr. NUSSLE. No, no. You accomplished it at the end of the year because we passed it. You did not accomplish it when you proposed it.

Let's talk about what the President has proposed. He has never proposed a balanced budget without dipping into the senior Social Security benefits. You and I both know that.

Mr. LEW. Last spring we proposed a modified budget in order to address that concern. I think that we proposed balanced budgets for 3 years running.

Mr. NUSSLE. Jack, you and I both know the President has never done that.

I didn't ask a question, Mr. Chairman. If we want to debate this, I am going to have to ask for more time.

Chairman KASICH. Why don't we let the witness go ahead and respond?

Mr. LEW. If I could respond, I would just say that the notion we are raising taxes I just don't think is by any measure fair. It is not what we——

Mr. NUSSLE. Let me ask a question. Is it going to require a bill through the Ways and Means Committee in order for this to be accomplished?

Mr. LEW. Everything that would change policy requires——

Mr. NUSSLE. Read your Constitution. That is a tax increase.

Mr. LEW. That is not correct. Tax cuts require legislation.

Mr. NUSSLE. Then it doesn't have to go through the Ways and Means Committee if it isn't a tax increase.

Mr. LEW. I would actually suggest, with all respect, that tax cuts require legislation just as well. You have tax legislation on the floor I believe today on the marriage penalty.

Mr. NUSSLE. Your increases will have to go through just like our tax reduction.

Chairman KASICH. I would ask the gentleman from Iowa——

Mr. NUSSLE. I didn't ask for a question, Mr. Chairman. He had his opportunity to present his budget. I have presented ours.

Chairman KASICH. The witness has a right to be able to make a few comments in terms of the comments of our Members. If the gentleman would keep it short, we could come on to Mr. Davis.

Mr. LEW. Thank you, Mr. Chairman. I appreciate the courtesy.

I would make two other brief points. The question of what proposals we have for spending really ought to come down to the question of what is it for. We think that additional resources to reduce class size, to build and repair classrooms, those are good investments. We think that the American people want them. We should be in a debate about what we are trying to accomplish, not into just a count of what is new.

Chairman KASICH. Mr. Davis is recognized for 5 minutes.

Mr. DAVIS. Thank you, Mr. Chairman.

Let me start by saying that I agree with you, Mr. Lew, about erring on the side of caution in terms of your projections, the $746 billion you have used as far as the projected surplus.

I also agree with what I hear you saying, that we need to devote the lion's share of this projected surplus to paying down this massive $3.7 trillion publicly held debt.

I further agree that I think it is credible to suggest that we set aside some of those funds to extend the solvency of Medicare and Social Security. After all, the baby boomers who were generating a lot of this income tax revenue in this general revenue are the same people whose retirement will drive up the cost of Social Security and Medicare and test its solvency.

I think that the standard of using the lion's share of the surplus to pay down the debt ought to be the standard against which we judge any tax cut or any spending proposal in this Congress.

In my State of Florida and in my community, the benefits of lower interest rates have provided dividends to homeowners and others far beyond any of the tax cuts that were proposed last year and the tax cut bill that the President threatened to veto. I would like to ask you to first elaborate on your views about the relationship between using the lion's share of this surplus to pay down debt and lower interest rates and the benefits to consumers.

Mr. LEW. I think you have really put your finger on what is the fundamental policy decision or the two fundamental policy decisions that we will collectively be making this year. One is, how big is the surplus and are we doing it in a prudent, conservative way? Secondly, what are the trade-offs we are making to allocate that surplus? I think, setting the lion's share of the surplus aside, we have proposed $299 billion to augment the Medicare Trust Fund, to extend solvency, is a very high priority; and we should do it.

I think there is an additional point, that if you were to spend that money on a tax cut or on new benefits you are doing something very different in terms of economic policy. You are consuming instead of saving. You are not paying down debt by that amount. We think that that will have an effect on the economy, on interest rates; and it is not the right way to go.

In terms of conservative projections, we think $746 billion is the right number. But it is very different if we put $300 billion into the Medicare Trust Fund than if we have spent or tax cut $300 million if the projections are off a little bit. It is not prudent to spend up to the very limit on new commitments. We think Medicare benefits are a commitment in law that we are bound to and we should honor. We think that taking surplus dollars and using them to pay those commitments is a very prudent and responsible thing to do.

We could work through the mechanics of how it works and confuse people quite a lot, but the simple fact is that you could spend the dollar or save the dollar. By putting it into the Medicare Trust Fund, we save the dollar.

As far as interest rates go, I think that your observation again is very correct. The average American family saves $2,000 a year right now because of lower interest rates that are, in large part, related to our fiscal policy. The amount of Federal borrowing is down. Federal pressure on interest rates is down. We have a monetary policy that has been managed, taking account of our fiscal policy. I think we have done an enormous amount of good both directly and indirectly with a prudent fiscal policy. We should stick to that course because I think most Americans consider the lower interest payments they are paying on their mortgage the best kind of tax cut of all.

Mr. DAVIS. One further question, Mr. Lew. As you know, this is the only committee in the House of Representatives that has the opportunity and I believe the responsibility to make the decision as to how we allocate this projected surplus as far as paying down the debt. I share my colleague Mr. Minge's concern that we are on the verge of shirking that responsibility, because we all know that the bottom line question we are about to address here is the magnitude of the tax cut proposed by the Republican leadership. I am concerned that we are about to see that broken into installments.

Last year, that proposal was for roughly about $800 billion over 10 years. There is another proposal out there that is far in excess of that sum. I would like you to comment on what situation would we find ourselves in right now had we passed that $800 billion tax cut last year and if there is an attempt to pass it again this year.

Mr. LEW. I think the numbers speak for themselves. If we are looking at a $746 billion surplus, it is impossible to accommodate an $800 billion tax cut because, as Congressman Spratt pointed out, there is over $100 billion of extra interest costs that you have to subtract out before you are spending the Social Security surplus. I think that if you use realistic starting points, a realistic baseline, there just isn't room for it.

Within the realistic assessment of what the surplus is, it is a question of priorities. I don't believe a tax cut should be the entirety of our economic program right now. It should be a balanced part of it.

I will defer to you on the prerogatives of this committee and on the proper process of the Congress, but I would just argue, in terms of fiscal policy, that the key is to make balanced judgments, to have everything fit together and not to just do it piece by piece not knowing how it all adds up. I think that the budget process in this Congress is much aided by this committee and the Senate budget committee doing its work. We look forward each year to working with you to do it in that kind of a comprehensive way.

Mr. DAVIS. Thank you.

Thank you, Mr. Chairman.

Chairman KASICH. Mr. Pitts is recognized.

Mr. PITTS. Mr. Lew, according to GAO audits, the Navy alone has simply written off about $3 billion worth of in-transit items as lost over the past 3 years. They could have been lost. They could have been stolen. What is the administration doing to improve this obviously cumbersome, inefficient system, call it a defense transportation network?

Mr. LEW. Congressman, I would have to get back to you on the specific issues regarding that specific GAO finding. But I know that, as a general principle, we take very seriously the need in each department, and the Defense Department is no exception, to manage things well.

There is a lot of work to do. In our budget, we highlight 24 priority management objectives that we suggest are major concerns. But we do take very seriously all those reports.

I think that over the past few years the Defense Department has done much better both in terms of putting its audited financial statement in shape and in terms of accounting for the various transactions. But they are not where they should be, and they know they are not where they should be. They are still working on it.

As to the specific finding, I would have to go and look at it. I don't know whether it has merit or not, but I know I would take very seriously any questions it raises.

[The information referred to follows:]

During OMB testimony before the House Budget Committee on February 8, 2000, Congressman Pitts raised questions about the Administration's acquisition reform effort in the context of the Army's program to procure High Mobility Trailers (HMT) for High Mobility Multipurpose Wheeled Vehicles (HMMWV). He also asked about reports that billions of dollars of Navy materials were lost in transit.

Like the Congress, the Administration is concerned about wasteful spending in the Federal Government. The Office of Management and Budget has been working closely with all agencies, including the Department of Defense, to develop and improve efficient, cost-effective procurement strategies and ensure that our systems properly track government assets.

To date, the Army has procured 6,700 high mobility trailers for about $57 million out of a total acquisition goal of 25,112 trailers; the last of these 6,700 trailers were delivered in July 1999. However, the HMT program has experienced several problems since its inception. At this point, the Army is unable to use the delivered trailers as intended because of safety and reliability problems associated with the trailer's drawbar and brakes. The Army is considering several options ranging from limiting trailer payload to retrofitting trailers and HMMWV bumpers so they can be used for their intended purpose. Final costs will not be known until a decision is made.

The Army did not include warranty requirements in the 1993 trailer contract because the estimated additional costs to the government to purchase, administer and enforce a warranty outweighed expected benefits. The trailer industry does not maintain an international distribution, maintenance, and repair capability. Any trailer warranty would have required the government to perform actual warranty repairs and then to seek reimbursement via a claims process from the original manufacturer.

The trailer design approved for production in 1994–1995 met all stated contract performance requirements and testing of the first production units was designed to focus on verifying the trailer's compliance with these requirements. Later, during more rigorous system-level testing, i.e., HMMWV and trailer operating in concert, the Army first detected structural weaknesses in the trailer drawbar and brake system.

The Army does not intend to procure any more trailers of this design. The remaining HMMWV trailer requirement (18,412 additional units) will be met with a new trailer design. Further, the Army has established an Integrated Product Team comprised of representatives from the user, safety and maintenance, program management, testing and procurement communities to ensure that the new trailer meets both its subsystem performance requirements, as well as those established for the HMMWV/trailer system.

Mr. PITTS. Another problem. The GAO reported that the Air Force had a parts inventory of $7.8 billion that exceeded requirements, and there was no reported demand to use them. In other words, they had $7.8 billion of parts sitting in storage, while at the same time we hear of the growing number of combat aircraft that are unusable because of lack of spare parts. What is the problem here? Is this a management problem or a money problem? Would you comment on that?

Mr. LEW. Let me break that apart into several pieces. The question of spare parts and the readiness of our forces is something we have been very concerned about and working with the Department on. We have tried very hard to make sure that our funding levels will provide the resources necessary to have aircraft in the air, at the rates they should be.

I have met with the senior military officials at the Department very recently. I think they feel quite comfortable that we have taken care of readiness, we have taken care of personnel requirements, and the buildup that we proposed last year carried forward this year, with the increases I described earlier, provide for the readiness that we need.

On the question of whether there are spare parts that they don't need, I would suggest you have to look item by item and ask some questions. I know of instances where some of the spare parts are not things the Department asked for, where they are appropriated for one reason or another. I have no doubt that there are spare parts that the Department and we haven't requested. I don't know the extent to which that explains all of the issues the GAO found, but I suspect it is a part of it.

[The information referred to follows:]

The concerns about materials lost in the defense transit network are based on the results of a March 1999 General Accounting Office (GAO) audit of the Navy's handling of materials transported to various storage sites. GAO found that from 1996–1998, the Navy could not account for $3 billion in assets and that the Navy had categorized them as lost in transit. The Navy promptly responded to these concerns and determined that 80 percent of these assets were not misplaced, but were instead accounted for improperly. However, GAO's subsequent small sampling of lost items determined that 16 percent of those items it sampled could be accounted for. To help rectify their accounting procedures, the Navy has formed several teams to review their in-transit practices and create a plan of action for attacking the shortcomings in the reporting system. GAO is following the progress of these initiatives. New Navy reporting procedures and software tracking systems will be operational by December 2000. With these reforms in place, and with OMB oversight, the Administration believes that this situation will improve and that it will continue to make progress to ensure efficient tracking of these materials.

Mr. PITTS. A few years ago, the President mentioned acquisition reform in his defense budget. I don't want to neglect the Army. The GAO in a recent audit said that the Army spent $50.6 million for 6,700 two-wheel trailers that cannot be used. Most of the trailers have a safety problem, and they damage the trucks towing them. They plan to spend an additional $640 per trailer to correct the flaw. The service doesn't require a warranty up front. They still want to purchase 18,000 additional trailers. What is the administration doing about acquisition reform?

Mr. LEW. We have been working on acquisition reform, governmentwide as well. We have been moving as quickly as possible toward commercial, off-the-shelf acquisitions. We have tried to put in place the kinds of controls that prevent situations arising that none of us like, whether it is the military or other branches of the government paying more than they should for things.

I think that, in the case of the military, it is important to realize that there are many things that they do that no one else does. They have equipment that no one else needs. And I don't think we can hold them to the standard of having everything be just something that you or I could go out and buy for ourselves. Many of the things that they use have higher costs because the number of units are small, and they are the only consumer of them.

Again, I try to track very closely what is going on in the Defense Department. You are using examples that are really quite small. I would be happy to go back and check.

One of the things that I think is important is that, as we build up defense which we have proposed and Congress has gone above us, that we ask the kinds of questions you are asking. Because, within a buildup, we have to make sure that we are spending the dollars wisely. We have worked on a 5-year plan to make sure we have what we need to have the warfighting and the peacekeeping capacity that we need to have. In order to get what we have proposed, we have to be careful about our use of each of the dollars, and we shouldn't be tolerating waste. I think we have to be realistic. In a budget that is roughly $300 billion, there is not going to be 100 percent control. We have to find the right balance. But we look forward to working on issues like that.

Mr. PITTS. I appreciate that.

That is all the questions I have, Mr. Chairman.

Chairman KASICH. Mrs. Clayton.

Mrs. CLAYTON. Thank you, Mr. Chairman.

I also want to join the chorus of praise for you submitting a budget that indeed will reduce the deficit in 10 years. It is amazing that on both sides of the aisle we seem to know the value of that but just don't know who we want to give credit to. If we could celebrate the fact that the budget says so many important things about the priorities of our country I think we may begin to know that we have differences of approach but the budget says to us who is important and who is not; it says what we believe in the future. It also indicates how we can balance some of our pressing needs.

The fact that you will be reducing the deficit in 10 years allows, I think, for some of our resources to go for some of our pressing needs. Obviously, there are pressing needs that all of us know in terms of Medicare as well as Social Security, and we must find ways not only to reinsure those—there is some reform there needed and obviously more reform perhaps than the budget indicates—but you must admit the President is indeed committing part of that to the security of Social Security as well as for Medicare.

I am also pleased about some of that spending going to health care, because it means that some of the needs that we have not met because we have been fiscally responsible we are now in a position to respond to some of the needs that the American people say they need.

I live in rural America. I share the disproportionate care that are in hospitals. I am concerned there ought to be resources there to make sure that rural Americans have that opportunity.

I also want to express appreciation for knowing that our investment in education equally talks about the future of our country. Again, paying down the debt allows us to be not only in a good position now but also in the future to continue that investment to education. Investment in education means an investment in our children. It means the kind of education and the productivity of our workforce that we wouldn't have unless we make those investments.

As we look at the expenditure in our discretionary fund, we shouldn't just see that as more government spending. We should see that as an appropriate use of our government resources going back to the people who need those resources.

There is a role for the Federal Government with our education system. Obviously, an appropriate role should always be examined, but there is a role, and to shirk that responsibility under the disguise that we are spending more Federal dollars is I think unworthy of our Federal responsibility and opportunity.

Finally, I also understand that there will be a supplemental budget coming up that has resources for all those people who were devastated not just in North Carolina but from Florida to New York, some $304 million. I want to thank you for that consideration and say that all of us in all of those States could benefit from that. I can tell you, eastern North Carolina can benefit from that.

I just want to take you a little further beyond relief, because indeed I think Americans are at their best when they respond to Americans who are in the worst need. But this economy, this budget also says something else to us, that we have been marvelously blessed. We have got to think part of that is not our wisdom, by the President or Congress. We have been very blessed to have the most prosperous period of time, to have the best economy.

But in spite of that economy being robust for most Americans, there are some disconnections. Part of that is in rural America. Part of that is in eastern North Carolina where we had the flood. They weren't doing too good before we had the flood. So the opportunity to see how we can get some of this good fortune that we are using to invest and to demonstrate that if we invest in a comprehensive way we can make that opportunity for those who happen to be living in eastern North Carolina or rural America prosper from that.

I would just remind you of a recent article that was in the New York Times, I think it was last week, where they visited a young girl who was living in Femerville, in a trailer. She said, "I study my homework in the snow because it is too crowded, and I can't breathe in the trailer." Six people in one of these little recreation trailers, six people. Sometimes heat it too much, other times it is too cold. She goes out in the snow to study because she is relegated to live like that. I can tell you that more than 9,000 such persons are living like that.

The opportunity, it seems to me—and when we look at this budget I just want to say there ought to be an opportunity that we can use our resources, and I hope you have some ideas for us, how we can do more than relief. I understand the relief package. I am grateful for that. But I think we can use some of these resources to say how rural America and particularly in eastern North Carolina—by the way, I would remind my colleagues that that area is larger than the whole State of Maryland, affecting more than a million people who have been affected. We have some 11,000 homes destroyed.

So how in this robust economy can we find some of these resources that are already allocated perhaps, already appropriated, to see how we can direct it to make sure that this economy makes some difference in their lives as well?

Mr. LEW. Congresswoman, if I could just briefly respond, as you know, the President when he came back from the area that was most severely affected, was very moved. We worked together last year on the first stage of recovery, and we have put into this budget a $304 million supplemental to provide further relief.

I would respond on the question of what we are doing for economic development——

Mrs. CLAYTON. What can we do?

Mr. LEW. That it is really a broader question. Because you are absolutely right. There was a need for economic development before Floyd came along. We have proposed in this budget a variety of initiatives, which I hope will get bipartisan support, to give the kinds of incentives to invest in American markets that we give to investing in underdeveloped markets overseas. We have opportunities in this Congress, and the New Markets Initiative that the President has proposed gives us the opportunity to tap those opportunities, to give people a chance to invest there in their own businesses, hire people in their own communities and have the American economy do what it does best, to bring about that kind of economic recovery.

I think that the proposals we have put in this budget are very solid, the conversations the President has had with the Speaker are very encouraging, and I hope that this is a year when we can actually work together to get that done and in that context deal with the problems in this area as well. But not just because there was a hurricane. Because here we have the best economy in recent memory. There is no better time for us to reinvest in our own communities.

Mrs. CLAYTON. Thank you, Mr. Chairman.

Mr. CHAMBLISS [presiding]. Mr. Thornberry.

Mr. THORNBERRY. Thank you, Mr. Chairman.

Mr. Lew, you have made two comments today that really surprised me a little bit. One was, you said essentially that tax relief and more government spending are both consumption essentially of equal consequence to the economy. As I understood your point, you have debt reduction, which results in savings; and anything else you do with money, spending it or letting people keep more of their money, is about the same sort of thing.

I realize there have always been people who believe that government can spend someone's money better than an individual can, that people can't be trusted to spend their money in the way that best benefits them and their families. But it does surprise me quite a bit that you would automatically assume that if people were able to keep more of the money that they earned that none of it would go to savings for their children's education, that none of it would go to savings in a medical savings account, if that were available, that none of it would go into personal savings and that, as the economy goes, that government programs and that kind of relief for people are all the same.

The second thing that I was surprised at, in response to Mr. Pitts' question, was you argued at the end that we are never going to get 100 percent of the control of the money the government spends and that we just kind of have to find the right balance, that you can't have your expectations too high.

Yesterday in one of the papers here was an article which said that to make the fiscal 1998 financial statement of the government balance, the Treasury had to record a $24 billion plug for unreconciled transactions. We don't know where $24 billion, an amount greater than the budget of the Department of Education, was spent in fiscal year 1998 because our accounting system is so bad we don't know where that money went.

Of course, this article goes on to talk about something that has concerned all of us concerned with Medicare, and that is over about a 3-year period, I believe, HCFA paid out more than $56 billion in payments that they could not show were proper payments.

So it does seem to me, and I know you have said we are concerned about this, we have got 24 management initiatives, that we are going to try and do something about it, but if we have got errors or an inability to track money on a scale like this it seems to me that more than a few management initiatives are going to be required.

I want to ask——

Mr. LEW. I would like to respond just on that one question. I think it is a very important one.

Mr. THORNBERRY. Sure, but I have got one other area I want you to respond to.

Mr. LEW. We are in the process of working on the first audited financial statement that will come out clean in the history of this government. We did the first audited financial statement at all. We were going back 200 plus years and try trying to account for things that had hundreds of different bookkeeping systems in order to make it add up.

You are asking a very good question and something that we agree on, we should be able to account for everything. But what I was saying in response to Congressman Pitts is where we have started we have made enormous progress. To say that it is going to get to 100 percent, I wouldn't mislead you on expectations. We are getting very close. That is a real accomplishment that we are very proud of.

In terms of HCFA, we have actually done more to reduce fraudulent payments and wasteful payments in HCFA than ever before. We are very proud of our record on that. We are now hearing from hospitals and other providers who are saying that that is causing a problem because they don't get enough revenue from the government. We are doing the right thing, and we have to figure out what are the right ways for reimbursements. We take these challenges very seriously and work very hard on them.

Mr. THORNBERRY. Let me just say, on HCFA squeezing down everybody does not root out——

Mr. LEW. That is not what I meant.

Mr. THORNBERRY. According to Mr. Nussle, his comments and Mrs. Clayton's, in rural areas you are squeezing down so much that the people who are fighting to stay in business are not having——

Mr. LEW. I am talking about the payments that shouldn't be, that we would all agree are wrongful payments.

Mr. THORNBERRY. I hear what you are saying. I don't doubt your sincerity at all.

On the other hand, when this budget creates 80 new programs, it does lead you to question whether the administration is serious about keeping track of where the money goes or whether we are just adding to the monstrosity. I think that the American people share a similar concern.

Let me ask you about one final thing. One of the issues that has been most concerning in the area of national defense is recruiting and retaining top quality people. A key to that is keeping the promises that we have made to those who have served. I am talking primarily about health care for military retirees.

The Joint Chiefs of Staff, it was widely publicized, went into the tank a few weeks ago and worked and worked and came up with all these proposals on what this budget proposal would do to help keep the commitments that we made to people who have served in the military. Then when it comes out, there is essentially nothing there for military retirees. There is a couple of things to help active duty folks but, as you suspect in Washington, a lot of what they wanted to do has been leaked and all of these suggestions that they had, including mail order pharmacy, MediGap insurance, expand TRICARE Prime, end enrollment fees, was taken out by OMB.

Do you think that there is a commitment? Do you think, to the retirees to take care of their health care needs, is it such a low priority that you in the Office of Management and Budget took those things out after they came from the Pentagon? How are we ever going to get there to keep the commitment? And if we don't keep the commitment to them, how are we ever going to get the young people that we have got to have?

Mr. LEW. Let me respond if I may.

First of all, just to correct something, there was never a proposal that came to us for us to accept or reject. So this is not a question of the Office of Management and Budget in some way being at odds with the Pentagon. It is a serious issue, an issue that I have met with military leaders on.

I would say, that when we meet with military leaders, they tell us that we have made tremendous progress in terms of recruitment and retention. The pay raise, the improvements in living conditions, all the things that we have done together over the last few years have made a difference.

I heard from each service last week. It made me feel good that we have actually done something that made a difference. The retention is up. The recruiting is turning around.

On the question of the health benefits, Secretary Cohen has a review under way within the Pentagon to look at this question very seriously. There are all kinds of different proposals. I have spoken with General Shelton about it as recently as Friday. I know how strongly the Chiefs' concerns are.

I think we have to look at the cost of some of the proposals and ask what can we realistically do within the constraints of a budget. Some of the proposals cost multibillion dollars a year. I think that if that came out of our defense readiness, that would be a problem. We have to be careful within a realistic set of resources to make planned judgments. For that process to continue, I have made the commitment to work with General Shelton and with Secretary Cohen to look at this question seriously to see what we can do working together to find a solution to the problem.

I fear that some people may have been advised of benefits that were not legally provided at the time of their enlistment. That is no fault of theirs. If there was anything in recruiting 10 years ago, 20 years ago that shouldn't have been said that was, people have expectations. We need to go back and work through it. We have to do it within a budgetary context that we all understand and working together. The reason I started with a correction is we have not reached the point of a disagreement because we are in a process that hasn't concluded yet.

Mr. CHAMBLISS. Mr. Price.

Mr. PRICE. Thank you, Mr. Chairman.

Mr. Lew, I would like to add to the expressions of my colleague, Mrs. Clayton, my gratitude also for the inclusion in this budget of the supplemental relief package for eastern North Carolina, the inclusion of items in many cases that were rejected last fall by the

House leadership but which I am hopeful we can enact this winter, particularly the direct grants for damaged farm structures, the assistance for marketing cooperatives and additional funds for replacement housing. We are grateful for that and eager to work with you on it.

I also want to congratulate you on the broad outlines of this budget that anticipates paying down the publicly held debt by 2013, that does restrain spending and that provides for a modest and targeted tax cut within the context of a budget that not only has no deficit but actually systematically pays down the debt.

I would like to ask you about your proposal with respect to spending levels and approach this through the way this has been handled in the Congress over the last couple of years. As you know, we have these budget caps in place from the 1997 bipartisan agreement. Our spending, as I understand it, has gone well over those caps in fiscal 1999 and fiscal 2000 largely through the device of emergency designations for such things as the census, through forward funding proposals that have pushed spending into the next fiscal year and so forth. Could you tell us just in brief how much over the caps our discretionary spending is in fiscal 1999 and 2000 according to your estimates and what kind of adjustments you are proposing for fiscal 2001 in those caps?

Mr. LEW. Let me talk about fiscal 1999 and 2000, because that is really the base off which we are building for 2001. In 1999, appropriations were $38.5 billion above the caps. In 2000, they were $54 billion above the caps. There were many devices employed to try and fit in a technical way within the caps, calling things like the census an emergency, doing all kinds of unusual budgetary approaches to try and technically comply with the caps. But if you just add up the appropriations, that is where we ended up. We are proposing that we not scrap the caps, but we set the caps at a realistic level and that we have caps that we can use as a planning tool in the appropriations process, in the budget resolution process and as an enforcement mechanism.

One of the things that we proposed doing is to try to go back to 2000 and restore budgetary conventions. We have a table in the budget, S7, that tries to show how we would move things back where they belong. It is very, very difficult to even answer the question of what happened in 2000. It is the most complicated set of budgetary decisions I have ever seen. We have tried to attach all of the spending in 2000 that was really intended by the appropriations with the 2000 levels, pull it out of 2001, put it back in 2000. On that basis, we have projected that the requirements for next year are $614 billion in budget authority.

Mr. PRICE. How does that compare to the statutory amount from the 1997 agreement?

Mr. LEW. I guess it is $72 billion above the statutory agreement. And we started at $54 billion above last year so there are year-to-year increases that are consistent with the past. It is largely allowing for inflation.

Mr. PRICE. Your assumption is that with this adjustment in the caps, unlike the last 2 years, we can pass a budget resolution that actually offers some guidance in passing the appropriations bills and lets us pass those bills on budget and on time?

Mr. LEW. I think that the way for the appropriations process to work smoothly and for judgments to be made in an orderly way is to start with a realistic beginning point. I have the greatest respect for the chairmen and ranking members of the Appropriations Committees, but I don't envy them the task of putting together appropriations bills when their targets don't permit them the room to make the kinds of judgments that each of us expect them to make. Where you start has a lot to do with where you end up, both in terms of your ability to put together appropriations bills and in terms of maintaining fiscal discipline.

Mr. PRICE. Thank you.

Mr. CHAMBLISS. Mr. Knollenberg.

Mr. KNOLLENBERG. Mr. Chairman, thank you very much.

Mr. Lew, welcome. I have a couple of questions, but I want to relate specifically to the climate change initiative and particularly the climate change initiatives that you have in this budget just to give you an idea about what bothers me on this whole thing. By the way, somebody said that this gives us a budget to build on. It also gives us a budget to subtract from. I am more interested in subtracting from some of these things that concern me.

For example, the proposals in the area of climate change include approximately $4 billion in funding. But that just tells you part of the story because hidden within some of this—and I'll bring those up—are some expenses and some potential problems of expending money that I have concerns about.

Here are some of the increases:

$333 million, a 30 percent increase in the climate change technology initiative.

A 5-year, $4 billion tax credit initiative for biomass generation of electricity, including solar homes and hybrid cars, et cetera. Interestingly, that is $201 million in the 2001 fiscal year, but they have got it up to almost a billion in each of the 4 years thereafter, which means this is funding in another administration at another time. It is not now.

A $39 million increase in global change research. There is a 100 percent increase in the USDA budget relative to climate control measures. In fact, following that, there is $176 billion for the global environmental facility. That was $36 billion in the 2000 budget.

A lot of money just coming across, and it is concerning us who look at the emphasis that the President is putting on climate change in his State of the Union address and the substantial increases in his budget. Our concern is that it would appear that the administration is doing its best to implement the Kyoto protocol before providing the U.S. Senate with an opportunity to debate and vote on that treaty.

So my question, although many of these initiatives are good and they are research driven, but you wonder are they aimed at improving the global climate behavior, or are they geared toward pushing consumers in the direction of costly and possibly unnecessary programs? My first question is, in your opinion, do you believe any of these initiatives are aimed at implementing the Kyoto protocol mechanisms here in this country without first having the Senate review the process and vote as mandated by the Constitution?

Mr. LEW. Congressman, I believe that all the proposals we have made on climate change make good policy sense for the United States, with or without Kyoto. The President spoke in his State of the Union about improving efficiency of cars and through the miracles of technology that give us the ability to have economic growth without having to compete with our environmental objectives. This is a budget that is designed to move us down that path because that is what we believe is the right thing to do.

Mr. KNOLLENBERG. But the question is, do you think any of this could be used to actually implement the Kyoto treaty in this country?

Mr. LEW. You and I both know the history of debate on this subject. I am trying to choose my words carefully because I don't want us to have any misunderstandings.

Our goal is to have policies that help us reduce emissions. We want to have cleaner technology, and we want to reduce emissions. That doesn't mean we are implementing the Kyoto protocols. It may mean that when the Kyoto protocols are ratified that we have an easier time meeting the targets. These are things we should do as a country just to use our resources wisely.

Mr. KNOLLENBERG. I don't disagree with that. I think we should look at some of those alternatives.

Let me go to my next question. My real question to you is, you say you are not going to implement. Do I read that you are not implementing the Kyoto protocol?

Mr. LEW. We have said repeatedly that, to the extent that there is requirement of Senate ratification of a treaty, we are not proceeding absent ratification.

Mr. KNOLLENBERG. Let me go to a second section here. Because, on the energy front, this whole idea of the area in which these investments are being made, as you called them, for R&D, I am concerned about the money that goes into certain research, like wind, solar, and biomass. There is a whole lot of money in this budget forecasted for spending in future years on biomass.

Here is my concern. There are many articles that substantiate this, the whole idea of R&D is to ensure that reliable and safe power is available for the U.S. consumer. Here are some figures. These aren't mine. These are validated. I can give you the sources on all of this. This is based on a 1997 study.

The ratio then was 5 cents spent on R&D for every megawatt hour of either coal or nuclear generated electricity. At the same time, this study showed that 41 cents was spent for gas, 58 cents was spent for oil, and here is where we get into some numbers. And there is more money being put into the renewables than any other sector of this budget. The same figures there for a megawatt hour of electricity generated was $4,769 for wind and $17,000 for voltaic.

Now, here is the thing that concerns me. If you looked at a graph 10 years ago you would have found that we were at the very same position then, 10 years ago, in terms of where our energy come from. It does not come from solar or wind; it doesn't come from biomass. In fact, they have had a number of years to prove themselves.

Now, perhaps they will never get there. I hope they do. I hope there is a breakthrough, and a lot of people are hoping for this breakthrough. In fact, they are spending money with the expectancy that there will be a breakthrough, but there hasn't been. You can't just say, as they say, this is a recent circumstance; this is a 10-year study, and the question I have for you is, when will self-sufficiency be attained or is it even in sight? And this is an era of high technology.

I am focusing now on those areas that haven't produced, they haven't come through, and I would like you to comment on how in the world we can continue within government—we can certainly transfer it to the private sector—but within government how do we continue working at such a high level of expenditure when we get less than 1 percent of our electrical energy from those areas that get most of the R&D money. I would just point out, that this is less than 1 percent for the solar, the renewable and the biomass.

It is interesting that for nuclear energy, they only spent something like $306 million, and it is way, way less than that over a period of time. The difference is 1 percent of our electricity versus 20 percent, and we are spending huge amounts of money to get that 1 percent working and commercially viable.

So the question is yours.

Mr. LEW. Congressman, I think you have made a very compelling case for our budget.

Mr. KNOLLENBERG. I have made a case for looking at the alternative-type fuels, but I wonder, are we as a government succeeding; and secondly, should we think about transferring this to the private sector.

Mr. LEW. I think that we, as we have in the case of the partnership of new generations in vehicles, we have looked toward partnerships with the private sector because that is the way for the research to become applied technology that works.

Mr. KNOLLENBERG. Is there a breakthrough coming?

Mr. LEW. I think in many of these areas there are breakthroughs coming.

Mr. KNOLLENBERG. When?

Mr. LEW. I think if you look at solar and biomass electric generation, this is actually relying on old memories—I used to practice law in this area 15 years ago—we have made progress from where we were. And frankly we wouldn't have got into the marketplace without——

Mr. KNOLLENBERG. Members just told you, you are not making progress. That is the concern I have.

Mr. LEW. I think it depends which technology you are looking at and——

Mr. KNOLLENBERG. I am looking at wind and I am looking at solar.

Mr. CHAMBLISS [presiding]. Gentlemen, we need to move on now. Let us let him comment and move on.

Mr. LEW. There are many examples of technology that have promise that are improving. I think that we, perhaps outside of this hearing, should have a longer conversation about it, but I think the fact that there is still a steep hill to climb in the case of many of these technologies is why we need to be putting Federal research dollars into them to get things to the point where they can reach commercialization. It is important that we develop these technologies, not for any international commitments, for our own good in terms of using our resources wisely and having growth and domestic environmental standards that we as a people want. I don't think we really disagree in terms of where we want to get to. It may just be how to get there.

Mr. KNOLLENBERG. I think that is right.

Mr. LEW. And I hope we can work together to find appropriate funding levels because, frankly, had we put more resources into some of these technologies over the last 15 years, we would have made more progress.

Mr. KNOLLENBERG. I will be happy to work with you.

Mr. CHAMBLISS. I would remind Members that we have got a lot of other folks we have got to get to, and if you will, please try to ask your long questions first.

At this time, I would like to recognize the best two-handed set shot artist this side of Massachusetts, the gentleman from Massachusetts, Mr. Markey.

Mr. MARKEY. I thank the Chairman very much. I would have to stipulate, as the chairman knows, that that is if nobody is covering me. Once someone covers me, unfortunately my accuracy goes down dramatically.

I think that the last discussion is very helpful because Joe Knollenberg was focusing on kind of the issues of Kyoto, the greenhouse effect, and there is a big debate that goes on there. I would add parenthetically that we built the Internet, the Federal Government, and in 1992 after 25 years, we actually had to have a vote in Congress after we had built it to transfer it over to the private sector. The same thing is true for NIH.

The same thing is true for satellite technology. We built it all. We have to then finally vote to pass it over to the private sector. So we wouldn't even have this telecommunications revolution, this wonderful prosperity without the Federal Government having made the fundamental research. So this whole greenhouse effect is a good debate as well.

But unfortunately, just to take the metaphor a little bit further, the Republicans kind of use the terms of winter, you know, it is a freeze, caps, it is cold outside, you know. Meanwhile, we are living inside of our own monetary greenhouse effect, or our "Greenspan effect" we will call it. There is great prosperity out there, and the country is doing very well.

Now, Dan Crippen, who is the handpicked head of the Congressional Budget Office by the Republicans, has said that there is an $800 billion surplus over the next 10 years. The Republican tax cut proposal last year, and if passed as prologue this year, was for $800 billion. So that basically wipes out the surplus for the next 10 years, and while we have created in the 1990's 8 million millionaires who are all sitting snugly by their country club fires right now, very warm in this great Greenspan effect, the Republican tax cut sent 70 percent of the tax cut, 75 percent of the tax cut to their homes, throw another log on that Greenspan effect for the wealthy in America.

What do they leave over for poor children? What do they leave over for poor seniors? What do they leave over for the environment? They leave over a freeze. For them we pretend that we can't afford to give them anything.

Now, not only is that a fantasy, it is morally wrong, morally wrong for the United States of America, enjoying the greatest prosperity in our country, to take the entire surplus and give it back to people who have become millionaires in the 1990's. They are those who have been the greatest beneficiaries of this enormous wealth effect. The proposal of the Republicans, though, is to give them $800 billion, or a huge percentage of that, and to leave nothing over, freeze social programs for poor people, for elderly, for children. Morally wrong.

Now, the reality is that in fact there is plenty of money left over to pay down the debt. Two-thirds, three-quarters of the entire surplus over the next 10 years under the Democratic plan goes to do that; but then we have to decide what to do with the remaining quarter, the remaining piece of money that is left over, and we say it has got to be shared, got to be shared between the millionaires and ordinary people, and that is what the Republican Party doesn't do.

Now, Jack, you mentioned that you are proposing a limited plan to deal with the Social Security insolvency issue. The chairman of the committee said you have no boldness, the administration really hasn't focused on the need to reform Social Security. I see inside of your budget a proposal that Roscoe Bartlett and I have made which is to allow for the Federal Government to invest in index funds that will be managed by the private sector, by Fidelity, by Putnam, that will increase dramatically the solvency of the Social Security Trust Fund. Now, I know the Republicans pose that, but it seems to me if we had begun that a year ago, since the NASDAQ index went up 84 percent last year, the S&P index went up 20 percent last year, we would already be well on our way to helping to solve this Social Security issue and pushing back the solvency another 5 or 10 years.

So I would like to propose to you that we all work together to raise this issue once again, because I think it is foolish that we don't take advantage of the stock market, that we don't ensure that we are getting the benefits for ordinary people of having invested in the stock market. And I would just like to hear your comments in terms of the likelihood, given your conversations thus far, that the Republicans will be responsive to this notion.

Mr. LEW. Well, I must say that we are at the very beginning of the process, and I begin optimistic that we are able to persuade the Congress, and the majority in the Congress, that our proposal is a wise one. We, I think, have taken a prudent approach toward equity investment. It may not be as aggressive as some have proposed. It may not be as aggressive as what you have proposed, but we think it is a step in the right direction by taking the surplus dollars, using the reduction in interest, saying that in 2011 we begin putting money in the Social Security Trust Fund that just reflects the savings because we paid down the debt using the Social Security surplus, that half the dollars go into equities, and until we hit 15 percent of the total trust fund, we continue.

I think it is a highly reasonable, modest proposal that is real reform in terms of Social Security financing. We hope we can work toward that this year.

Mr. MARKEY. I hope we can, as well, and again, with Roscoe Bartlett and I agreeing upon it, OK, only the centrists in Congress are the obstacle, but I think it is highly possible for us to achieve that goal.

I thank you, Mr. Chairman.

Mr. CHAMBLISS. I would remind my good friend from Massachusetts that the example he used is one of the three paths that CBO said we might go down, and they laid out the facts on each of the three. Now, CBO is not committed to any one of those paths, but there were three of them out there.

The gentleman from New Hampshire, Mr. Sununu.

Mr. SUNUNU. Thank you, Mr. Chairman. While I don't want to make it a habit of using any of my time to respond to Mr. Markey's comments, I do think it is worth noting in response to a lot of the traditional class warfare rhetoric that he put forward so eloquently, that the kinds of taxes or tax relief he refers to as being tax relief for the rich, I think is not a matter of rich or poor. Getting rid of the marriage penalty, for example, Mr. Lew talked about how there is just not necessarily enough money to do it in this particular budget context if we want to spend all the money we want to spend. It is not a question of that; it is a question of fairness. Either you are for making the code more fair or you are not.

Getting rid of death taxes—it is true that death taxes apply to upper-income families, by and large, but I don't think any American, rich or poor, really believes that it is right for the Federal Government to take half of what a family owns because the owner of a business happens to pass away. It is a fundamental matter of fairness.

And I think it is unfortunate if we start using a lot of rhetoric to try to pit rich and poor against one another. We can't legislate our way out of poverty. We need to invest in the right things, we need to create the right opportunity, and that, more than anything else, is going to make a long-term difference.

What I do want to focus the bulk of my time on, though, are some broad points about this budget. It is worth reinforcing that this budget does dramatically expand spending. There is over $35 billion in new budget authority above what we had in fiscal year 2000, and we can and should talk about priorities. But this budget dramatically expands the size and scope of the Federal Government. More to the point, or more problematic, it relies on tax increases to do this. Mr. Shays pointed out that next year alone it has $9 billion in tax increases, $160 billion in tax and fee increases over 10 years.

And this is not a partisan point. The minority leader of this committee pointed out that these tax and fee increases simply are not going to happen. And for those that might harbor some belief or hope on hope that they will happen, we put these very same proposals up for a vote last year on the floor of the House, and it was defeated, not on a party line vote, but by a vote of 416 to nothing. I think we do a disservice to the process when we construct the budget around tax increases and fee increases that aren't going to happen.

And I know Mr. Lew feels that it is not a tax increase. In this hearing you have been quoted as saying, we are changing tax policy, revenues will increase. Yet you suggest these aren't tax increases, and I think it is not necessarily constructive to hold to that position.

Mr. Price made some good points about getting rid of the gimmicks in the budget process, and I think that is something we can and should agree on as a Budget Committee. It is an important goal to have, but I think we need to be clear on where the budget that you have proposed is. It is based on these tax and fee increases that I firmly believe will never happen, but it also relies on some gimmicks of its own, some timing shifts.

You show roughly $8 billion in offsetting receipts and timing shifts in order to get to your total discretionary number of $614 billion, and the biggest single one of these is a timing shift of deposit of earnings for the Federal Reserve. Now, that may or may not be an appropriate offset, but I think most people on this committee and certainly our constituents back home would view that as a bit of a gimmick.

I would like you to respond to whether or not you are really willing to submit a budget without any gimmicks and, two, to respond to the very serious concern that the minority leader and others have stated that these tax increases aren't going to happen; and if that is the case, this house of cards comes down.

Mr. LEW. Let me start, if I can, by correcting two things where I think you were quoting me incorrectly.

First of all, I didn't say there is no room for a marriage penalty. I said there is room for a marriage penalty. Our budget has a legislative proposal to reduce the marriage penalty. What I said was, it has to be properly sized as part of an overall, balanced package.

Mr. SUNUNU. And my point was that it is not a question of whether you are for the First Amendment but not in certain cases, or free speech is good, but not all the time. This is about fairness. Either you have a penalty in the code that affects a couple when they choose to get married or you don't.

Mr. LEW. But, Congressman, there are many aspects of the legislation the Ways and Means Committee wrote that have nothing to do with penalties for married couples. There are benefits that go to individuals that don't pay a marriage penalty, and we can have a serious debate about what is required to eliminate the marriage penalty.

Mr. SUNUNU. The biggest single provision that goes to couples that aren't currently paying the marriage penalty goes to couples that are penalized by the phaseout of the earned income tax credit. So in the case where we are focusing on couples that aren't necessarily hit by the marriage penalty, it is for those at the lowest end of the income spectrum, which Mr. Markey is appropriately concerned about.

Mr. LEW. I don't think we are going to resolve at this hearing the proper design of a marriage penalty provision. I just want to establish for the record that we are all for addressing the marriage penalty and, hopefully, we can work together on a bipartisan basis;

and at $182 billion, it will squeeze out an awful lot of things that we also all support.

Secondly, I didn't say that there were no provisions in this that are tax increases. We have many loophole closures where we are very pleased to be proposing policy that would reduce loopholes that provide for sham transactions and other things that we shouldn't tolerate in the Tax Code. We are deliberately closing loopholes and using that to give tax cuts for families.

The only thing that I said was that I think our tobacco policy needs to be viewed not as a tax policy but as an attempt to take the profits associated with selling cigarettes to kids and saying we won't tolerate that.

Mr. SUNUNU. In direct response to Mr. Nussle's question about the tobacco policy, you said we are changing tax policy and that revenues will increase, and that is why I jumped to the conclusion that that is a tax increase.

Mr. LEW. I will go back and check the transcript. I appreciate that, and I don't think you would deliberately take anything I said out of context. I will go back and check.

To respond to your sort of fundamental question about reliance on revenues——

Mr. SUNUNU. Gimmicks, timing shifts.

Mr. LEW [continuing]. I think that you have pointed to something that is a real policy. We did last year in the Appropriations bill include a one time provision to have the Federal Reserve deposit more of its reserves with the Federal Government. It didn't really make sense to do it on a one time basis. There has been a long discussion, there have been GAO reports on the subject, that the reserves were too high. All we proposed in our budget is that we take the provision and make it permanent. It does have revenue effects in 2001. We use them for 1 year.

It is not a gimmick. It is a real policy, and frankly, I think the right way to do it is not to go year from year, different levels, but just to set a policy and say this is where the Federal Reserve deposits should be.

As far as the tax levels go, I point out that in 2001 we have a surplus of $9 billion. It does not rely on any tax increases to run that surplus. So we haven't spent a penny of any new tax, as you suggest we do in 2001. I think that there are——

Mr. SUNUNU. But the net tax increases in that year also happen to be $9 billion.

Mr. LEW. Then I go to the policy, because we do have a tobacco policy that starts right away. As I said, I am pleased to have a debate on our tobacco policy. Not everyone on this committee will agree with us, but we think it is the right thing to do.

In other areas, there are user fees where we think they are different from regular tax provisions. We think that where there are special services provided there should be user fees charged; and we will go through those on a case-by-case basis. I offered this last year; I offer it again. I am happy to go through the list with you, item by item.

Mr. SUNUNU. Thank you, Mr. Chairman.

Mr. CHAMBLISS. The gentleman from Tennessee, Mr. Clement.

Mr. CLEMENT. Thank you, Mr. Chairman. Good to have you here, Mr. Lew. I have sat through the entire testimony, and you have made an excellent presentation on behalf of the President and the administration.

CBO uses three different baselines for appropriated programs in its recent forecast of the surplus. Are any of these baselines realistic, and what baseline did the administration choose to use?

Mr. LEW. Congressman, I think as I mentioned in my opening remarks, the CBO did a real service to this process by suggesting the three alternative baselines. I only believe one of the three alternatives is realistic, but I think all three really warrant our consideration, and in order to make a sensible judgment, I think we have to understand why two of them are not realistic.

They have suggested we look at a freeze, sticking at 2000 levels for 10 years; returning to the 1997 caps which would require almost $70 billion of cuts from 2000 to 2001; or looking at an inflation-adjusted or no-real-growth path.

If you look at the experience over the past number of years, it is clear that we haven't complied with the caps. Congress hasn't complied with the caps in 1998 or 1999 or 2000. In 1999, spending increased 7 percent over 1998; in 2000, increased 3.5 percent over 1999. I don't think saying we are going to freeze at 2000 levels is any more realistic.

We have suggested as a baseline that we use the inflation-adjusted, zero-real-growth path, but our policy over 10 years is actually slightly below that. We have said we should continue to have some constraints on the growth of discretionary spending. I think to assume that we can make savings that we can't make is going to put us directly at odds with the fiscal policy that has brought us where we are today with the economy growing, with low inflation, low interest rates and high employment.

We have to use realistic numbers. If we end up spending more than the surplus that materializes, what we have effectively done is we have spent the Social Security surplus that we all said we wouldn't spend; or we have gone back into debt, and that is not the measure of fiscal discipline in a time of surplus.

I think that the suggestion has been made that we put the government on autopilot. Nothing could be further from the truth. We have just said that for the purpose of making an allocation of a surplus, you have to start from a realistic total. Many things will go up and many things will go down. It is not autopilot by any stretch of the imagination, and I would oppose any budget that went on autopilot, because items should be considered item by item, year by year. That is what we did in 2001, and that is what should be done in each of the succeeding years.

Mr. CLEMENT. Second question. The President's budget calls for eliminating the publicly held debt by 2013 for the first time since Andrew Jackson, my President from Tennessee, was President in 1835. Some economists have said that completely eliminating the debt would actually be detrimental to the economy. What is your opinion of that?

Mr. LEW. Well, let me make a couple of observations because it has been, I think, quite interesting over the last few weeks to watch the discussion in this area and the general press and amongst observers.

I think we have finally reached the point where people outside of government, outside of this room actually believe that we are reducing the debt, we are paying down the debt, and they are trying to figure out what does it mean in terms of managing national economic decisions. There are very different needs in terms of Federal financing if we pay down the debt. We are not going to need to be issuing the same amount of 30-year debt that we needed to issue when we were running up deficits and having the national debt go through the roof. That is a pretty high-class problem to manage.

The Treasury Department, I think, has taken the first important step by coming out with rules and announcing its plans to buy back debt, to manage the financing of the Federal debt. There are all kinds of technical issues that, frankly, we are discovering as we go along; that is, some of the debt is not callable on the date when you run out of the need for it, and we may have to come up with some other financing mechanisms to deal with realities like that. We will work through those problems.

I hope that whoever is sitting here next year and for the next 10 years can come to you and say we have accomplished our goal and here is how we are dealing with it. We have gone down that road for 3 years. We should stay on the road and eliminate the net debt held by the public by 2013.

Mr. CLEMENT. My last question. What does the President's budget provide for the veterans' health care system?

Mr. LEW. We have provided an increase of $1.5 billion for the veterans' health system. It was, as was noted earlier, the largest increase proposed. Last year there was a long debate about veterans' health spending levels. What we have done this year is maintain the program commitments made last year.

One thing I would point out is that anyone who talks about a freeze has to ask what would you do with that $1.5 billion: Would you not provide it? Would you freeze it at last year's level? If you do increase veteran spending, where are you going to take it from, education, child care?

It is not realistic to say we are going to freeze because some things are going up because of policy judgments that Congress has made, policy judgments that we share in, in many cases like this one. We have to be honest about the numbers we use, and with a surplus, with honest projections, we have plenty of resources available for balanced judgments. The burden on us is to make balanced judgments, not just rush off into putting all the resources in one or another place.

Mr. CLEMENT. Thank you, Mr. Lew.

Mr. CHAMBLISS. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. Mr. Lew, I have listened to a number of comments about who is to take credit for this economy, but I recall the President's State of the Union a couple of weeks ago. He said, we need to thank the American people for this economy because it is those who have worked and are enjoying the fruits of that labor and those who continue to work who thrive and make this economy.

Mr. LEW. Absolutely.

Mr. COLLINS. You know, I look at this budget, and I not only listen to you talk about programs and spending, but I hear others talk about programs and spending, and it is not just one group in town here. It is most everyone.

I am reminded of the fellow who becomes payday rich. In my estimation—in the eyes of the majority of the people that I represent in the Third District of Georgia, we don't believe we have a surplus. We are facing a $5.5 trillion debt. We have unfunded liabilities that are ahead of us, especially in the area of the Social Security and Medicare, and those things are going to come due some day. It is like the guy who draws a paycheck every week and he pays all of his bills—his house mortgage, his car payment, his insurance, everything—out of the first 3 weeks, and the fourth one he considers to be a surplus; but yet, if he had a layoff, he would need those moneys to make those payments in the out-months.

We are going to need all the funds we have coming, so I think we have to be very careful in how we deal with the people's money here. And with interest—your comment about low interest rates equating to the same thing as a tax cut, I believe I am right in your comment there?

Mr. LEW. I made the point that mortgage payments have gone down for the average family by $2,000, which is the equivalent of a tax cut.

Mr. COLLINS. Well, we just recently experienced several rate increases. Do you consider those tax increases because you know someone is going to pay a higher interest rate now? In fact, I received a little notice the other day, due to the change in interest rates, your amount of interest has just gone up another quarter percent. Was that a tax increase on me?

Mr. LEW. Interest rates will go up and down.

Mr. COLLINS. I know, but you are considering them the same as a tax, tax relief, a tax increase.

Well, you are not going to answer that one, I can see.

Mr. LEW. I don't think you want me to respond to that.

Mr. COLLINS. When I look at this debt, I hear a lot about paying down this public debt. We actually have two debts, right, government debt, public debt?

Mr. LEW. Congressman, we do have two measures of debt. I think only one of them impacts on the economy.

Mr. COLLINS. That is right. In the lock box, we not only set aside the payroll tax for the Social Security, but the interest owed to the trust fund from the general fund because of the government securities that it holds, right?

Mr. LEW. Well, Congressman, the way Social Security financing has worked for decades is that we credit to the trust fund on a daily basis interest on the securities held.

Mr. COLLINS. Well, that is the same thing, you know, but now, as you pay down this public debt and you are increasing the government-held debt with those Social Security trust funds, are you not? So how can you credit the interest that you talked about to the Social Security because you owe Social Security interest?

Mr. LEW. In terms of the effect of the Federal budget on the economy, what we have used for years as the measure is net interest and unified budget analysis, because that is the presence of the

Federal Government out in the credit markets competing with others.

Mr. COLLINS. I understand all of that. That is good Wall Street talk. I am talking about Main Street in the Third District of Georgia. I mean, we understand debt is debt. But let us go one step further, and I am not trying to cut you off, the light has changed already. But I have one other thing.

You said if we do all of these things—and Mr. Spratt, I believe, agreed with you or you agreed with Mr. Spratt—in order to meet these obligations that we are creating, because in your budget you create some new entitlement obligations out there, that we would raise money from the economy. How? Because if I understand right, in order to meet the obligation of Social Security and Medicare in the out-years, unless something happens to transform them, the payroll tax will almost double to cover those liabilities.

Is that how you are talking about meeting—raising money from the economy, more taxation?

Mr. LEW. I will let Mr. Spratt speak for himself, though I did agree with a comment he made, which was that if we succeed in continuing down the path of debt reduction, eliminating the debt held by the public by 2013, that that will have beneficial effects on the economy which will lead to greater growth; and to the extent that there is greater growth, there are greater revenues available because growth is income, and that is a good thing.

So I was only agreeing that we haven't taken account of that, but there are benefits to paying down debt that we should realize.

Mr. COLLINS. I know you agree with him, and I was just asking a question of how.

One other thing, GDP, you know, that is understandable here, in the beltway of the District of Columbia here, but GDP at home doesn't ring a whole lot of bells. What rings the bell at home is the bottom line on a paycheck after the payroll tax, the FICA, after the State withholding, after the Federal withholding. You know, that is what counts; and I am not seeing a whole lot of relief right there.

Mr. LEW. I agree with you, the term GDP doesn't mean much on Main Street, and I think we should simply say the size of the economy, so people can know what we are talking about; and I will try to do that.

Mr. COLLINS. Well, people refer to the size of their paycheck, you know; and we hear a lot about we are giving tax breaks to the rich, you know. Lord knows, if you are going to use percentages around this place, you ought to use the one that 25 percent of the taxpayers pay about 80 percent of the taxes.

So, you know, we talk about fairness and relief and all that—my light has done turned red, Mr. Lew, and I am sorry. We could enjoy a good conversation for about 30 minutes, you know. Thank you.

Mr. CHAMBLISS. Ms. Hooley.

Ms. HOOLEY. Thank you, Mr. Chairman.

Mr. Lew, thank you for the patience that you have had at this hearing. It must be a little discouraging at times when you bring in a budget to find out that it is dead on arrival, but I think this is a Congress hopefully that can work together on some of these issues and come up with what is best for the American public.

One of the things that I appreciated in the President's budget is the increase in education and particularly trying to get our classroom sizes down. I have spent a lot of time—I am a former teacher. I have spent a lot of time visiting classrooms, and I know that it makes a real difference, not to go from 27 students per classroom to 25, but to go from 27 down to 18; and the learning that takes place and the number of years that sticks with that child, having that good start in the first—kindergarten through third grade, and how that follows through with their achievements, not only for the rest of grade school, but in junior high, high school and college.

When I look at the President's budget, how close are we going to get to our goal of reducing classroom sizes, putting at least 100,000 teachers into our classrooms? Where is that going to get us?

Mr. LEW. Well, the funding level that we proposed would get us to 49,000, which is just about halfway to our goal in the third year of the program. We are very pleased by being able to make that progress so quickly, and we are committed to staying with that right through the end and having that as an accomplishment to show for the year.

I think while others might choose to describe our budget as not being terribly relevant, I am very, very comfortable looking back over our track record over the last 2 years. The priorities the President has put forward have stuck right until the end. We have been there in September, October, November.

This is an election year. I hope we finish it early, but we are going to stick with it until the end, and we are going to get smaller class sizes, and I think we are going to get funding for school construction, and that is what we are committed to doing; and we want to work with the Congress to get it done. I believe we can.

Ms. HOOLEY. How far are we going to get with the school construction modernization piece? I mean, how much of the problem does that take care of? I am one of these believers—by the way, I need to tell you when I am back home sometimes people say, well, boy, is she being—18 per classroom is a really tough goal, and how do we do that; it means new buildings to put our teachers in.

I am a believer that if you don't start someplace, you will never reach your goals. So, tell me, on the modernization piece or school construction, how far do we get on what the real problem is out there?

Mr. LEW. We have this year modified the proposal from the past several years, which in the past was just a tax proposal where we provided a substantial amount of tax assistance to leverage bonding to build new schools. That is still part of our proposal, and we hope that will get us—I forget if the number is 5,000 or 6,000, but it is on that order, schools built.

What we have done on the spending size side this year is tried to address this very real need for renovations in thousands more schools, and I think the funding we put in the budget for the spending side, $1.3 billion, would get us to the point where we could renovate 5,000 to 6,000 schools with that funding.

I think it is not a question of choosing. We need to modernize classrooms, we need to build new schools. We need to have smaller classes, which means more classrooms. Every teacher is going to need a classroom for their 18 kids, and we just need more capacity than we have; and we have proposed an approach that is going to help us to take the resources we have and bring them into the 21st century and to build resources that we need for the future.

Ms. HOOLEY. One other question, if I may. Last year I introduced with a Republican, Greg Walden from Oregon, a tax cut proposal including the marriage penalty. Yours is less than the Republican proposal. What is the difference and where is the cap? Where is that level that we give marriage penalty relief to?

Mr. LEW. I would say that our marriage penalty provision was designed to be just that, a marriage penalty provision. We defined the policy as trying to deal with the problems particularly of moderate income levels where there was extra tax burden for a couple, as opposed to two individuals who were unrelated. The provisions that are in the much larger bill have a substantial amount of resources going to individuals who have actually a bonus, where their taxes are lower because they are married than if they were individuals.

I would have to go through the individual items item by item to answer your question carefully, but I think that the aggregate number kind of speaks for itself.

If we are going to have a balanced approach, and we think there is room for a $256 billion tax cut, then we have to be careful how we design each component; and we all agree that there ought to be legislation that addresses the real marriage penalty, but we need to be careful and have what we do in the name of the marriage penalty be dealing with the marriage penalty.

Ms. HOOLEY. OK. Thank you.

Mr. CHAMBLISS. Mr. Fletcher.

Mr. FLETCHER. Thank you, Mr. Chairman.

And, Mr. Lew, certainly we have enjoyed your presentation. This is the second budget that I have heard presented, and as the gentlelady said, the second one is probably dead on arrival. It does seem more like campaign promises and a budget that is projecting to make sure you give something to everyone; and I am disappointed in this last year that the President hasn't put forth something that is a responsible budget that we can begin from to negotiate—as you said, you would like to get out early, election year—but something we can really work with.

Now, last year you presented a budget with $82 billion of tax increases. This one has $11 billion of tax increase in the first year. You may call them taxes and fees, whatever—if interest is considered taxes, I guess we can throw all of that into that—but there are several things I am concerned about.

As I look at Social Security, last year I remember at the State of the Union, 62 percent was all he wanted to save on that. And now you have come our way, 100 percent, and I imagine there is some discussion in the West Wing, how do we one-up them this time so we add a little interest in there? And we are glad that you have come that way, that you want to save all the Social Security, but in fact, there is no change in the system there.

Last year you presented something, to invest it in stock, government-owned companies but by and large, a majority of the people see the fallacy and the error in that policy, but there is no real change. All we have done is put in more IOUs. Yes, we pay down the debt, and because of the economy and because of what Congress and the President worked together to do, we do have a balanced budget and a surplus.

Medicare is another thing. You talk about making changes with that and putting more in the trust fund, but there is really no money, just more IOUs, more commitments. In the future, we are going to either have to raise taxes more or go more in debt. There is no option there. There is no change in the form.

You have also put forward a prescription drug benefit, and many, like myself, would like to see us provide prescription drugs—a change of medicine is very necessary. But it provides a broad spectrum of benefits that benefit those who can most afford it, and 65 percent of the folks have benefits at this time, and it displaces a tremendous amount of private money with taxpayers' money.

I think we can focus that, and I would like to know, as I finish here, whether or not you would look at something more targeted and something more fiscally responsible, because I think your projections do not include any increase in utilization and, therefore, are far short of what that is going to cost.

Tax fairness package, we talk about marriage penalty. You do add, and you talk of, a bonus that goes to those moms that are not working, that are, say, staying home, or fathers, that it provides a benefit for them, and you call it a "bonus" or whatever.

I know you all do provide an additional tax credit for taxpayers with infants, but it stops at 1 year and do you think—is that adequate? Is a child on its own after 1 year? And you are sending the message that mom or dad go to work after 1 year instead of staying in the home and caring for that child? So I would like to see if you are willing to move on that and to really eliminate the marriage penalty tax instead of just using it as a political issue and say we are for it, but we are really not going to address it.

The other thing is just more and bigger government—82 new programs, 149 programs increased in spending—and it doesn't seem like a realistic budget. You can't even get your side to support it at this time, and I wonder, would you be willing to come back with something that is reasonable?

Can you address those questions that I have asked?

Lastly, our farmers in Kentucky with your policy are getting killed. Since 1992, since President Clinton was elected, our farmers have had devastating effects. They are about to go bankrupt, and I wondered what you would be willing to do for them.

Mr. LEW. Well, I am not sure I can address all the questions you raised in the 30 seconds to a minute that I have left. I am going to do my best.

First of all, last year we proposed using over the period of our budget 100 percent of the Social Security surplus for Social Security.

Mr. FLETCHER. I was just quoting the President from his State of the Union.

Mr. LEW. That was 62 percent of the unified surplus.

Mr. FLETCHER. At that time it was only Social Security surplus. You are talking about 10 years, and we were talking about the fiscal year 2000.

Mr. LEW. That was a 15-year projection, and over 15 years, it was 100 percent of the Social Security surplus; on a year-to-year basis, it wasn't. We came back; we revised it on a year-to-year basis.

Mr. FLETCHER. In the Year 2000 it was only 62 percent of the Social Security surplus. That is what we are talking about.

Mr. LEW. I have described correctly last year's budget. We could debate it, but I am going to say the same thing. Last year's budget was as I described it.

In terms of prescription drugs, I think ours is a fiscally responsible proposal. I would be happy to discuss with you the questions of utilization and price, but we have adjusted our estimates to reflect changes in utilization and price. We think our estimates are right.

I think what we believe in prescription drugs is that it should be available to all who want to participate in it. There are premiums, so not everyone will. We ought to try and make it attractive so people will participate; and we think that that is the right way to extend prescription drugs.

I would just conclude—I see the red light is on for me as well. On questions like agriculture, we have put in this budget resources to have farm security policies in place between now and the reauthorization of the Freedom to Farm bill. The President has raised very serious concerns—we have raised very serious concerns about the adequacy of Freedom to Farm. We didn't believe that it provided a safety net.

Mr. FLETCHER. Let me interject this. The issue here is our tobacco farmers back home, and it is not a Freedom to Farm issue. We can open up markets, but it is more of a policy that hasn't taken into account—and I don't want to debate your tobacco policy. What I am talking about is, how do you compensate for your tobacco policy to those farmers whose livelihood depends on it?

Mr. LEW. If I can just give one quick response to that, one of the proposals we have in this budget—which may or may not meet with your approval, but we think it is very important—is the Federal Government continuing the course of engaging in a lawsuit to recover for the Federal Government the excess payments that have been made by Federal programs for tobacco-related illness. We have said that one of the uses of those funds should be to compensate the tobacco farmers, and we have, since we proposed our initial tobacco policy, tried to include as we go along the concerns of tobacco farmers, who are not the problem. We are focused on the companies that are selling cigarettes to kids.

Mr. FLETCHER. Thank you, Mr. Chairman.

Mr. CHAMBLISS. Mr. Toomey.

Mr. TOOMEY. Thank you, Mr. Chairman.

And thank you, Mr. Lew, for joining us. I just want to make a couple of observations and then ask a couple of questions.

First, on the topic of taxes, I just have to say that I find it amazing. Here, the Federal Government is taking in more money from the American people who have earned it and own it than it takes to pay for a record-high level of spending. We set an all-time record last year. There is more than enough to not touch any of the Social Security money. We are not going to spend any of that; that is going to get retired. And despite taking in all of that money, the President proposes that we increase taxes another $10 billion in the first 2 years of this budget.

I find that amazing, and I will be proud to be part of this Congress that makes sure that that just doesn't even come close to happening.

On the spending front, again last year we had a record-high level of spending in dollar terms certainly. 2001, the President proposes a huge increase in spending; and last month the Government stumbles upon some extra money for fiscal year 2000, this newly found surplus, and I see that the President wants to spend most of that also.

I wish the administration would support my effort, which is to take 100 percent of the fiscal year 2000 surplus, just that little bit of money that we didn't spend because we didn't know we had it, and either lower taxes immediately or pay down debt. Instead, apparently the administration wants to spend most of that, and I know that some people think and my colleague from Massachusetts believes there is a moral obligation to keep spending more money. I just have to disagree. I think the moral obligation is for the Government to take as little money as possible from the people who own it and who earned it.

The question I wanted to ask you has to do with Kosovo, actually. As you know, the President committed American forces to a massive and sustained attack on Serbia. Our forces bore the overwhelming majority of the military burden, anywhere from 70 to 90 percent, and because the President failed to secure financial commitments from our allies in advance, when he asked for an appropriation to fund this, we passed that funding request for the President, but we included with it specific language that I authored and that was signed into law that required the President to seek reimbursements from our European allies who clearly were not paying anything close to their fair share.

He was also required, the President, to report to Congress on the status of his effort to collect those reimbursements by September 30th of 1999. As best as I can determine, the President is not in compliance with that law, but not only has the administration failed to collect any reimbursements, the President now wants an additional $2.5 billion for Kosovo. So I have several questions.

First, could you tell us what is the status of collections from our European allies to begin to approximate a fair share of the cost of that burden?

Second, when can we expect to see the report that is now 4-1/2 months overdue?

Third, do you think it is too much to ask on behalf of American taxpayers that the administration at least try to get our European allies to pay their fair share?

And lastly, why should Congress authorize another dime for this when the administration is not in compliance with the law that requires the Europeans to kick in their share?

Mr. LEW. Well, I think the record is substantially different from what you just described, and I would be delighted to describe what we have done.

At the November 17th donors conference in Brussels, the international community pledged a total of $1.06 billion, of which the U.S. share was $156.6 million, or 14.8 percent. So we have done about exactly what we said we would do, which is to go to the international community and seek the kind of burden-sharing that is appropriate.

Mr. TOOMEY. How much of that has been collected?

Mr. LEW. We are working on the collections. I can get back to you with a report on the collections to date, but you start with the donors conference where pledges are made, and then you make sure the pledges are paid.

Mr. TOOMEY. How much has the total U.S. expenditure been on the effort in Kosovo, approximately?

Mr. LEW. Well, obviously the military piece has been and continues to be substantial. We have continuing requests to fund the military and the international component.

Mr. TOOMEY. Ten billion dollars, $12 billion?

Mr. LEW. I don't think it has been $10 billion. Rather, than answering it off the top of my head, why don't I get back to you with an exact tally?

Last year, there was far more appropriated for Kosovo than we requested, more than was needed. Much of that money in the final appropriations bill was moved into other defense purposes. I have to go back and unravel them in order to give you an exact answer.

[The information referred to follows:]

A COMPARISON OF U.S. AND ALLIES' COSTS FOR KOSOVO

The Allied victory in Kosovo is a major U.S. foreign policy accomplishment. NATO forces stopped ethnic cleansing of Kosovars by Milosevic's forces. In addition, hundreds of thousands of Kosovars who had been driven from their homes were provided food, shelter and medicine, then repatriated to their communities. The follow-on task of rebuilding and revitalizing Kosovo itself is as important if we are to foster peace, stability, and democracy. As with the military campaign, it is and should be an allied effort, but as both we and European leaders have acknowledged repeatedly, the European Union will provide the "lion's share of the necessary resources."

We are firmly committed to ensuring that the allies shoulder most of this responsibility. As the President noted in a letter to House Appropriations Committee Chairman Young on August 17, 1999, "other donors will shoulder the bulk of the bricks-and-mortar reconstruction effort." The Administration continues to press the case with our allies at the highest levels. In public and private, we have urged them to meet their obligations in Kosovo, and to increase their participation as demanded by circumstances. In various settings this year, Secretary Albright, Secretary Cohen and Ambassador Holbrooke have all made this point directly. The President is contacting the leaders of the major European powers to note that as we continue to evaluate our own contribution to the stabilization and development of a peaceful Kosovo we expect them to do the same.

This effort has paid off. At the Donor's Conference in Brussels on November 17, nations other than the U.S. accounted for over 85 percent of all pledges. The U.S. Government pledged 14.8 percent of the total pledge of $1.058 billion. Combining these pledges and other assistance provided separately brings the current total to just over $1.2 billion. Therefore, our current estimate is that the U.S. share is 13.9 percent for FY 2000 spending on Kosovo revitalization. Absent any additional funding assistance from European or other allies, the requested FY 2000 supplemental would increase the U.S. ratio to 20 percent. We believe, however, that other countries will continue to pledge additional resources. The European Union and the government of France, for example, have both recently pledged additional resources to help the UN Interim Administration Mission in Kosovo (UNMIK) administration in Kosovo. The U.S. will continue to press its allies to provide greater assistance to Kosovo.

In other areas, the U.S. share of costs has varied. Our share of humanitarian assistance has been about 20 percent, reflecting the traditional generosity of the

American people in providing resources for refugees and others in need. Congress appropriated more for humanitarian relief than the Administration originally requested. Our costs for UN peacekeeping through UNMIK have been at the 25 percent share mandated by U.S. law, and costs for the U.S. share of peacekeeping through the Organization for Security and Cooperation in Europe (OSCE) have ranged from 10.1 (FY 1999) to 16.9 percent (FY 2000).

The military campaign involved higher ratios, due to superior warfighting capability and the desire to protect American soldiers with the best weaponry and the best communications, control, intelligence and logistics support available. Our estimates almost certainly understate the allied burden: some estimate NATO allies may have absorbed up to one-third of U.S. stationing costs by paying or deferring rents, taxes, surcharges and other indirect costs. Also not included are economic costs many neighboring countries suffered as a result of the air campaign. Regarding the Kosovo (KFOR) military peacekeeping force, the U.S. has provided a sensible share of the troops—only about 15 percent. The U.S. share of total dollars spent has been higher, largely because we choose to provide our troops with a better quality of life and greater force protection than other countries. In addition, the U.S. peacekeeping effort has other unique costs: extensive intelligence gathering and communications activity; naval and air presence to support our mission; and greater costs simply because we are farther from Kosovo than our European allies.

This analysis provides the best available information about U.S. and allied efforts in a variety of categories. Several caveats are important. Budget comparisons with other countries are difficult. Other countries have different fiscal years, making annual comparisons difficult. Information frequently is not readily available and not compiled in the same manner as the U.S. budget, making accurate comparisons tricky. Numerical estimates cannot always capture in-kind contributions, regional costs suffered or other meaningful contributions. Therefore, the burdensharing estimates provided below should be recognized as the best estimates possible with imperfect data. The true measure of burdensharing must include an appreciation of contributions not measured numerically or understated because of incomplete information.

INTERNATIONAL AFFAIRS SPENDING

This section provides our current estimates of total international affairs spending in four categories. In estimating burdens shared between the U.S. and other countries, this report has not included funding for the operating expenses of either the State Department or the Agency for International Development. Those amounts would not normally be considered in accounting for total assistance for Kosovo, nor are the equivalent expenses of other donors included in the charts below.

KOSOVO STABILIZATION AND REVITALIZATION

Donors other than the U.S. account for over 86 percent of the resource commitment for stabilization and revitalization so far this fiscal year. As the table below shows, the U.S. share would rise to 20 percent of total resources if the requested FY 2000 supplemental were enacted, and the Europeans and other donors pledged no additional resources. As noted above, we expect the Europeans and others to commit additional resources.

[Dollars in millions]

	Total cost	U.S. cost	U.S. share	Other donors' funding	Other donors' share [1]
FY 1999	$614.0	$105.0	17.1%	$509.0	82.9%
FY 2000	$1,210.7	$168.0	13.9%	$1,042.7	86.1%
FY 2000 including supplemental	$1,303.5	$260.8	20.0%	$1,042.7	80.0%

[1] For other donors, the cost of contributions to CIVPOL is estimated as a factor of $50,000 per policeman. Further, this number assumes no further funding from other donors. In fact, we expect other donors will pledge more.

Spending in Kosovo covers several areas, including near-term stabilization and peace implementation as well as large scale reconstruction and longer-term economic development Near term needs include contributions for UNMIK's Kosovo consolidated local budget, police deployments, stand-up of the Kosovo Protection Corps, creation of a civil registry, and immediate economic revitalization. Given the urgency of these tasks and their direct relationship to the security environment in which our troops operate, the U.S. has focused its contributions on this area. The

European Commission, EU member states, and other UN members have also provided assistance in this area.

A 4 year reconstruction program prepared by the World Bank and the European Commission was submitted to donors at the November 17, 1999, Donor's Conference. The first phase (which goes through December 2000) priorities are housing, energy and industry. European countries' contributions cover the vast majority of those costs. For large-scale physical reconstruction, European and other donors bear the entire burden, since the U.S. is by law precluded from funding such reconstruction

Assistance data on the reconstruction effort as well as all other assistance was gathered from the World Bank and directly from other donors. Estimates of police costs are based on pledges by the individual countries involved, which currently totals 3,530 personnel. The total cost should increase as the force builds toward the UN's approved strength of 4,718 personnel.

In FY 2000, the U.S. will provide $81 million for peace restoration efforts which include: $52 million to fund the U.S. contingent (550 personnel) of the International Police Force deployed in Kosovo, $15 million to help train a Kosovar civilian police force, $5 million to help support the Kosovo Protection Corps, and $9 million for demining, human rights and war crimes programs. Almost $20 million will be used to support democratization programs such as the development of independent media, judicial reform and political party building. An additional $12 million is being provided to support UNMIK's support to the local government budget from which the costs and salaries of local authorities including teachers, judges and municipal employees are paid. Lastly, $55 million in economic and social recovery programs will help rebuild Kosovo's basic infrastructure, create jobs, and generate income necessary for a self-sustaining economy.

Funding the FY 2000 budget supplemental request would allow the U.S. to join the international community in addressing the immediate needs of the international authorities in Kosovo. Recent violence continues to jeopardize the success of the peacekeeping mission. U.S. soldiers will face greater risks unless order and viable economic opportunities are brought to the province. Increased support is necessary to maintain and strengthen local institutions and governance, repress ethnic violence and restart the economy. An increase of $12.4 million for additional civilian police would maintain the U.S. share of the UN International Police Force at original levels as the international civilian police presence expands to help address the continued unrest in Kosovo.

An additional $63.6 million in economic reform would assist the stimulation of private sector growth to absorb workers from the downsized or closed public firms. The inability of these individuals to find employment could weaken support for reform and complicate the mission of U.S. troops in KFOR. U.S. and other KFOR forces can gain better cooperation with local citizens if jobs are created in areas where unemployed refugees or former militiamen might otherwise turn to crime or take revenge against Serbs. The remaining $16.8 million of the supplemental request would cover further efforts to strengthen the judicial, human rights and municipal authorities as well as supplement the revenue collected by UNMIK's local authorities to cover the gap in the budget of this local administration.

KOSOVO HUMANITARIAN ASSISTANCE

In response to the plight of hundreds of thousands of Kosovars forced to flee for their lives, global allies, including the U.S., provided more than $3.4 billion in food, shelter, medicine and other forms of urgent assistance. In the FY 1999 Kosovo supplemental, the Congress provided substantial amounts of assistance, reflecting its concern for the welfare of the Kosovars.

[Dollars in millions]

Program	Total funding	U.S. funding	U.S. share	Other donors' funding	Other donors' share
FY 1999 Humanitarian Assistance	$3,313.9	$571.0	17.2%	$2742.9	82.8%
FY 2000 Humanitarian Assistance	n/a	$95.6	n/a	n/a[1]	n/a

[1] Complete data on contributions from other donors is not yet available, although at least $97.6 million has been pledged to date in response to the UN Consolidated Appeal in 2000.

These costs include refugee assistance in first asylum countries, refugee repatriation, and some support for third country resettlement, including to the U.S. The costs also include food aid, medical assistance (including psycho-social services and special programs for women and children), emergency shelter, infrastructure repair, and winterization materials. Costs for FY 1999 include assistance to Kosovars in Macedonia and Albania, as well as other minor costs to assist impacted communities in those countries, and for Montenegro. U.S. financial support for these efforts is provided through both international organizations and private voluntary organizations. Following refugee returns to Kosovo, U.S. assistance has focused on health programs, shelter and winterization materials, and efforts to help restore Kosovar agriculture. U.S. assistance also has supported small scale projects such as repairing schools and markets, cleaning wells, and restoring small scale infrastructure. Included within this estimate is $124.6 million of DOD costs for refugee relief operations.

For FY 2000, U.S. humanitarian assistance to Kosovo consists of $67 million of PL480 and $7 million of 416(b) food aid donations, as well as $22 million of aid via the Office of Foreign Disaster Assistance. Food aid costs include the total required to procure, ship, distribute and manage U.S. contributions. Other donors contribute primarily though the World Food Program and many donors contribute cash that can be used for local procurement. Since most other donors are closer to Kosovo and therefore incur lower shipping costs, the amount of food they are able to provide per dollar is higher. Nevertheless, the U.S. is the largest donor of food aid to Kosovo in terms of both value and volume.

UNITED NATIONS INTERIM ADMINISTRATION MISSION IN KOSOVO (UNMIK) ASSESSED COSTS

As determined by U.S. law, the U.S. has paid 25 percent of the assessed peacekeeping costs. The U.S. contribution is paid from the Contributions for International Peacekeeping Activities (CIPA) account.

[Dollars in millions]

	Total cost to UN	U.S. cost—CIPA	U.S. share	Other donors' funding	Other donors' share
FY 1999	$266.5	$66.6	25.0%	$185.5	69.6%
FY 2000 [1]	[2] $712.6	$87.0	12.2%	$496.7	69.7%
FY 2000, including Supplemental	$712.6	$178.0	25.0%	$496.7	69.7%

[1] Represents amount allocated to UNMIK at the time of the preparation of the FY 2001 budget.
[2] Includes all assessments expected during U.S. FY 2000.

The UN Security Council established the UNMIK in June 1999. The mandate of the mission is to: provide civilian administration of the province; organize and develop provisional institutions for a democratic and autonomous self-government, including the holding of elections; facilitate a political process to determine Kosovo's future status; support economic reconstruction; support humanitarian and disaster relief; maintain law and order; protect and promote human rights; and assure the return of refugees and displaced persons.

To fulfill these myriad tasks, UNMIK is organized into four "pillars": civil administration, humanitarian affairs, institution-building, and reconstruction. UNMIK works with the UN High Commission for Refugees, the Organization for Security and Cooperation in Europe, and the European Union to administer these functions.

As seen in the table above, the supplemental request reflects the additional amount needed to pay the expected assessments (at a 25 percent rate) for UNMIK in Fiscal Year 2000.

PEACEKEEPING WITH ORGANIZATION FOR SECURITY AND COOPERATION IN EUROPE (OSCE) [BOTH ASSESSMENTS AND VOLUNTARY CONTRIBUTIONS]

[Dollars in millions]

	Total cost to OSCE	U.S. cost—OSCE	U.S. share	Other donors' funding	Other donors' share
FY 1999	$115.0	$11.6	10.1%	$103.4	89.9%
FY 2000	$177.5	$30.0	16.9%	$147.5	83.1%

The OSCE mission in Kosovo began in CY 1999 as a verification mission attempting to contain the building crisis. The U.S. cost for the 1999 mission was comprised of a formal assessment of $5 million (12.4 percent of the total OSCE assessment) and the U.S. costs for its seconded employees at an average estimated cost of $100,000 per seconded employee. Estimates for the mission costs in FY 2000 are based on the same methodology with the added costs of registration and municipal elections, scheduled for the Fall. The OSCE formal assessment for the U.S. is $12.4 million in 2000, with the costs for seconded employees, registration, and support for municipal elections planned for this year totaling an additional $17.65 million.

MILITARY SPENDING

Operation Allied Force, the air campaign against Serbia, was a North Atlantic Treaty Organization (NATO) operation. The United States, along with 13 other NATO nations, conducted a 78-day air campaign. Following the air campaign, approximately 47,000 peacekeeping ground forces from 35 different nations deployed into Kosovo as part of Operation Joint Guardian—NATO's peace implementation force or KFOR.

Each nation participating in NATO military operations assumes the cost of its own operations. NATO does not provide estimates of the total cost of the Kosovo operation or of each member's military contribution. To assess the United States' contribution relative to other NATO countries, the DOD and Department of State attempted to obtain information on contributions made by our NATO allies. Based on the data obtained and reasonable estimates for unavailable data, comparisons were developed for two categories: (1) the air war from March 1999 through June 1999, and (2) the peace implementation force from July 1999 through September 2000. Not included are estimates of the value of in-kind support because they were too difficult to estimate with the information available. Subject to these methodological limitations, the DOD estimates that the United States contributed no more than 58 percent of the total cost of the air campaign. For peace implementation activities, the DOD estimates the U.S. will provide 15 percent of the total force; because support costs per U.S. soldier are higher than for other countries' troops, the U.S. share of KFOR's costs is estimated to be about 36 percent. This differential occurs because we choose to provide our soldiers a better quality of life and greater force protection than do other nations. It also occurs because the U.S. has unique and superior capabilities, such as communications and intelligence assets.

OPERATION ALLIED FORCE

The United States' share of the air campaign was driven largely by NATO military requirements for the technically superior capabilities of U.S. weaponry and the need for communications, control, intelligence, and logistics assets unique to our forces. As a result, the U.S. shouldered the lion's share of NATO's air campaign costs.

All NATO allies, except one, reported a cost for the air campaign. Reported costs include deployment, sustainment, and redeployment of all aircraft used during the air war. It is not clear, however, that the allies calculate these costs in the same manner. The U.S. cost also includes: reconstitution of aircraft assets used during the campaign, incremental costs associated with the deployed aircraft carrier, and the cost to establish base camps for Army Apache helicopters deployed to Albania. As shown below, the estimated share of costs closely corresponds to the share of sorties flown.

AIR CAMPAIGN COMPARISON

Metric	U.S.	Allies [1]	Total
Dollars in Millions	$1,776	$1,292	$3,068
Percent of Dollars	58%	42%	
Percent of Sorties	67%	33%	

[1] For the nonreporting nation, the Department estimated the cost of their contribution using a factor of $2.5 million per aircraft.

The FY 1999 amount for this funding is not included in this cost comparison for the value of munitions used during the campaign and the value of in-kind support because they were too difficult to estimate with the available information. However, some sources have shown that our NATO allies absorbed nearly one-third of U.S. stationing costs in the region by paying or deferring rents, taxes, surcharges, and other indirect costs. Also not considered in this comparison is the economic loss that many neighboring countries absorbed as a result of the air campaign. *Again, little data is available to quantify this effect of the air campaign. If these in-kind contribution and economic losses were considered, the estimated U.S. share of the air campaign would decline, probably significantly.*

OPERATION JOINT GUARDIAN/KFOR

Given the need for our European partners to share a greater burden of sustaining peace in Kosovo, the U.S. has limited its participation in KFOR to supplying only 15 percent of total troop strength. DOD sought to compare FY 1999 costs and FY 2000 estimates for KFOR with other participating countries for a similar time period. However, the Department had to generate estimates for many of the participants due to their reluctance to provide cost projections. To develop an estimated peacekeeping cost for non-reporting nations, the Department used a factor of $10,000 per soldier per month. This cost factor is modest and should not overstate the total contribution by other nations. Shown below is a comparison of costs from July 1999 through September 2000 and troop contributions to KFOR.

PEACEKEEPING FORCE COMPARISON

Metric	U.S.	Allies [1]	Total
Dollars in Millions	$3,244	$5,800	$9,044
Percent of Dollars	36%	64%	
Total Authorized Troops	7,200	39,845	47,045
Percent of Total Troops	15%	85%	

Total U.S. troop strength is the sum of 6,200 troops in Kosovo plus 1,000 troops in the rim countries. This figure is within the 7,005 ceiling for U.S. deployed in Kosovo discussed with Congress.
These costs include the deployment, start-up and sustainment of troops committed to the KFOR. Figures for allies include non-NATO countries that have contributed forces to KFOR. (Note: DOD generated estimates for about one-third of the countries participating in the KFOR).

Key Differences Between U.S. Costs and Allied Military Costs: Differences between the U.S. cost of Kosovo operations and the costs experienced by other countries fall into two main categories: (1) cost which vary with the size of the forces and (2) costs unique to the U.S. because of capability and geography.

Costs that Vary with Force Size: During FY 2000, the Department of Defense will spend approximately $17,500 per soldier per month for ground operations in Kosovo. The Department estimates the basic cost incurred by other countries participating in Kosovo peacekeeping operations is $10,000 per soldier per month. While the lack of cost details prohibits an exact comparison of U.S. and the Allies' costs, there are factors that explain why the U.S. cost per soldier per month is higher than the estimates of other countries. These factors are (1) an increased emphasis on force protection, (2) a deliberate focus on soldier quality-of-life, and (3) significant use of reserve (vice active) personnel.

Force Protection: The most important difference in cost is driven by U.S. efforts to protect our forces. Since U.S. forces are prime targets for many terrorist and dissident forces around the world, U.S. forces deploy with a more robust inventory of equipment—both weapon systems and support equipment—in order to adequately protect our soldiers. Other countries may not provide this level of protection to their military and, if they do, it would not necessarily be in their troop strength cost. Moreover, though other nations house their forces among the population (e.g., in local hotels), the two U.S. base camps are located away from populated areas and have more extensive force protection features. A perimeter security area surrounds each camp to ensure an adequate set back from any potential bomb blast; the camp's perimeter is protected by roads, towers, lighting, a perimeter berm, fencing, concertina wire, and fighting positions (should they become necessary).

Quality-of-Life: The Department of Defense has a strong commitment to quality-of-life programs that is reflected in its deployments. In addition to the force protection element, camps include morale and recreation facilities. Off-duty travel outside of the base is severely restricted for safety reasons, so entertainment, shopping, and physical fitness activities are provided on the base.

The U.S. forces are also entitled to special pays and allowances such as imminent danger pay, family separation allowance, and subsistence. Some nations do not make these payments, or pay a lesser amount. Finally, force rotations are an important quality-of-life element. The U.S. forces rotate on average every 6 months. To the extent forces of other nations have a longer period of time between rotations, their costs will be less.

Reserve Personnel: The United States relies on personnel from guard and reserve forces for peacekeeping operations because the Reserve Components perform many of the combat support services that are required for these efforts. When guard and reserve forces are brought onto active duty, there is an incremental cost to the military personnel appropriations because only their pay for weekend drills and 2 weeks active duty are budgeted. Other nations have minimal if any, costs for reserve personnel.

U.S. Unique and Superior Capabilities Costs: In addition to the troop strength-based costs, the United States incurs unique costs to execute the peacekeeping mission (as well as the air campaign and humanitarian operations). These costs are related to capabilities that the U.S. military alone possesses and to geographic realities, and are in addition to the cost per soldier per month of $17,500.

Intelligence and Communications: The U.S. operates extensive intelligence gathering, intelligence processing, and communications activities. These activities require satellite technology and the establishment of an infrastructure on the ground.

Naval and Air Presence: In addition to ground troops, the United States will deploy Navy, Marine Corps, and Air Force assets to assist in the operation, primarily to fly surveillance and reconnaissance missions. These costs are driven by the number of platforms deployed and the tempo of operations.

Geographic: Because of the extensive distances between Kosovo and the United States compared to European nations, the United States spends more on transportation than other nations; especially to rotate forces and to transport troop-related and U.S. produced sustainment supplies and material.

Mr. TOOMEY. But is it still true that we have not collected any reimbursements and, so far, the entire cost of America's military burden in that war has been borne by the American taxpayer?

Mr. LEW. Each party in the allied effort paid their own burden. We did not fly all the sorties. We did not provide all the troops. We paid for ours.

Mr. TOOMEY. I said the American, and we still haven't been reimbursed, and the President has not submitted this report?

Mr. LEW. I will check on the report. We may have, we may not have; I have to check.

Chairman KASICH. Mr. Hilleary.

Mr. HILLEARY. Thank you, Mr. Chairman.

Thank you, Mr. Lew, for coming and staying so long.

Real quickly, your budget has spending increases, both mandatory and discretionary, of how much for next fiscal year?

Mr. LEW. The total levels that we have proposed for 2001 is $614 billion. That is $7.4 billion above the baseline, and as I described earlier, it is largely because of the defense spending levels.

Mr. HILLEARY. And mandatory, how much is the increase?

Mr. LEW. The total mandatory spending in 2001 is $993 billion. I mean, the aggregate of all outlays, outlays in 2000 is $1.79 trillion; in 2001 they are $1.835 trillion. As a percentage of GDP, it comes down from 18.7 to 18.3.

Mr. HILLEARY. I am not worried about the percentage of GDP. What I am concerned about is what happens when that—that is being funded by the surplus partially, as well as other nontax tax increases in your budget. What happens when the economy goes down and those surpluses are no longer there, yet we have increased our spending levels? Regardless of what percentage of what economic phraseology you have got, what do we do?

We have two or three choices there. We have a choice of increasing taxes, borrowing the money again or cutting the spending at that point; is that not correct? That is pretty easy.

Is that not correct? Those are our three choices.

Mr. LEW. I actually think you have made some assumptions that I don't think are correct. Let me just work through it. We have made projections that do not require any policies outside of what we proposed in the budget. Obviously, to the extent that any projections are wrong, there will be changes.

One of the things that we are saying is that we have to start with conservative projections. We think we have started with conservative projections. Any assumption that there is more money to spend, we think would create a problem. So if you look at our allocation of the surplus, by setting $299 billion aside for Medicare solvency, we have taken the lion's share of what we think is available and not made new commitments with it.

Mr. HILLEARY. I know that you are using conservative estimates of increases in revenue, but what I am saying is, with the economy going up to a certain level. But if the economy decides to take a downturn, which at some point it must, there are three things that can happen—I will just state it for you since you won't go ahead and state the obvious—three things that can happen: You can have a tax increase, you can borrow the money, or a spending cut.

And what kills me is that every year that you have sent a budget over, it just seems like the chief goal of it—which I am sure you will disagree with, but the chief goal is to create opportunities for pounding us politically. And let us say that the economy comes down—you know, we don't want to raise taxes; no one is going to want to raise taxes—we may end up borrowing the money. That may be politically the least painful thing to do.

We sure don't want to cut spending at that point, because then we get all the commercials saying how we hate kids and how we hate education and how we hate this and how we hate that, and how mean spirited we are—just opportunities for demagoguery.

It seems to me that that would be the more responsible thing to do here. And it is kind of like what this administration has done on defense spending all these last many years that they have been in office. They have basically gutted defense, and I think there are some savings to be made after the Cold War was over, but that is long well past, and in my view, the reason was—with all due respect, is that it is hard to get an emotional response from that soldier that you can't see, that is over in some other country, that maybe doesn't have as many flying hours, maybe doesn't have as many bullets, maybe doesn't get as much training. It is so easy to get a 30-second emotional response from some person on the front porch saying, I have got this terrible disease, and those mean, old Republicans weren't interested in increasing my budget.

So this year, I finally see, well, geez, after being gutted all these many years and being able to use that money when you lower defense spending; and increasing other spending, and us having to do the responsible thing, and then cutting back on your increases and all these other programs, I finally said, well, they are increasing spending in defense for the first time, that is great—significantly, for the first time.

And then I look over, and I see what we have now as the gimmick is, all these—it is actually $10.7 billion in tax increases over the next 10 years, which you all know are not going to happen. You know are not going to happen—in a bipartisan way, they are not going to happen; this has nothing to do with Republican or Democrat.

But then we, in having to do the responsible thing, will have to take all those areas where you have plussed up, because now you are depending on a $10.7 billion increase in taxes over the next 10 years that isn't going to be there. It falls on us once again to do the responsible thing and cut back; and so then we are all susceptible to that demagoguery again next fall about how those mean-spirited Republicans, they didn't care about me, and I had this terrible disease. They didn't care about me, and I couldn't get after-school, whatever.

It just seems to me, regardless of which party is in power over there at the White House, it would be nice to have a budget that comes over that is realistic.

I don't get any pride in saying that it is dead on arrival. That doesn't give me a little warm fuzzy inside to say that, but you all created one on purpose that was going to be dead on arrival because you used revenue enhancements—whatever it is; it doesn't matter what you call it. Revenue is going to go up, and you know that is not—in a bipartisan way, that is not going to happen; and we have the responsibility of cutting those things back.

And you are more than welcome to respond.

Mr. LEW. I don't think that the test of a good budget is one that we propose that you accept 100 percent. We may disagree on some things, and you can make fun of the words we use to describe our tobacco policy, but we have tried very hard this year to present a tobacco policy that will present, foursquare, what we think is a moral issue.

It is wrong to sell cigarettes to children. It is just wrong. Maybe you have a better idea about how to stop it than we do. But we can work together on a bipartisan basis to stop tobacco companies, from selling cigarettes to kids, forget the name you call it, it would be one of the most important things we can do. It is just wrong.

Now, you can call it a tax increase if you want and you can try and parody our policies, but we are not trying to make a fight on this. We want to get it done. We really do want to get it done. We think it is one of the most important things we can do as a public health matter.

I was talking earlier in the exchange with Congressman Sununu about some of the fees. We believe that when there are extraordinary services provided that help an industry, they ought to pay for it; that is a perfectly reasonable thing. Republican administrations have proposed it. Democratic administrations have proposed it.

So I think our budget is realistic. I look forward to September when it is proven to be correct.

Chairman KASICH. Mr. Smith is recognized.

Mr. SMITH. Thank you, Mr. Chairman.

Thank you, Director Lew. It is a long session for you. You do a very good job.

I think both sides need to be careful about spending and aware of the real budget challenges in our future. The way our budgeteers have told me, you increase net taxes and fees by 10 billion the first year, and another 5 billion the second year. Over 10 years you increase taxes and fees by 237 billion. You know, the other side of the aisle says, look at all these good things we are creating, but nobody is going to vote for this kind of tax increase. We didn't do it last year; we are not going to do it this year.

So I would like you to report back to the committee, assuming that we are not going to pass these taxes and fees, where are you going to cut back? It is so easy to say, let us expand government spending for everybody because everybody is happy.

The Wall Street Journal this morning says, look, politically the President has done a lot for California for the Vice President in his campaign out there. He has done a lot for New York for his wife's campaign up there. So the Wall Street Journal suggests there is a little politicizing of this budget. In light of this, the misrepresentation of what the debt of this country is and where we are going particularly concerns me.

You say in your testimony, and I quote, "By 2013, the United States will be effectively debt free," and what you are really suggesting is, the debt held by the public is going to be paid down a great deal. But do you agree that the total debt of this country, the total public debt as defined in law, is going to be going up, and by 2013 the total public debt is going to be $6.815 trillion?

Mr. LEW. The debt subject to limit and the public debt are different. The public debt, the debt held by the public——

Mr. SMITH. No, no. In law the way we define public debt is the gross debt of this country.

Let me ask you another question, then. Do you think the debt that we owe the Social Security Trust Fund is less important than the so-called Wall Street debt or the debt held by the public?

Mr. LEW. No, I think that the commitments we make to the Social Security and Medicare Trust Funds in the form of treasury securities are real.

Mr. SMITH. You think that debt to the Trust Fund is just as important?

Mr. LEW. Let me answer the question if I might.

Mr. SMITH. Yes, but you have got to answer my question.

Mr. LEW. It is just as important, but it is very different. Because there are two sides of the ledger. We are also already carrying the outlays in the budget associated with paying back that debt. We assume we are going to pay all our bills.

Mr. SMITH. Do you agree that the total debt of this country increases right up through your years up through 2013?

Mr. LEW. I don't agree that the debt, as measured in economic terms, goes up.

Mr. SMITH. No, no, the total debt of this country as defined by law. The debt subject to the debt limit, do you agree that that increases up through year 2013?

Mr. LEW. There is no doubt that that subject to limit goes up——

Mr. SMITH. That is because, I would suggest, we are taking the dollars out of the Social Security Trust Fund. We are using those cash dollars to pay down the T-bills. That is what we are doing. We are taking money. It is like moving boxes around and pretending we are accomplishing something.

But the fact it seems to me is, and I am disappointed that you don't agree, that the debt that we owe these Trust Funds means that sometime in the future we are going to have to increase taxing or increase borrowing if we are going to pay back the money to those Trust Funds.

Let me say this. Your proposal, as I understand it, can be analyzed as extending the life of Social Security till 2050 or 2054. You suggest we use the interest savings from paying down the debt held by the public and put that into the Social Security Trust Fund. Let me ask you this question: Are you spending the interest savings every year for the next 10 years of this budget? Are you spending it on other government programs?

Mr. LEW. We are treating the interest savings as we do currently under present law——

Mr. SMITH. And the answer is yes? You are spending the interest. Then on the 11th year, in 2011, where do you come up with the money to somehow magically re-create this money that is already spent?

Mr. LEW. I don't think we do the public a service by making this more complicated than it is. Respectfully, I think that you have just made it more complicated than it is.

Mr. SMITH. You spend the interest savings every year on other government spending?

Mr. LEW. If I could just take a minute to answer—I would like very much to answer. What we do until 2010 is we pay down the debt, and we are paying down debt in an amount that is equal to the Social Security surplus. Last year, we proposed starting Social Security transfers earlier. We were told by many on both sides of the aisle, pay down the debt first before you talk about putting general revenue into Social Security. This year's proposal reflects those concerns, and we wait until we have actually accomplished the debt reduction. It is very real.

What we are proposing is the only proposal out there that would take any of the benefits and put it into the Trust Fund for solvency. If you would like to discuss doing it earlier, we would be happy to engage in that discussion, but we are criticized whichever way we go. We are trying to take care of this problem. It is complicated accounting. The current system is complicated, but I think our proposal is quite straightforward.

Mr. SMITH. In 2011, where are you going to come up with the $200 billion plus?

Mr. LEW. I know that we are running late, but our long-term projections have on-budget surpluses adequate to pay this back.

Chairman KASICH. Mr. Ryan for the final questions.

Mr. RYAN OF WISCONSIN. Thank you, Mr. Chairman.

Thank you, Mr. Lew, for coming. I appreciate you spending the time here. I will try to be brief so we can get going with our day.

I was intrigued with something you just said a few minutes ago. You said that this year's discretionary number is only $7 billion above the baseline, meaning 614 minus 7 assumes the baseline is at a $607 billion mark. Is that an accurate reflection of what you said?

Mr. LEW. Correct.

Mr. RYAN OF WISCONSIN. If you look at what we spent last year in discretionary spending and add the forward funding that occurred and then add the one-time emergencies we spent, that number would be $586 billion. So with the math that we are seeing from the OMB, that means you are assuming $21 billion exists, was new money that was spent. Forward this to 10 years, take this math that you are saying, $607 billion is our baseline when actually, arguably, 586 is our baseline, take that out 10 years, and then you see that you are consuming $800 billion of new discretionary spending built into your baseline.

What I wanted to ask you is this. Yesterday the administration said that this budget simply increases spending by $300 billion. If you look at real math, where I come from in Wisconsin, if you spend more money one year given the next year, you spend more money. If you spend money from $586 billion last year and then go to $614 billion this year, you are spending more money. If you take that common sense mathematical approach to this budget, you are actually increasing spending by $1.3 trillion over the next 10 years, not by $300 billion. So what we are looking at is a difference in the discretionary side of the budget where you are actually increasing spending by $800 billion.

So that is what the American consumer sees. I had 60 town hall meetings on these very topics. I asked my constituents this question. After we lock away Social Security, after we dedicate 100 percent of the Social Security surplus to paying down public debt and Social Security, which we are all fairly much in agreement here, what about that non-Social Security surplus? Looking at your budget, you are simply saying that we are going to spend 70 percent of the non-Social Security surplus here in Washington on entitlement programs, on creating 84 new programs, and you are saying that it is not actually happening because your baseline hides that fact.

If my constituents are posed with the question of what would you rather have with the non-Social Security surplus, your money back to you in the form of tax cuts or in the form of more debt reduction, I would probably get mixed results. Half of them would say more debt reduction, half of them would say give me my money back. But if you ask constituents around this country, would you want to see more spending with your non-Social Security surplus and your income tax overpayments be plowed into more spending in Washington or given back to you, it is an overwhelming result. People want their money back.

By looking at your budget and seeing that you are actually increasing spending not $300 billion but by $1.3 trillion, $800 billion of which comes from discretionary spending, that is in a sense taking this on-budget surplus off the table before we even get a crack at it. It is saying the government gets the money first, the taxpayer last. That is something that I think is very important in this discussion, as we compare apples to apples instead of apples to oranges.

I would appreciate if you could comment, and then I have one more question.

Mr. LEW. I would be happy to comment.

I think that most of what you have just been discussing really gets down to which baseline you choose to begin with. Our definition of the current service baseline is very close to the Congressional Budget Office. It is based on the statute, the Budget Enforcement Act. The reason that our projection of $746 billion is so close to $838 billion is that we are using the same definitions with relatively small forecasting differences.

I think that if you look at the two alternatives that they proposed, they are just not realistic. We are not going to freeze for 10 years. We haven't done it in the past. I don't believe we will do it in the future. We are not going to go back down $70 billion. It may be that we disagree as to how much it should be. But to start with either of those other starting points I think is fooling ourselves. It is not a good way to make fiscal policy to pretend that we can have savings that we haven't been able to make in the past.

Mr. RYAN OF WISCONSIN. Reclaiming my time, even if we don't go down $70 billion, which I think I would agree with you, we are not going to go back down to 541 or whatever the number may be. You are still spending $800 billion more over the next 10 years.

Basically, the point is this. By assuming the government will grow and discretionary spending will increase every year and then calling that a freeze, it is just dishonest. But also the fact that you include a current services baseline which, if you use CBO numbers like you just referenced, you are increasing spending by $800 billion over the next 10 years. More importantly, that basically assumes that there will not be any wasteful spending in this country over the next 10 years, there won't be any unnecessary, duplicative or redundant programs that should be weeded out, that should be cut. Simply, we are going to spend more money every year to the next, and it is going to consume 70 percent of the non-Social Security surplus, 70 percent of the income tax overpayments from the American taxpayer for the next 10 years. That is basically what this budget is. It is very clear, in black and white, and it is clear by the CBO baseline numbers.

One more thing I wanted to ask you is, can you describe to me exactly what your Social Security lockbox proposal is?

Mr. LEW. Yes. First of all, I would agree that our budget is clear and that it is in black and white. I don't think that I would agree with your description of what it says. Our Social Security lockbox proposal is different in an important way from some of the proposals that you have debated in the Congress.

I agree with you, that mostly we have been agreeing that we should set aside those funds. In addition we are saying that for the benefits of debt reduction that are coming about by setting aside those funds, we need to provide for extending Social Security solvency. We take the interest savings, that is, the lower net interest payments by the Federal Government and, beginning in 2011, we dedicate those to the Trust Fund.

Mr. RYAN OF WISCONSIN. How do you enforce the lockbox?

Mr. LEW. How do we enforce the lockbox?

Mr. RYAN OF WISCONSIN. How do you make sure somebody can't pick the lock?

Mr. LEW. We require in law that the transfers be made, and it would be up to Congress if they wanted to vote to repeal it.

Mr. RYAN OF WISCONSIN. Are you opposed to lowering the publicly held debt limit as Social Security surplus payments are made toward paying down the public debt?

Mr. LEW. I think the last year we saw some proposals in that regard that we worried very much about in terms of their workability.

Mr. RYAN OF WISCONSIN. Cash management positions on a month-to-month basis?

Mr. LEW. Cash management positions. We have got to be very careful what we do in terms of the public debt that we not roil the markets.

Mr. RYAN OF WISCONSIN. If those concerns are addressed on this month-to-month cash management position, would you then take a look at this proposal again?

Mr. LEW. I don't believe that using the public debt as a budgetary enforcement tool is wise. I think that it is inherently risky in terms of managing our very important role in the financial markets. I think we need to have strong enforcement tools. I would look forward to working to try to find tough tools that we could agree on.

Mr. RYAN OF WISCONSIN. The administration is agreeing that we should pay off the publicly held debt by the year 2013, correct?

Mr. LEW. Yes.

Mr. RYAN OF WISCONSIN. But you are opposed to lowering the statutory limit of the public debt? You are opposed to lowering that ceiling as you pay off that public debt?

Mr. LEW. They are different measures. Let me give you an example. Let's just say that the economy grows faster than we projected. Payroll taxes come in, Social Security reserves go up. So far it is all good. That is debt subject to limit. You don't want to be in a position where you are unable to go out and do the month-to-month financing needs of the Federal Government because you had a good economy and your payroll receipts went up and your Trust Fund is doing well. It is very difficult, it is impossible to predict over a long period of time the month-to-month needs that closely. I don't think the debt held by the public measure necessarily serves us well now. I think that would make it a very difficult tool.

Mr. RYAN OF WISCONSIN. Reclaiming my time, Jack, those cash management concerns I think can be adequately addressed. I am new in Congress, but I wasn't born yesterday. I realize that if we don't have any artificial discipline in this institution between Congress and the President, it won't get done. They will spend the money. It happened last year. You are proposing it to happen for the next 10 years. If we do not reduce the publicly held debt limit ceiling as we try to reduce the publicly held debt, there is a good chance it won't happen.

I would like to just conclude with one quick observation that I hope you can take into consideration. You are using a different measuring stick in measuring spending for the next 10 years. You are simply assuming that the overpayment of income taxes over the next 10 years, 70 percent of which will go into new spending, new spending above next year, above the next year's new spending—that is where I come from. If you spend more money next year than you spent last year, that is additional spending. By rejecting that and by suggesting that this budget is only calling for a $300 billion spending increase over the next 10 years is just simply wrong. You are calling for a $1.3 trillion spending increase over the next 10 years.

That is by CBO numbers. I hope that we can reconcile these numbers. I hope that when you analyze the product that this committee puts out that you will use the numbers we used, the CBO numbers, so that we can tell—we can compare our budgets on an apples-to-apples basis.

Thank you.

Chairman KASICH. Just as an observation, I think it is interesting that we dismiss the spending caps, as staying with them is kind of being viewed in this city as absurd, even though it was just an agreement that was made less than 3 years ago. And then we say it is kind of ridiculous to think that we could freeze spending at last year's level because we don't have the will to do it. And then we reject all other artificial means of trying to get us on a bipartisan basis to do what I think—when we say we can't do it, that should be woe is us. So we can't control the spending, and we also can't put in the artificial means that would help us to do what we all think we ought to do.

This is not directed at you, Jack. It is just an observation. It is going to be interesting.

I am going to have a provision that is going to say that if we pass a tax cut and you veto it that we would take that money and put it in a lockbox and use it to pay down debt. It is going to be very interesting to see whether I can enact that provision.

And Paul Ryan—as I mentioned yesterday, Paul has been very strong on this. It will be very interesting to see whether I can work that through my own party. Because the tougher you make it, the more money it takes off the table, and it starts to get people nervous that we might not have enough money to spend. It is just very interesting, our inability sometimes to be able to control spending.

Mr. Spratt.

Mr. SPRATT. Let me just make an observation. For the spending caps to have a real constraint, they have to be realistic. If they aren't, they only invite circumvention, evasion, gimmicks, from both sides. If they are so tight that you can't possibly meet them, then they really get honored in the breach. We first set them in 1990 and, as a result, throughout the 1990's real spending, discretionary spending is 11 percent less than it otherwise would have been. That is one of the reasons we are where we are. We have found that we can't abide by the very tough and tight caps set in 1997.

One is the reason I mentioned in my statement, defense. What we are providing for defense, and I think your side of the aisle and mine both share this commitment, we have found it is not enough. We are stretched out. We have got recruitment problems, we have got retention problems, we have got modernization problems that need to be met. We are providing $24.4 billion more than we had in the baseline. That in itself is half of the increase in discretionary spending.

Chairman KASICH. I agree that defense was underfunded, which was a significant reason why discretionary spending went down. But a pox on everybody's house when it comes to the need to reform defense.

I have been off this kick for a few years because, frankly——

Mr. SPRATT. There is another hearing right now in our committee, the House Armed Services Committee, where the witness will testify that defense is underfunded by $100 billion.

Chairman KASICH. Let me tell you, there isn't any question that our troops, our soldiers, are in a dire circumstance. But there is no question that you have a Pentagon that can't reconcile $1.7 trillion worth of spending to make the books add up, that we are incapable of disbanding the depot caucus because that is about what I can take home, it is about a Congress that appropriates money for weapons systems that the people who fight the wars don't want, it is about the inability of us to bring about any significant reform in that building. We tried it under Republicans. We didn't get very far. We tried it under Democrats. It doesn't get very far. They have been trying it since Washington commanded the Army. It is a very frustrating effort that needs to constantly be engaged in.

Mr. LEW. Some of the accounting problems go all the way back to the beginning.

Chairman KASICH. You are absolutely right.

But, to make a long story short, I just wish that sometimes we could accomplish a few of these things. Yet you don't want to pour rain on what we have accomplished, as I think John is pointing out.

Mr. Lew, I want to thank you for your patience, your energy and for being here for the whole duration. I look forward to being with you the rest of this year.

Mr. LEW. Thank you, Mr. Chairman.

[The prepared statement of Ms. Hooley follows:]

PREPARED STATEMENT OF HON. DARLENE HOOLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OREGON

Thank you Mr. Chairman—and thank you Mr. Lew for the patience you have demonstrated throughout this hearing.

I know that for the last several months you and your colleagues have been working hard to craft the President's budget request. It must be frustrating to see all your hard work declared "dead on arrival" before even getting a chance to present it to the committee.

That's unfortunate. Regardless of which political party controls the White House or Congress, every one of us knows that in the next few weeks we're going to have our share of disagreements. But in the long run, I would hope we can work together and craft a spending resolution that gives the men and women in this country the sense that we can get things done here in Washington.

And I think the President's budget proposal is a step in the right direction. Not only would this budget pay off our national debt 2 years ahead of schedule (2013 as opposed to 2015), it offers a number of common sense, substantive solutions to fund the priorities that Americans care about.

Foremost among them is the President's $40.1 billion dollar request for the Department of Education—a $4.5 billion increase over FY 2000 spending. As a former teacher, I know how important it is to give our kids the attention they deserve. If enacted, this would be the largest jump in discretionary spending in the history of the Department, and would give our communities the help they need to create smaller, safer and better public schools.

I'm also excited about the administration's determination to provide the American people common sense tax relief. All of us can agree that we need to create family-focused tax credits and eliminate the marriage penalty. But we also know that how we do that is important—because we have to save enough of the projected budget surplus to extend the life of Social Security and Medicare.

I'm pleased to see the President's tax-cutting proposals are similar to the ones that Oregon Republican Congressman Greg Walden and I included in our bipartisan tax plan last spring. The President's proposal rightly takes aim at the marriage penalty by providing $45 billion in tax relief over the next 10 years. At the same time, this budget would set aside and save 100 percent of the Social Security surplus and ensure the long-term solvency of Medicare. While we might disagree on the size of the tax cut, we can all agree that we need to keep our hands of Social Security and revitalize Medicare.

Mr. Chairman, speaking of Medicare—I would like to point out that prescription drugs are not supplemental to basic health care, they are integral to it. Yet the high cost of these drugs—and the inability of Medicare to help our seniors cope with them—are a looming public health crisis. As a matter of fact, some seniors in my district—as I'm sure in yours—have been forced to travel to Canada and Mexico to obtain cheaper medicine. Others have had to cut corners by buying less groceries or even not heating their homes.

Quite frankly, these are men and women that have worked hard and sacrificed an enormous amount to get us where we are today. They shouldn't have to make a monthly or bimonthly trip to another country just to buy the medicine they need to stay healthy.

As elected officials, it is imperative that we look out for the welfare of every constituent, regardless of their age or health. However, it's especially unfair that so many of our seniors should be forced to suffer. While I am pleased to see that the President has proposed adding a voluntary prescription drug benefit to Medicare, I urge all of my colleagues here today—and the witnesses from the administration—to undertake an honest effort in the remainder of this session of Congress to give our seniors the relief they so badly need.

Thank you Mr. Chairman.

Chairman KASICH. The committee will stand adjourned.

[Whereupon, at 1:30 p.m., the committee was adjourned.]

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