PRESIDENT'S TAX RELIEF PROPOSALS: INDIVIDUAL INCOME TAX RATES

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HOUSE OF REPRESENTATIVES

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COMMITTEE ON WAYS AND MEANS

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PRESIDENT'S TAX RELIEF PROPOSALS: INDIVIDUAL INCOME TAX RATES

TUESDAY, FEBRUARY 13, 2001

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

The Committee met, pursuant to notice, at 10:05 a.m., in room 1100 Longworth House Office Building, Hon. Bill Thomas (Chairman of the Committee) presiding.

[The *advisory* announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE CONTACT: (202) 225–1721
February 6, 2001
FC–1

Thomas Announces Hearing on President's Tax Relief Proposals

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on President Bush's tax relief proposals. **The hearing will take place on Tuesday, February 13, 2001, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

Oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

On February 8, 2001, President Bush is expected to submit to the Congress a package of tax relief proposals, including, among other items, reductions in individual income tax rates, an increase in the child tax credit, relief from the marriage tax penalty, incentives for charitable contributions, and repeal of the death tax. The approximate 10-year cost of the tax relief is expected to be $1.6 trillion.

In announcing the hearing, Chairman Thomas stated: "The surplus means it's time for immediate, across-the-board tax relief for all taxpayers to boost our economy, create jobs, and give Americans more confidence by returning some of their surplus taxes to help them get through these uncertain times. We need to cut taxes for working Americans."

FOCUS OF THE HEARING:

The Committee will receive testimony on the President's tax relief proposals and their impact from invited witnesses.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should *submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5—inch diskette in WordPerfect or MS Word format, with their name, address, and hearing date noted on a label,* by the *close of business*, Tuesday, February 27, 2001, to Allison Giles, Staff Director, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Committee office, room 1102 Longworth House Office Building, by close of business the day before the hearing.

FORMATTING REQUIREMENTS:

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

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect or MS Word format, typed in single space and may not exceed a total of 10 pages including attachments. **Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.**

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

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

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

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

Note: All Committee advisories and news releases are available on the World Wide Web at "http://waysandmeans.house.gov".

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

Chairman THOMAS. Everyone find their seats as quickly as possible please. Thank you.

The subject of today's hearing is President Bush's income tax relief proposal. This morning we will hear testimony from Secretary of Treasury O'Neill. This is Treasury Secretary O'Neill's first appearance before the House and we will welcome him here. He will be with us, unfortunately, only for about 2 hours. He has to move on at noon. I do hope the members will be expeditious in the questions they ask. I know he will be economical in his answers. If there are any elaborations that need to be done, I am quite sure we can do it with written questions and written answers.

Then this afternoon we will hear testimony from a panel of three economists: Kevin Hassett, Martin Feldstein, and Bob Greenstein. I think if anybody knows their backgrounds and will listen to the testimony, no one will say that we did not cover the spectrum in terms of economic analysis by economists of the President's program.

As we begin the discussion of the President's income tax proposals, I would like to remind members that we will have ample opportunity to address other problem areas in this session. Indeed, today the Congress will have an opportunity on the floor to vote on legislation that once again creates a Social Security and a Medicare lockbox. It is very similar to the legislation that we passed previously and it puts approximately $2.9 trillion of the surplus away, preserving it for Medicare reform and Social Security reform. These payroll taxes as a separate issue will certainly be examined by this Committee under its jurisdiction. Medicare and its modernization, including prescription drugs, will be the subjects of hearings of the House subcommittee under the leadership of Chairwoman Nancy Johnson and Ranking Member Pete Stark.

Social Security reform was a major issue in the last Presidential campaign. President Bush has said he would be presenting proposals on reform as will Members of Congress. Obviously the Social Security Subcommittee, under Chairman Clay Shaw and Ranking Member Bob Matsui, will provide leadership on this issue for the Committee. Areas of concern will be examined by this Committee of the President's proposals from time to time.

But today the subject is the Income Tax Code of the United States and changes to that Code offered by the President. There are many reasons to amend the Code. It is too complex. It is unfair. Its current structure collects more money than is needed to fund the government. Some are asking that our examination of the IRS Code should wait until we have a more complete budgetary picture of where we are on the projected surplus so that we could examine all the competing demands on our resources. And there are some, I have a hunch, who just want to stall because they don't want to reduce the income tax burden on Americans.

The economic juggernaut that has propelled us to these surpluses is slowing. How much is up for debate. I don't think, though, that we should pause, clean our glasses, and adjust our green eye shades before we as Congress respond to this economic slowdown.

One of my interests today is to find out if we should act sooner rather than later and, if so, in what way. And with that, without objection, each member will have an opportunity to submit a written statement and have it included in the record at this point.

[The opening statement of Chairman Thomas follows:]

Opening Statement of the Hon. Bill Thomas, M.C., California, and Chairman, Committee on Ways and Means

Good morning. We are pleased to have Treasury Secretary O'Neill and some of the nation's top economic experts with us today to testify on the President's tax relief plan, and I look forward to hearing their views. But before we begin I'd like first to put some things in perspective and remind my colleagues of the significant milestones we've accomplished for the American people.

Republicans in Congress are already saving the entire $2.9 trillion of the off-budget surplus for Social Security and Medicare. Later today, we will again have bipartisan support to create a Social Security and Medicare lockbox so that every penny actually goes toward those programs for our nation's retirees and seniors. We're keeping our commitment to older Americans that have paid into the system their entire lives, so they can enjoy a secure and healthy retirement.

Since 1997, we've paid down more than $363 billion in debt, and for the first time in generations, we are on track to eliminate the debt entirely. Our priorities have not changed. Even after we have set aside $2.9 trillion for Social Security and Medicare and put our fiscal house in order, we still have $2.7 trillion more that's coming into the Treasury than the government needs. And if that money is left in Washington, politicians will surely spend it.

The health of our nation's economy demands that we act quickly. Pick up the local newspaper and you can see the beginnings of sluggish economy—tens of thousands of layoffs, production cutbacks, and over-stocked warehouses. Working Americans continue to feel the tax bite. A typical family spends more in taxes than they do on food, clothing and shelter combined. Is it any wonder that one in five Americans says they're having trouble paying the bills?

It's time to give hard-working American taxpayers some of their money back. Every day, taxpaying families are struggling to make ends meet. So the sooner we can give them real tax relief, the sooner they can pay the light bills, make their mortgage payments, and cut into their credit card debts.

Chairman THOMAS. But I would turn to my friend and colleague, the Ranking Member from New York, Mr. Rangel, for any comments he may have.

Mr. RANGEL. Thank you. And again, Mr. Chairman, I congratulate you on your ascension to the awesome and powerful position that you enjoy and I am confident that you will carry this great responsibility with a great deal of power-sharing and principle-sharing on this Committee, and we look forward to working with you.

Mr. Secretary, I think our Nation is fortunate that someone of your stature was willing to give up the private sector to come back to help us to work out some of the problems that we face. And I enjoy talking with you about the things that you hope to accomplish, and I do hope that you will be able to bring us together to do what is good for the people. We have a tax cut before us that it is generally felt that we have accumulated a surplus to which the American people have contributed and that we have a responsibility to return a part of that to the people. There are differences in terms of the size and how we should do it, but this Committee has the constitutional responsibility to work that through.

There is also a problem with the framework that the President has sent to us because we hear some people in the House say the reason why higher income people receive so much of the tax cut is because they are the ones that pay the taxes. And the truth of the matter is that in my community, people think that taxes are the difference between what their salary is and what they come home with. And it is so unfair in my opinion not to include payroll taxes as a part of the relief which the President talked about in the campaign and which we have a responsibility to deal with.

During the campaign the President's promises were so similar to the Democrats that I think we could walk away saying that we want to reach the same goals, we want to make certain that that Social Security system is not here just for us but for the baby boomers that are to come. We want to make certain that health care is available to them. The President made a great deal about improving the quality of life of our young people who put their lives on the line in the military. He doesn't want to leave any child behind in terms of education. And on that issue I think he has more friends on our side of the aisle than the other. He wants to be able to make prescription drugs affordable for our people.

So where could our difference be if we believe in tax cuts, we believe in programs? The difference I think, Mr. Secretary, is that we do not have a budget, and we can only support a tax cut when we know what's going to happen with the rest of the budget. And it appears to me, and I may be wrong, and you are a businessman, that this tax cut to a large extent is based on doing all of these things because we have a reasonable possibility that in the next 10 years we will have $5.6 trillion to deal with, and we are assuming that if we do all the things we have to do with this tax cut program, it could easily reach $2 trillion. In any event, we will have some questions, relying on your expertise to help us to get through these things. We welcome you to Capitol Hill and we hope that you and your wife will never regret your decision to come up.

Thank you Mr. Chairman.

[The opening statement of Mr. Rangel follows:]

Opening Statement of the Hon. Charles B. Rangel, M.C., New York

We have a tax cut before us (and) it is generally felt that we have accumulated a surplus to which the American people have contributed and that we have a responsibility to return a part of it to the people. There are differences in terms of the size (of a tax cut) and how we should do it, but this Committee has the Constitutional responsibility to work that through. There's also a problem with the framework that the President has sent to us because we hear some people in the House say that the reason why higher income people receive so much of the tax cut is because they're the ones that pay the taxes. And the truth of the matter is that, in my community, people think that taxes are the difference between what their salary is and what they come home with and it is so unfair, in my opinion, not to include payroll taxes as a part of the relief which the President talked about in the campaign and which we have a responsibility to deal with.

During the campaign, the President's promises were so similar to the Democrats' that I think we could walk away saying that we want to reach the same goals. We want to make certain that the Social Security system is not there just for us, but for the Baby Boomers that are going to come. We want to make certain that health care is available to them. The President made a great deal of improving the quality of life of our young people who put their lives on the line in the military. We agree. He doesn't want to leave any child behind in terms of education and, on that issue, I think he has more friends on our side of the aisle than the other. He wants to be able to make prescription drugs affordable for our people. We have tried to do that for years. And so, where could a difference be if we believe in tax cuts (and) we believe in these programs?

The difference I think, Mr. Secretary, is that we don't have a budget. And we can only support a tax cut when we know what's going to happen with the rest of the budget. It appears to me, and I may be wrong and you are a business man, that this tax cut, to a large extent, is based on reason to believe that in the next 10 years, we will have $5.6 trillion to deal with. Nonetheless, we're assuming that if we do all the things we have to do with this tax cut program, it could easily reach $2 trillion. Before we proceed with such a tax cut, we should have a budget in place so that we know what we are doing.

[The opening statements of Mr. Crane, Mr. McDermott, Mr. Ramstad, and Mr. McInnis follow:]

Opening Statement of the Hon. Philip M. Crane, M.C., Illinois

Thank you Mr. Chairman.

Mr. Secretary, I want to welcome you for the first of what I hope will be many productive and collegial visits to our Committee. I think you have had a splendid start in your tenure as Secretary.

It will surprise no one, I am sure, when I say I support the President's program in its entirety. That said, I want to make just a very few points.

First, I want to recognize our friends from the other side of the aisle who have now joined the tax cut movement. After years of opposition, the question is no longer whether, but how much. I say that not in gloating, but in sincere appreciation.

Second, I want to point out that we are at this juncture because of forecasts of enormous surpluses. These surpluses represent property—the income and wealth of our citizens—that the federal government is taking without cause or need. The great American economist, Walter Williams, once captured the matter with the phrase—"Taxation is theft." It is, to an extent, a necessary theft. But when it produces enormous surpluses, it becomes far less a necessity and far more theft. And it is irrelevant against whom this theft is committed.

Third, we hear how these surplus projections are uncertain. Indeed, they are. In recent years we have seen the projected surplus rise by a half trillion dollars or so every six months. I submit that recent experience tells us the uncertainty goes in both directions. The surpluses are more likely to turn out to be larger than forecast, not smaller.

Fourth, we can reinforce our confidence in the projected surpluses if we reduce spending in some areas. After the last few years of bi-partisan profligacy, with discretionary spending increasing over 18 percent in the past three years alone, no one can argue with a straight face that spending restraint is not in order. Further, if we hold the line on spending, then there is no doubt there will be a second and a third tax cut bill in this Congress.

Finally, I do not know if we can enact this program quickly enough to shorten the downturn in the economy. If we had enacted significant tax relief last year, we might have avoided the downturn altogether, but that is water under the bridge. I do know that sound tax policies such as the rate reductions in President Bush's plan will assure us a stronger economy in the future. As the recent downturn has indicated, and as the decade-long troubles of the once high-flying Japanese economy underscore, we must never take prosperity for granted.

Mr. Secretary, I pledge to you today to work with you to enact the President's plan in its entirety with all the dispatch the legislative process can muster.

Opening Statement of the Hon. Jim McDermott, M.C., Washington

I believe in a tax cut for all Americans, within the context of a fiscally responsible budget framework.

In contrast, the tax cut proposal from President Bush is biased and unfair, giving disproportionately less money to working poor families.

Why should lower-income families who do not owe any federal income tax, but who do pay substantial payroll taxes, get no tax cut? Bush supporters talk in terms of marginal tax rates and percentages, but not dollars. They will tell us that the poor receive a large reduction in marginal tax rates in order to help them obtain access to the middle class. But they do not tell us that one in three families receive no benefits. That is, an estimated 12 million families with children would not receive any tax cut. Nor do they tell us that the lowest 20% income group earning less than $13,600 will receive an average tax cut of $42 as compared with the top one percent group who receive an average tax benefit of $46,000.

Why should the child credit be extended to families with incomes between $100,000—$200,000 before making the credit refundable? This is in effect giving the relatively more affluent taxpayers a raise in the child credit from zero to $1,000 while many low income individuals receive no benefit. Why shouldn't *all* Americans benefit from the economic growth and prosperity that has resulted in our surpluses?

Furthermore, President Bush's tax cuts are irresponsible.

His proposal does not leave enough money to pay off the debt, strengthen Medicare and Social Security, and invest in health care, education and defense. There will not be enough money for the partial privatization of Social Security that Bush has proposed. There will not be enough money for prescription drugs or helping the uninsured, (for which he committed $130 billion). Nor does the Bush proposal account for extending expiring tax provisions and AMT reform.

Supporters of Bush's plan will argue that tax cuts are needed to stimulate the economy. But this tax cut was proposed in 1999. It had nothing to do with the economy then. Further, the principle reason CBO's budget projections show larger surpluses than previously assumed is that CBO now believes the economy generally will be *stronger* over the next 10 years than previously thought. Therefore, the argument that a large, permanent, and growing tax cut is needed because of a weaker economy does not stand up well.

I support a responsible tax cut that gives something to all families. I support a budget that recognizes economic and fiscal realities. The current projections are just that—projections. The budget must maintain a reserve for inevitable errors in these projections. It must pay down the debt, shore up resources for Medicare and Social Security, allow for other initiatives, as well as providing for tax cuts.

There has been much focus on Chairman Greenspan's testimony and the peril of reaching zero debt. There is a misconception that government spending is a bad idea. If the surpluses do indeed actualize, what about the commitment to our seniors—to ensure financial viability for the Medicare and Social Security programs? And what about the 44 million uninsured?

In fact, in a recent Newsweek poll, 65% said they would rather see the surplus used to pay down the federal debt and make entitlement programs more solvent than have the surplus used for a tax cut.

I support tax relief, which includes modifying the estate tax, easing the marriage penalty and expanding the earned income tax credit. But any tax cut must be designed within the framework of balanced priorities.

Thank you.

Opening Statement of the Hon. Jim Ramstad, M.C., Minnesota

Mr. Chairman, thank you for holding this important hearing today to examine President Bush's proposals for tax relief.

What a difference a year makes. At this time last year, we were debating whether we should have a tax cut. The question now is not whether, but how much and how quickly!

The time for tax relief is now. The dire state of the economy is no longer in doubt. A major tax cut is needed to stimulate the economy and keep people working.

The plan before us is fiscally responsible. CBO estimates project a surplus of at least $5.6 trillion over the next 10 years. With this surplus, it is unconscionable that Americans are paying the highest peacetime level of taxes in history. It is entirely reasonable to strengthen the economy by returning to taxpayers one fourth of their tax overpayments, and to use the remainder to pay off the debt, shore up Medicare and Social Security, and improve education.

Cutting taxes in this modest way will not threaten our fiscal discipline. On the contrary, it is a well-documented paradox that tax revenues actually increase after taxes are cut, as more jobs and rising incomes send money to the Treasury.

President Bush's tax cut initiative is also fair. Lower and middle income Americans will see the most dramatic percentage drop in their taxes under the plan. And although all Americans who pay taxes will receive a tax cut under the President's plan, wealthier taxpayers will actually pay a larger portion of America's tax burden than they do today.

On a "micro" level, this tax relief will raise the standard of living for individual families. It will allow working Americans to save and spend more of their own money for their family's needs. For a typical family of four, this means an extra $1,600. And from a "macro" perspective, this broad tax relief will create jobs and spur economic growth. Our families and our national economy need this relief.

Mr. Chairman, thanks again for convening this hearing. I look forward to hearing from Secretary O'Neill and our distinguished panel of economists. Working together, we can provide tax relief that will strengthen families and the economy.

Opening Statement of the Hon. Scott McInnis, M.C., Colorado

Mr. Chairman, it is with great optimism that I await today's opportunity to discuss legislative proposals to cut taxes for Americans. Today we look forward to the opportunity to work to lower marginal rates, reduce the marriage penalty, help Americans save for their children's education, enable middle class taxpayers to get proper credit for their charitable giving, and work toward ending the death tax. Since taking a seat on the Ways and Means Committee, I have championed the effort, along with some of my colleagues, to bury the death tax. I am pleased that this year we have a real opportunity to address some of the death tax's punitive operation on constituents in the Third District of Colorado and everywhere in the United States.

The case for killing the death tax is a compelling one, and at its basis is a rejection of the notion that the death of a loved one should be a taxable event. This concept is so absurd that only the federal government could have dreamed it up.

Let me put my opposition to the death tax in concrete terms. Take the case of Brookhart Building Centers in Montrose and Grand Junction, Colorado. After 52 years of doing business in western Colorado, Brookhart's owners were forced to sell their family owned business to a national chain because of the impending threat of having to pay the death tax. Rob Watt, who ran the business along with his aging mother and father prior to its sale, said at the time "[i]n order to protect our family and our current employees from a liquidation upon the death of [my parents], the best thing now would be to sell the company." The death tax sealed the fate of this family business, and I am firmly convinced that there is no sound argument to support the federal government imposing such an onerous tax that literally forces the sale of these family businesses. Moreover, Brookhart's owners sold it early in order to protect their employees, but many small business owners, ranchers and farmers don't realize the death tax will hit them, and their employees end up suffering because of it.

Derek Roberts of Livermore, Colorado tells a similar horror story about the impact of the death tax on his community. Derek, a fifth generation northern Colorado rancher, worries that the death tax will doom his family run operation, preventing his sons from becoming the sixth generation of Roberts to run the family ranch. The death tax has already claimed many of his neighbors in his community, "[w]e are one of only one or two or three ranchers left around here," he said in a letter to the editor in which he called for the elimination of the death tax. "One of the last to go was a family that had been there as long as ours. When the old folks died, the kids borrowed money to pay the taxes. Soon they had to start selling cattle to pay the interest. When they ran out of cattle, their 18,000 acre ranch was foreclosed and is now being developed. The family now lives in a trailer near town, and the father works as a highway flagman."

Stories like this are far too common in Colorado. And they raise the question why tax policy, specifically the death tax, is driving the development of ranch and farm land in our country. At a time so many people out there are asking policy makers for more open space, why is the death tax foreclosing our open space. Local land use planning can and should be done without the help of the federal death tax. As Derek Roberts makes clear, it is not the ranching family or farmer who benefited when his neighbor's ranch was eventually foreclosed. The community also lost a source of strength, because often it is these families who are foundations of the community's local institutions and charities. When the death tax bankrupts a family, the money is sent to Washington D.C., and the local community and family suffer as a result.

So, in closing, Mr. Chairman, I am excited that today Congress and the Bush Administration will have the first real opportunity to work on a broad tax cut for Americans, and I eagerly look forward to working with all who are seriously committed, as I am, to ending the penalty the death tax imposes on Colorado's farmers, ranchers, small business owners, and everyone else who shares the American Dream.

Chairman THOMAS. Thank you very much. And prior to introducing the Secretary, I would be remiss if I did not look behind him and see a longtime servant of the people on the House Ways and Means Committee, Chris Smith. I am sorry he left us, but I am glad that his expertise is now serving the administration downtown. And with that, the 72nd Secretary of the Treasury, Mr. O'Neill, the time is yours.

STATEMENT OF THE HON. PAUL O'NEILL, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary O'NEILL. Mr. Chairman, Mr. Rangel, honorable members, it is a great pleasure for me to be here this morning in this first of your meetings and my first opportunity as Secretary of the Treasury to speak to you about the Nation's business and particularly to speak to you about the President's proposals for changing our Income Tax Code and giving the American people, however you might stylize it, a tax reduction or a pay raise which would go to every Federal taxpayer.

As the Chairman observed, the structure of our tax system today is producing very large amounts of excess funds, funds greater than we need to pay for agreed public purposes that have been legislated by you and your colleagues. And it is also true that as we do the conventional process of looking at the 10-year forecast that, by the CBO reckoning which you will see in a couple of weeks, we will substantially validate in the administration's own economic forecast, this surplus over the next 10 years will approximate $5.6 trillion.

In order not to end up in a situation in a few years, as Chairman Greenspan has observed, in a position where we have such large surpluses that we have completely eliminated the publicly held debt and go into the business of buying private assets as a government holder of private assets, it is important that we make structural changes in the way the tax system works so that we do not accumulate the huge and ongoing surpluses at the Federal level. And importantly, as the President has said over the last couple of years, our tax structure needs attention to deal with some issues of fairness and to deal with the accretion that has occurred in the tax rate over the last 10 years as compared to where we were.

And so we have the President's proposal in front of you. It is a proposal not fashioned in the last few weeks or in the last few months, but created out of his ideas of what he thought would be a fair system for the American people as he went around the country and campaigned for office over the last 2 years. And it would do several very important things:

First, it would reduce the marginal rates for American taxpayers. It would reduce the marginal rates for the lowest-income Federal taxpayers by 50 percent, not an inconsequential change. And at the top end, it is true, the President's proposal would reduce the top rate from 39.6 percent to 33 percent which would still be 2 percentage points higher than where we were 9 years ago.

So there is a shift in the portions of tax incidence in what the President has proposed to favor low- and moderate-income taxpayers. So, for example, for a four-person family with an income of $35,000, they would be taken off of the Federal income tax rolls. And for a four-person family with an income of $50,000 they would have their tax cut in half, from $4,000 a year to $2,000 a year. And serially up the line of income levels, the President's proposal would provide relief to every American taxpayer.

The President has also proposed that we make a change in the Tax Code that is pro-family, effectively doubling the child credit from $500 to $1,000.

And then there are proposals that are certainly familiar to you, because in this body in the last couple of years you have dealt with the issues of the penalty that is imposed on two-person families with a so-called marriage penalty and then the estate tax or the so-called death tax issues that again you dealt with in the last couple of years, and finally making permanent the R&D tax credit.

We believe the time to act is now. In addition to the structural reasons to act, as has been noted, our economy has slowed down in the last 6 months, I would say beginning in August. And Chairman Greenspan has said, and I agree with him, we are now bouncing around in a narrow range of economic activity of perhaps minus .5 to plus .5 percent or something approximating zero real growth. And whether you are Keynesian or not, it does seem to me that since we are, I think without exception in agreement that we should have tax relief and a pay increase for American Federal income tax payers, it seems to me the burden of proof is if we are going to do it, why not now? Why not immediately?

Mr. Chairman, I have a prepared statement. With your permission, I would insert in the record perhaps at the beginning of my remarks and then with these following on a brief characterization of what I think about those issues and open myself to questions.

[The prepared statement of Secretary O'Neill follows:]

Statement of the Hon. Paul O'Neill, Secretary, U.S. Department of the Treasury

Good morning Mr. Chairman, Mr. Rangel and members of the Committee. It gives me great pleasure to be here this morning, as we move one step closer to providing comprehensive income tax relief to American taxpayers. On Thursday I presented the President's tax package to House and Senate leaders, and I urged then that we get right to work to deliver tax relief to working Americans as soon as possible.

I am pleased that you are starting the hearing process so quickly. I hope that your leadership will help ensure early passage of the President's proposals. With you I am ready to roll up my sleeves, get down to work and leave money in the pockets of every income tax paying American.

Through hard work and ingenuity, Americans have created a booming economy that has spread prosperity around the world. Individuals have created new technologies that have made our industries more productive and have improved the standard of living for millions of Americans.

Our prosperity has made the unthinkable possible. After decades of budget deficits, we now have the opportunity to wall off the Social Security surplus so it can't be spent on other government programs. And even after we lock away Social Security, we still have more tax dollars coming into Washington than Washington needs to pay for agreed upon public services.

This isn't just a budget surplus, it's a tax surplus. We have no business continuing to collect more in Federal taxes than the cost of the services the government provides. If the phone company overcharged one of your constituents, you'd join them in calling for a refund. The same principle applies to this tax surplus—it's not the government's money, it's the people's money, and we should return it to them as quickly as possible.

The President has proposed tax relief that reinforces the values that make America great—opportunity, entrepreneurship, strong families and individual success.

First, the President has proposed reducing income taxes for every American who pays income taxes. The current five rate system will be simplified to four rates, and the tax rate on the first $6,000 of taxable income earned by every American—$12,000 in the case of married couples—will fall from 15 to 10 percent.

High income tax rates block access to the middle class for working Americans struggling to get ahead. And high income tax rates punish success. We should not allow the threat of higher taxes on the next dollars earned to discourage Americans from working harder. Increased productivity has been one of the fundamental engines of our economic success, and the tax system should not dampen our ability to be more productive. We must have a tax code that keeps the American Dream in everyone's reach and helps people move up the economic ladder of success. We must have a tax code that encourages entrepreneurship and rewards hard work.

The President's tax relief plan also strengthens the ties that bind families together.

- It doubles the child tax credit to $1,000 per child. Parents everywhere have one goal above all others: to give their children the best possible opportunity for success and happiness in life. The increased child tax credit will give parents more resources to save for college tuition, pay for braces or hire a tutor.
- This plan also reduces the unfair marriage penalty. We as a society celebrate when two people decide to spend their lives together. Why would our tax code punish them?
- And this plan eliminates the unfair death tax. Government has no business confiscating the legacy parents work their entire lives to build for their children.

Today we are proposing a tax cut for every income tax payer. Four-person families earning $35,000 a year will no longer bear any federal income tax burden. Four-person families earning $45,000 will see their income taxes cut in half. And four-person families earning $75,000 will see their tax burden reduced by 22 percent.

The President's tax relief plan ensures that higher income earners pay a larger share of taxes than they do now. In 1998, the top 10 percent of income earners paid 65 percent of federal income taxes, while the bottom half of income earners paid 4.2 percent of the total federal income tax burden. After implementing the President's tax relief plan, the top 10 percent of income earners will pay 66 percent of all federal income taxes.

This plan provides relief to all income tax payers. There's a strange attitude around this town that once the money gets here it doesn't belong to the taxpayers anymore—it belongs to some amorphous thing called government. That's simply not true. Every person who paid income taxes created the tax surplus. And every one of the people who paid income taxes deserves to get some of it back.

Taxpayers in the higher tax brackets will invest their tax relief in the economy, creating jobs for all Americans. Economic studies have documented that higher income individuals tend to save the bulk of any new income they receive. A small businessman receiving tax relief will plow that back into the firm, either to increase productivity, which results in higher wages, or to hire more workers. A farmer receiving a large tax relief check will be able to trade in his tractor and purchase the newest technology to improve his crop yield. America's economy will grow as these investments go forward.

This tax relief package is sound fiscal and economic policy. It fits easily within our budget framework which walls off the Social Security surplus and continues to pay down the public debt in increasing amounts each year. I like to refer to it as the Goldilocks tax relief plan—not too big, not too small, just right.

There is no downside to enacting this tax relief package. Today, Washington takes more from American taxpayers than it needs to run the government. That's not fair. And it isn't useful to pile up resources in Washington, where they will be spent to enlarge government. Alan Greenspan has pointed out that at the current pace, we'll pay off most of the publicly held debt in a few years, and then there will be no place to put the surplus. We do not want government taking money from the taxpayers and using it to buy up private resources.

Individual Americans know better how to spend their money. The typical family of four will keep $1,600 a year that they would otherwise have sent to Washington. That's enough for two monthly mortgage payments or for a year of junior college tuition.

Evidence of an economic slowdown makes this tax relief all the more compelling. While the Fed has already acted to stem a downturn, I believe in a "belts and suspenders" approach. Cutting income tax rates can help keep this downturn from taking root. If the economy does worsen, I don't want to look back and say "if only we had acted sooner." We have a surplus that should be returned to the American taxpayers. To the extent that getting it back to them sooner can help stave off a worsening of the economic slowdown, we should move forward immediately. Taking action soon will boost consumer confidence, which in turn will boost consumer demand. And getting money in people's pockets quickly will enable Americans struggling with consumer debt to pay their credit card bills and get ready for another consumer-led expansion.

I can't accept the idea that it takes nine months to get tax relief on its way to the American people. I used to run a 140,000-employee company. If I decided to give my employees a raise, I wouldn't wait nine months to do it. With our economy slowing, now is the time to boost consumer confidence with quick congressional action.

I look forward to working with Congress to give relief to every income tax payer, and to do it quickly. It's time to give working Americans a raise.

Chairman THOMAS. Without objection. Let's start by asking you that although all of us have good reasons to change the Tax Code, especially reducing taxes, some of the President's proposals could put money in people's hands as soon as they became law. And if we do have a cloudy economic environment and we were able to put additional money in our working taxpayers' hands, my assumption is if we pick the right ones and we do it quickly enough, they will have a little extra money that they are going to spend, I daresay perhaps buy a muffler. Does it make sense to do this, notwithstanding the fact that Congress would tend to prioritize to a certain extent the President's proposals?

We would want, of course, to consult with you as to which ones seemed to be most appropriate, and our panel of economists. But if it does make sense, what is your reaction or the administration's reaction to which ones would make sense, or even to the extent of making them retroactive to even the beginning of the year?

Secretary O'NEILL. Well, there is no doubt that if you look at the distributional effects of the marriage penalty and the death tax changes, they don't occur and provide direct and immediate benefit to the entire population. On the other hand, the marginal tax rate proposals and the child credit would provide a broad sweep of benefits to American taxpayers, and if we were to do it on a retroactive basis to January 1st, money could begin to flow very quickly if the Congress could act on these things quickly.

Chairman THOMAS. I understand that the Federal Reserve, and as we speak I assume the Chairman, Alan Greenspan, is speaking on the other side of the Capitol, has taken some action recently, and many people say a monetary policy is much preferred. Obviously two half-percent cuts within a month would indicate that there is a degree of concern there above the ordinary and that if the Congress were to act relatively quickly on a portion of a package, do I understand you to say that it perhaps could also augment the monetary policy with a fiscal policy proposal, that if it doesn't do as much help as we would like, it certainly wouldn't do any harm?

Secretary O'NEILL. I've not found anyone who would claim that acceleration and putting money into people's hands right now would cause any harm. Certainly I agree with you that quicker is better, given the softness of the economy we are experiencing now. And I honestly do not think any of us know what it is going to be 6 months from now. But it does seem to me that if it is the will of the Congress that you are going to provide tax relief, sooner makes great good sense to go ahead and do it so that we have what I characterized as a "belts and suspenders" approach. If you can have both, why not have both?

Chairman THOMAS. I understand the concern, of course, that you would want the budget in place to look at the total revenue picture. And I assume the administration will be shortly sending the Congress the budget. But if we are talking about a portion of the whole, a piece of the program depending upon how large that piece is, my assumption is that that could readily move, notwithstanding the fact that the other portions of the President's plan could be considered along with the Social Security changes, the Medicare changes, the other budgetary concerns, especially in terms of debt reduction and making sure that we live within our means.

Secretary O'NEILL. Absolutely right. In fact, I should have noted at the beginning in response to Congressman Rangel's note about the budget, it is indeed very important that as you act you do it in the context of an understanding of complete fiscal policy. And 2 weeks from today you will have a budget. The President has asked me, in addition to my other duties, to serve on a budget review commission or committee with the Vice President and director of OMB, and yesterday we had a meeting to look at where we are with the budget. And I don't want to tell you exactly what the budget is yet, that is the President's business, but I am here to assure you that there is plenty of room to do as, Chairman, you suggest: to look at the changes retroactively and provide—and we will have plenty of room in this budget not only to protect Social Security but to implement what the President has proposed by way of tax changes and have arguably $1½ trillion over this 10-year period left over for other important public purposes.

Chairman THOMAS. I thank the Secretary. The gentleman from New York.

Mr. RANGEL. Thank you.

Mr. Secretary, were you and the Chairman suggesting that we might be able to take the President's package and pass a smaller part of that in order to get the money out there as fast as possible, sooner rather than later?

Secretary O'NEILL. Let me be as clear as I know how to be about this. The President has made clear in every meeting that I've been in with him that he believes in the component parts of what he has recommended in his tax package, and he believes that we need to discipline ourselves not to obligate more than $1.6 trillion over this 10-year time period. But he has also said, if I remember correctly, I think he said this when we had our meeting with you, that he is prepared to work with the committees of Congress and with the broader Congress to figure out exactly what the pacing is and what the details are, as long as we honor the principles and as long as we do not obligate more than $1.6 trillion.

So, yes, in response to your question and to the Chairman's earlier question, it is clear that if we are going to, or if we want to put money into the hands of Americans quickly, the two pieces of the President's proposal that would do that most successfully are changes in the marginal rate cut and the child credit.

Mr. RANGEL. And I assume the cost, if it was $900 billion out of the 1.6 trillion, that would be just considered as a part of the overall package.

Secretary O'NEILL. That would be a down payment on the total.

Mr. RANGEL. I just would want to ask a parochial question before I get to the general questions. Under the President's program, he doesn't make adjustments for the alternative minimum tax. Many of our high tax, income tax, States under existing law are able to deduct their tax liability from their Federal liability. The AMT doesn't make those provisions possible, so theoretically one could get a tax cut under the President's bill but then the AMT would restore—would prevent the deduction for local and State taxes. Has any thought been given to that?

Secretary O'NEILL. Yes. And honestly this is a very complicated subject. And I must tell you some of what I have read doesn't measure up to the true complexity that exists in the AMT, and I suppose it is because some of the people who write for a living having struggled to understand how the various aspects of the Tax Code fit together. And I must say on their behalf, they are not alone.

But now to your question about the AMT. First it should be understood that the interaction of the AMT and the current Code in the President's proposals would not cause anyone to pay net more taxes than they pay now. Everyone would still be better off. But it is true that the AMT would eat away at some of the benefits flowing from the President's tax proposals as compared to the absence of an AMT interaction with the rest of the Tax Code. But it is also worth noting that 85 percent of the AMT effect would be on the families with incomes—with higher-income families, let me say notionally, with families with incomes over $100,000. So this is not a huge substantial problem for people with incomes below that level. It does have some impact on higher-income families. But let me draw a strong line under this point. No one, as a consequence of interaction of the AMT and the President's Tax Code proposals, would pay more taxes than they do now.

Mr. RANGEL. I want to go as parochial as I can get, and that is, would the President and you support the final legislative package that would make certain that taxpayers from high-income States are able to deduct their income taxes from their Federal liability; and if that means adjustments to the AMT, then we will just do what we have to do. But at the end of the day, we want to know whether or not the President would support the deduction.

Secretary O'NEILL. You know, as I have looked at the AMT and its interaction with the rest of the Code, I would observe this: that the AMT problem has been one that has been developing since the AMT was installed into the Tax Code. And I guess I am not here to tell you that we are prepared to solve every problem that exists with the Tax Code with an early action tax bill. There is no doubt that eventually we need to work together to figure out how we can strip the AMT out, but it is not the only offensive provision, unfortunately, that we have in our Tax Code. And again I would say to you, it is important to know that no one would pay more taxes after the implementation of the President's proposals because of the AMT, even if it is left the way it is today. That doesn't mean that we shouldn't work together to see if we can soften the impact, but I think it is not—if we are going to tackle every aspect of income distribution and flaw in the Tax Code, then there is no hope that we are going to do this quickly. And the President has not proposed that and I certainly would not recommend to you that we try to fix all of the problems that exist in the 9,500 pages of the U.S. Tax Code.

Mr. RANGEL. I am just trying to use this in order to educate those people that support the President's program, that they may be losing a tax benefit that they have worked hard for because of the alternative minimum tax, and the position is that we can't help everybody. And so whether you are from New York or California, you know, we will get back and deal with it later. I just wanted to raise that, because as you pointed out, the AMT has a lot of other problems that we will have to work with, but that is one that I bring from New York State.

Chairman THOMAS. I thank the gentleman. The gentleman's time has expired.

Mr. RANGEL. Well, I didn't know that we had these expirations when we had the first witnesses; that is, with the previous chair. And you and I have not discussed it.

Chairman THOMAS. I understand that and our goal, as I indicated, was that the Secretary has to leave at noon. I had admonished members to try to move briskly, but if the gentleman has a couple of additional questions, certainly if he feels compelled to ask them, go right ahead.

Mr. RANGEL. I appreciate the courtesy and I regret that I spent my time on what is basically a New York State issue. But I really wanted to ask if you were familiar with the uncertainty about some of the projections that the Congressional Budget Office has made in the past as relates to surpluses.

Secretary O'NEILL. Yes.

Mr. RANGEL. Also I assume that you do not believe that Chairman Greenspan suggested a tax cut without taking into consideration the uncertainties of the surplus. Having said that, if we are projecting the 10-year surplus to be 5.6, do you agree that the majority of this expectation, or 70 percent of it, would occur after the first 5 years; that we would be expecting it in the last 5 years?

Secretary O'NEILL. A large part, yes.

Mr. RANGEL. Seventy percent.

Secretary O'NEILL. I don't know about 70 percent; but yes, a large part. And it depends what you do about acceleration.

Mr. RANGEL. Acceleration.

Secretary O'NEILL. And retroactivity.

Mr. RANGEL. Well, Chairman Greenspan does not have the political responsibility of taking care of the President's campaign promises on education, health care and Social Security. And if we do this sooner rather than later, and get it out there and get the money in the people's hands to save or to spend, as a businessman have you conducted your business relying on projections that go up to 10 years and take action in the first year in terms of what you expect to get?

Secretary O'NEILL. It is interesting you should ask me. In the business that I was in before I came here, when I made a billion-dollar decision it was a decision that had to last 50 years, because you do not get to vote maybe when you build an aluminum smelter and aluminum smelters do not come in 3-year flavors. And, yes, I am acquainted with the process of making long-term decisions. And in a way, it is very much like what you all do as Members of Congress. You don't get to vote maybe. It is either yes or no. And I think it is true, however, you do get to reconsider. It is not quite like building an aluminum smelter or building a plant that is going to last 40 or 50 years. And I think you demonstrate that all the time, that if things go awry and you do not like how things are going, you change the policy or you change the law.

I think that is a prospect that is always out there in front of you. But with a Tax Code and you are well aware of this, you know it better than I do, people make decisions in anticipation or in good faith on the basis of what you all do, so that if you say you are going to enact a phased-in program for a death taxes or the marriage penalty, people will rely on that. And so if you decide to change your mind in 2006 or something, some people will be quite offended that you decided to pull the rug out from under them if you chose to do that.

Mr. RANGEL. So you are suggesting that if the CBO and those people relying on do make a dramatic mistake, as they have in the past, that either we fulfill our obligation and support the programs or we increase taxes to support the programs or we go into the Social Security Trust Fund to support the programs.

Secretary O'NEILL. I don't think so. I don't know; at least in my lifetime, I don't think there has been a time when the Congress of the United States had the possibility of, on the one hand, protecting all the Social Security funds and enacting a $1.6 trillion tax relief bill for the American people and having the 25 percent safety valve.

Now, when I say safety valve, I am saying we are going to have to practice fiscal discipline if we are going to protect the safety valve that exists in the forecast. But it is very unusual, I think unprecedented, to have the amount of free resources coming at you better in these forecasts to protect us against having to have a tax structure change, almost no matter what happens in our economy. It is very difficult to believe—I guess I am a congenital optimist—I think frankly the CBO estimates, if we continue to do the right things in the private sector as we have over the last 10 years, the CBO estimates of surpluses are too low.

Mr. RANGEL. Thank you, Mr. Chairman.

Chairman THOMAS. Thank you very much. Does the gentleman from Illinois, Mr. Crane, wish to inquire?

Mr. CRANE. Thank you, Mr. Chairman. We welcome you, Mr. Secretary, and look forward to working with you.

President Bush is absolutely correct to call for the elimination of the death tax. It can't be justified on revenue grounds, on economic grounds, or on equity grounds. My only concern is that it is phased out slowly. Even so, we often hear about how few estates actually pay tax, as though a wrong committed against a few is acceptable. This is even more absurd when you realize that the tax is actually paid by those receiving the distributions. After all, neither the deal nor illegal fiction called an estate can bear a tax. Do you have any idea how many people receive distributions from estates that pay tax in a given year or how many such people there would be over the next 10 years?

Secretary O'NEILL. I am not sure I can give you an absolute number. The number that sticks in my mind is something like between 1 and 2 percent of all deaths end up in paying estate taxes, but I can give you an absolute number for the record.

[The following was subsequently received:]

About 2 percent of all estates are subject to tax each year. We do not routinely track the number of heirs associated with each estate tax return. Our most recent data on heirs, from returns filed in 1988 and 1989, indicate that on average, there are about 3.7 noncharitable beneficiaries per return (this includes both taxable and nontaxable returns). There were 49,870 taxable estates among returns filed in 1999, and we estimate that roughly 185,000 heirs would be associated with these taxable returns.

Death is a one-time event so the measuring of a single year or even a ten-year figure does not give an accurate representation of the total number of people granted relief by this provision. Nor does the direct tax relief measure the full value of this proposal because families spend a great deal of time and money trying to protect themselves from this confiscatory tax.

Mr. CRANE. Those are the ones that actually pay the tax.

Secretary O'NEILL. That's right.

Mr. CRANE. Not those that divide it up in an estate before they depart?

Secretary O'NEILL. Precisely.

Mr. CRANE. Second, we often hear about reducing the public debt reduces interest rates, and yet when I look at the forecasts of the CBO and the Clinton administration, I see no reduction in long-term interest rates. If debt reduction has this effect, surely it should be reflected in the forecasts. So I ask you, do you believe that buying down the public debt reduces interest rates and, if so, how much? And can we expect to see that reflected in the administration's forecasts and projections?

Secretary O'NEILL. Certainly in classical economic terms with only those variables under consideration, one would say if you buy it down, the rates are going to go down. Because if you assume all of the things are equal and it suggests—and the savings pool is larger and the interest rates would go down, it is not the only variable. It is not quite that simple, in fact. But it does raise a broader question which I know you all have been struggling with on and off for the past 25 years: the issue of static forecasting as compared to dynamic forecasting. It seems fairly clear to me that we need to stop having a food fight about this issue and work together, both between our forecasting institutions, the congressional ones and the ones in the private sector and the ones downtown, and create for the Congress' consideration the best of what professional economic minds can produce in terms of what is the range of respectable zone of possibility between static forecast and dynamic forecast. I know there are those who think it is only one or the other. I don't buy that, and I don't think economics is a sufficiently precise science that you can just say I know exactly what is going to happen 10 years from now. Most people would not say that. There are some I suppose.

But in any event, I do think that we should work with a more realistic set of numbers, and one of things that I hope to do in the time that I am at Treasury is to bring these warring factions together and stop the nonsensical arguments and provide a better information base for those of you in Congress, who then do not get to vote maybe. You get to vote yes or no. And I think the profession can do a better job for you than we have done.

Mr. CRANE. Finally, Mr. Secretary, I strongly believe this tax relief will permit the economy to grow faster. There is no real debate about that, only about the magnitude. I understand the administration does not intend to include these growth effects in its estimates of the cost of the tax relief, and I understand why, because you want to debate the merits of the plan, not the numbers. Even so, can you give us a specific idea of how much additional economic growth we might anticipate once the President's plan is enacted?

Secretary O'NEILL. I suppose I could give you something for the record. But as I said to you earlier, as I look at both the CBO estimates going forward and our own estimates, the private sector estimates for the next 10 years, I think we are still heavy influenced by the period from, say, 1945 until 1980 when we demonstrated, except for a period in the 1960s, a real growth rate well under 3 percent. And it is hard for the profession to square itself away with what we have experienced in the last 15 years or so because the rates of growth and the low levels of inflation and the high levels of employment are outside of the envelope of what the economics profession would have told you was possible even as recently as 10 years ago.

So I think aside from the question of what these changes do for the economy, the range of uncertainty on the upside is substantially understated, because I believe—and this is now from my private sector experience—that if you look at the great companies in our country or even the world, they are great because they have adopted leading edge practices and technologies. And when you look at how many companies there are yet to move to that level of proficiency, I would argue it is 80 or 90 percent of the companies in the world still haven't begun the acceleration phase in economic growth. And so I am a great optimist that we can do 4 percent real growth with no inflation and very high levels, unprecedented levels of employment in our economy, and I think we will see that.

Mr. CRANE. Thank you Mr. Secretary.

Chairman THOMAS. Does the gentleman from Florida, Mr. Shaw, wish to inquire?

Mr. SHAW. Yes I would, Mr. Chairman. And, Mr. Secretary, I would like to join my colleagues in welcoming you before this Committee. It is indeed a pleasure to have someone of your background and quality heading up the Treasury.

You and I have spoken briefly about the Social Security problem that is out there and facing us. On listening to some of the Sunday shows, I was noting that some of the political guests on those shows were, as Mr. Rangel was, beginning to talk about the FICA tax which, of course, is 12.4 percent of wages including the employers' and the employees' halves. And I can understand where that can be burdensome to low-income people.

But more than that, I am concerned about the fact that I want to be sure that particularly for the low-income people, that the Social Security Trust Fund will be there, funds will be there for them. As you and I have discussed, the Social Security surplus will go away in approximately 14 to 15 years and we will not have a surplus. Therefore, I am particularly concerned that we safeguard those funds and that we put them aside so that we will be sufficiently covered as well as we can so that we don't make the problem worse. Now, if we were to reduce the FICA taxes, I would assume—and I am pretty sure of this—that that surplus will dry up a lot earlier. Could you elaborate on that?

Secretary O'NEILL. You are exactly right. In fact, we talk about Social Security surplus, and it is true that we are going to have a cash flow surplus between now and the year 2015. But if you look at the actuarial projections, we have got a very large shortfall in the amount of money that we need to pay for Social Security obligations in the years after 2015. And so it seems to me very unwise to think about using Social Security Trust Fund monies in some other way or to reduce the Social Security tax rates, because at their current level, with the current benefit structure, we are not accumulating enough money. We are not going to have enough money without a big increase in rates or a change in the benefit structure to serve as what we said to the American people will be theirs.

But there is an additional issue of principle here, it seems to me, which again I have not seen in most of the things I have seen written, which has been an anchor point for Social Security since it was enacted, which says the American people that are attached to the work force will have an obligation to contribute to the Social Security Trust Fund. And when they come out on the other end of their work force attachment, they can count on a stream of benefits.

And while it is true that the way we have done this is an intergenerational transfer, I think if you go out and talk to most Americans, most of the ones I know, the ones who worked with me in ALCOA, they believe it is fundamentally an important principle that everyone pay for some of their retirement.

And so to argue the contrary, it seems to me, is to attack the fundamental principle that the Americans believe in about how the Social Security system works.

Now, in the other ways you all and we as an American people have recognized that for some people the Social Security tax is a substantial reduction from their weekly or monthly income, and that is why you have enacted the earned income tax credit, that is why we have Medicaid, that is why we have SSI, that is why we have a housing subsidy, that is why we have a plethora of things addressed to helping low-income populations.

As I said before, I don't think it is our purpose here, I would not recommend to you that we try to deal with all the social problems that exist in our society and try to encompass the welfare system in what we are doing with these tax proposals. This is about giving back to the American people who sent the money in at least some part of what they sent in, with a proportional shift from those who sent in the most to those at the low- and middle-income levels to help those low- and middle-income people to have more resources for the needs that they have in their daily lives.

Mr. SHAW. And for low-income people, the payoff as to the benefits of Social Security is very progressive in that the low-income people get a better deal out of Social Security than the higher-income people.

Secretary O'NEILL. Precisely.

Mr. SHAW. I would certainly hope that we would not go in and fiddle with the FICA tax, because that would certainly make our efforts, which hopefully will be in a bipartisan way, to save Social Security and preserve the existing benefits and make it much more difficult if we reduce the amount of money we have to work with, and it would certainly put in jeopardy the Social Security Trust Fund. Thank you, Mr. Chairman.

Chairman THOMAS. I thank the gentleman. Does the gentleman from California, Mr. Stark, wish to inquire?

Mr. STARK. Thank you, Mr. Chairman. Mr. O'Neill, in reviewing a most fascinating career, I am very pleased to see—I went back into an old Harvard case study that was written about you back in 1992 or 1991, and it lays out what an expert you became in Medicare and Medicaid and the old Hill-Burton Act when you started out in government. It also has some interesting insight into your philosophy.

One quote that I liked most, you said—and I am quoting—"The longer I was in government, the harder it was for me not to be able to say what I thought about everything. I hated when reporters would ask me something where I really had a very strong opinion but I didn't feel free to say what I thought because it was inconsistent with the President's policy. In the private sector nobody really gives a damn so you can have an opinion on just about anything you want to."

Secretary O'NEILL. I said that. That is true.

Mr. STARK. I hope you have your private sector hat on here this morning.

Secretary O'NEILL. The only thing they can do to me now is send me back to retirement.

Mr. STARK. Also you have indicated this morning that you are enthusiastic about the long-range growth, but also in researching a little bit about former colleagues at ALCOA I found that at ALCOA you would not allow into your planning, overall economic forecasts that went longer than 6 quarters because you didn't trust them. And further, that if your projections at ALCOA were wrong, you laid off people. We can't do that.

And I guess my question is: Would you, if we are wrong—in private projecting if you don't want to go one whole Congress with overall economic growth projections, who would be the people we would lay off; I suppose, the Medicare beneficiaries and the Social Security beneficiaries, because we can't fire civil service workers and you have trouble firing us in between election time. So I hope that you will look at these growth projections with the same skepticism in government that you did in the private sector.

But I want to skip to one more issue. Jane Bryant Quinn, of course, suggests on the issue of surplus belonging to everybody is—I liked her quote in today's Newsweek. It says, "Does the national debt belong to the man in the Moon? Why don't we prescribe the $34,000 of national debt to each household and let people pay that off out of their tax break?" But I think she is just having fun with you.

On Sunday, Secretary Powell was interviewed by Wolf Blitzer, and in referring to the problems that we are having in the Mideast and Arabic countries, Secretary Powell went on in great length about how these countries had a duty to protect their children, to educate them, to pay for their health care, much more important than wasting money on weapons. And I thought, boy, does that fit here at home.

And I just wanted to bring up these numbers and see whether you don't think, as a person who has an expertise in overhauling the social welfare system, starting back several decades ago, to take care of the 45 million uninsured in this country would cost about $750 billion over 10 years, to provide drug benefits for Americans could would cost about 325 billion over 10 years, and to put 20 percent of the surplus to save Medicare—if that is the right figure and it just happens to fit my numbers—it would take how many billion over the 10 years or, strangely enough, $1.6 trillion?

I guess I am going to suggest to you that I would like your opinion as to whether or not seeing that everybody had a drug benefit and had health insurance and that Medicare was solvent wouldn't create as many jobs, wouldn't be as helpful to workers, make them more productive, save some money for companies in having to provide for retirees? I am sure we could not take the whole thing, but I would like to measure it, as I say, based on your expertise in having to provide health care for a lot of workers, having done it in government, because there is nothing in the President's budget now that provides any help in terms of dollars for health care. Couldn't we use some of this tax cut economically now, and wouldn't it have just as good an effect as giving it back to spend more on health care workers and provide the money that we need to cover for the uninsured?

Secretary O'NEILL. Okay.

Chairman THOMAS. The gentleman's time has expired.

Secretary O'NEILL. Do I have 3 hours? Let me do this really quickly. First I said earlier in my previous incarnation, I didn't get to have the luxury of waiting to be able to see 10 years in the future. I had to make decisions that had 50-year tails on them. So I think I dealt with that issue.

You know, do I have respect for the difficulty of forecasting? You bet.

And then I just want to say very quickly—you commented about if I was wrong, I could lay people off. When I went to ALCOA there were 48,000 employees and today there are 143,000. I am not saying that I never had to make decisions about closing plants that did not end up costing people their jobs, but they were all dealt with in the most respectful way; and by that I mean giving them money so they went away. But because of what we were able to do, we basically tripled the size of our population in 13 years. And I believe as a generalization, good leadership produces amazing results and it is not ever bad for people.

Now, you are really taking me outside my portfolio by asking me about these health issues. And we honestly do not have enough time to do it here, but I will just say to you briefly, and maybe you will invite me over sometime to talk about these things, I honestly don't believe there is anything that can be done in this Congress or any other Congress that is going to do what we need to do about health and medical care in this country. And I have spent a lot of time working on this issue, including creating a coalition of all the interest groups in southwestern Pennsylvania on a quest to do what I believe is possible, which is to reduce the cost of health and medical care in our country by 50 percent, which means $650 billion a year. But it is not going to come from here. It is going to come from people understanding how to reorganize the provision of health and medical care, and then we will have done something really important.

And to the question of what we should do about the insured, again this is outside my portfolio, but I believe as a basic part of being an American, we should say to every American for, say, families with more than $35,000 or $40,000 a year, you have an obligation to your fellow citizens to put away enough money in an insurance plan for health and medical care for your family, and for families with incomes below that level, the rest of us should pay for it.

Chairman THOMAS. I thank the Secretary. I would remind our colleagues that although we are all very conversant with the Tax Code, we have a number of friends vicariously with us through television, and if we know what the AMT is, they may not know what it means—the alternative minimum tax. So as we conduct our dialog with the Secretary, if possible we will try to make sure that our friends who are following us understand exactly the jargon that we are dealing with. It probably makes for a much more useful viewing experience.

And with that, the gentlewoman from Connecticut, Mrs. Johnson, do you wish to inquire?

Mrs. JOHNSON OF CONNECTICUT. Thank you very much. I too want to welcome you here, the Honorable Mr. O'Neill, as Secretary of the Treasury, and I would particularly welcome you because I have been a long ally of manufacturing over my many years here in Congress, and particularly of the small manufacturers on whom big companies like yours depended for quality production.

And it is a special pleasure to welcome a Secretary of the Treasury that comes out of the manufacturing sector, with all due respect to those secretaries we have had from Wall Street. I really want to say it is a special pleasure to have you here, and I think already in some of the examples that you have cited, you have made clear that that concrete experience and production will be of value to us as we think through the impact of tax policy in people's lives.

As you said in your testimony, if you were going to give your employees a raise, you wouldn't wait 9 months to do it. And it is important that we remember that for many people, a tax cut will function like a raise.

But what my question goes to is what is on the front cover of the recent Newsweek. It says, "laid Off. How safe is your job?" And if you look at the statistics in January, the number of layoffs shot up to 142,000, the highest in 8 years for 1 month. DaimlerChrysler is looking at 26,000 people laid off in this coming year. General Electric, 60,000. I think working families are terribly worried about the future of their jobs.

And because I think job security is absolutely as important as a raise, and because so many small businesses and we all know that small businesses are really for the most part the engine of hiring in America, so many small businesses pay taxes at the personal level, I would like to ask you to talk a little bit about first of all what percentage of small businesses do pay taxes at the personal level and what impact do you think this tax cut will have on the security of small business jobs and creation of small business jobs.

Secretary O'NEILL. Well, your points are certainly right. And whatever tax relief we can get to small businesses, unincorporated people who are basically paying those high marginal tax rates at 39.6 percent, every bit of it will help them and it will enable them to keep the jobs they currently have and hopefully to expand. If you look at where wealth creation occurs in the United States, a very, very substantial part of it, the media reports about the big people notwithstanding, occurs in very small firms and local communities all over the United States. And so, as you indicate, it is really important that we not confuse where the help is going in these high marginal rate cuts. It is going substantially to sole proprietorships and small unincorporated companies that have been subjected to these very high tax rates.

Mrs. JOHNSON OF CONNECTICUT. Thank you, Mr. Chairman. In deference to the number of people to ask questions I will yield back the balance of my time.

Chairman THOMAS. Thank the gentlewoman. Gentleman from New York, Mr. Houghton.

Mr. HOUGHTON. I will pass.

Chairman THOMAS. Gentlemen from California, Mr. Matsui, wish to inquire.

Mr. MATSUI. Thank you.

Thank you very much, Mr. Secretary, for being here. I just want to make an observation. I don't want your response to it necessarily. But you talked about dynamic scoring as opposed to constant scoring or static scoring. I would just urge caution. I don't know whether it was deliberate in terms of raising that issue or whether it was just in response to Mr. Crane's question. But I remember back in 1981 when we used the word "rosy" or phrase "rosy scenario," which was another way of talking about dynamic scoring, and we ended up with $4 trillion worth of debt over the next 18 years. So I would caution you.

Second, I would be cautious because not only would the right use it in terms of tax cuts but the left could use it in terms of spending programs. Put more money into education, thereby a microeconomic change could have a macroeconomic impact of creating more GDP if you put more money into education. So I would just urge caution in this administration. I know Mr. Lindsey and others in your administration do support that approach or at least talked about that approach. But I urge particularly the Treasury Department to be cautious.

What I want to do is just very quickly read a couple observations. David Walker, the Controller General, on February 6th of this year said that no one should design—I am quoting him—"No one should design tax or spending policy pegged on precise numbers in any 10-year forecast." Then he also says on page 1, "It is important to remember, however, that while projections on the next 10 years look better, the long-term outlook looks worse." And basically you are talking about demographic changes, which you responded to in reference to Mr. Shaw's question.

Also, if you take a look at the CBO's January 2001 report, which I believe you referred to, they—in chapter 5, and they talk about the uncertainty of budget projections—essentially say that there is a 50 percent probability that some of their numbers may be off as much as 2.8 percent of GDP in years 5 and beyond in each year. And they can't even make any kind of accuracy predictions with respect to 10-year forecasts because they just don't have any.

That leads them to conclude, and I quote them, on page 95 in chapter 5, if these averages were applied to CBO's current baseline, the estimated surplus could be off in one direction or another on average in the year 2001 by $52 billion, by the year 2002 by $120 billion and by the year 2006 a staggering—and this is my word—a staggering $412 billion.

Would you comment on that? Do you dispute CBO and Mr. Walker or do you think they are accurate or do you think there is a probability—or that you have probabilities that might differ from theirs?

Secretary O'NEILL. Well, I think if you look at the CBO numbers, they have told you what they believe the central——

Chairman THOMAS. If the chairman would intervene, CBO is the Congressional Budget Office.

Mr. MATSUI. I hope that didn't take my time but go ahead.

Secretary O'NEILL. We are all guilty of jargon. I think what you have in the CBO estimates and for sure what you are going to get from the administration is what I would call the central tendency estimate. And in the statistical sense, it is the sum of all the probabilities and it is the midpoint of all of the possibilities. And in every distribution of estimates or distribution of samples you want to take, you get distributions. And they can look like a variety of things. They can look like these two alternative curves. And at the end of the day professional economists get paid for saying we think this is what the central tendency of the distributions is. And I think you will not be able to find someone who will say the number for the 10 years, the next 10 years, is $5.6 trillion, and I am absolutely sure and I guarantee it to you. But it is to the point that I made to you earlier.

Mr. MATSUI. If I may, go ahead.

Secretary O'NEILL. I don't think you are going to get to vote "maybe."

Mr. MATSUI. Okay. Let me raise something that is more than maybe. We are going to pay down the debt with the moneys fungible, but with the Social Security surplus. Now, by the year—I think Mr. Crane said this, and I agree, that within the next 13 to 15 years, starting 2013 or maybe 2015, all of a sudden that surplus is going to be tapped into. But if we pay down the debt with that surplus, that means that somehow by the year 2013, 2015, we are going to have a cash flow problem because we pay down the debt with it. What do you think we are going to do with that? The debt payment is really temporary. It is not a permanent debt payment in terms of the publicly held debt.

Secretary O'NEILL. I think you might think about two things. If you think about the debt capacity of an institution, and let's take a company in your district, and you go look at their balance sheet, you see they have, let's say, 10 percent debt in their capital structure out of a total capital structure where the other 90 percent is equity, and if it is a well run firm they are producing rates of return that pays for the cost of capital, then an intelligent business person would say they could borrow another 30 percent and they would still be a substantial company.

In fact, some people at the Harvard Business School would say you have got too much equity in your capital structure and you ought to have more debt. Now, I know the Federal government is not in business, but if you think about where we have been, we demonstrated we can run a first rate economy with something on the order of $5 trillion worth of national debt. We are headed in the direction to eliminate the national debt, so that when we get to a point where we have got to have money for Social Security we have debt capacity.

But, I would say something else to you: I believe and the President believes that as soon as you all are finished with this tax proposal, we will be back to you with recommendations to fix Social Security.

I would say one other thing to you. In 1973, this is now 27 years ago, I went with George Shultz, who was then the Secretary of the Treasury and appeared before the Senate Appropriations Committee, and George Schultz said to them, we have got to do something about Social Security because we are going to fall into the biggest intergenerational war that we have never imagined before. We must fix Social Security. And here we are 27 or 28 years later, we have used up most of the available time. The President has said we are going to fix this problem. And we are going to be here with a proposal to fix Social Security so that we all can rest easy and not be guilty of ignoring the consequences of our inaction for those who follow us.

Mr. MATSUI. My time is up, Mr. Secretary, but I wish you would come up with Social Security before you come up with the tax bill, because I think the tax bill is going to jeopardize Social Security in a significant way.

Secretary O'NEILL. I will be back.

Chairman THOMAS. Thank the gentleman. The gentleman from California, Mr. Herger, wish to inquire?

Mr. HERGER. Thank you very much, Mr. Chairman. Thank you, Mr. Secretary, for your refreshing comments. The President's package has been criticized by some for not being good for small businesses, but don't many small business owners now pay at the top rate of 39.6 percent? And wouldn't they be able to hire more workers, buy that new tractor, that piece of equipment or machinery or invest in their small businesses due to the reducing of this rate? And wouldn't the cost across the board rate reductions give consumers more money to spend, allowing these businesses to directly benefit from the increased consumer spending?

Secretary O'NEILL. My staff has been helpful to give me some facts so that I can respond directly to your question. Nearly 24 million flow-through businesses in 1998, over 75 percent, or approximately 18 million, would expect to receive a benefit from the tax cut through their owners.

In 2006, the first year the administration's tax cut package is fully effective, over 20 million tax returns, or 75 percent, of the 26.2 million returns with income from flow-through would receive a tax deduction. So indeed there are major consequences here for sole proprietorships and small businesses that would help them to maintain their current levels of employment and expand.

Mr. HERGER. I thank you. I understand there is even some 600,000 Hispanic small businessmen just in the State I represent of California that would be affected by this.

Secretary O'NEILL. Absolutely.

Mr. HERGER. Another question. There has also been much that has been made of the potential amounts of tax relief that may be provided under the tax plan. And to put that into context, what are the facts about the amounts of taxes already being paid by various groups of income taxes?

Secretary O'NEILL. Well, at the moment the highest income group is paying 65 or 66 percent of the total Federal income tax, and under the President's proposal, it would be 66 or 67 percent, and the President's proposal would have the effect of lopping off millions of people paying the Federal tax and very substantial reductions for those with incomes up to $100,000. So there are major distributional consequences of what the President has proposed. And, in fact, higher income people would continue to pay the majority of Federal income taxes.

Mr. HERGER. You know, I have some information in front of me here that is put out by the Tax Foundation that indicates that currently as far as who is paying Federal income taxes, the top 1 percent is paying 34.8 percent, the top 35 percent, 53.8 percent, the top 10 percent, 65 or some two-thirds are being paid by the top 10 percent, and the bottom 50 percent of those paying Federal income tax are paying 4.2 percent.

Secretary O'NEILL. Right.

Mr. HERGER. This has gone up fairly dramatically in the last few years.

Secretary O'NEILL. Exactly right.

Mr. HERGER. Thank you. I yield back the remainder of my time.

Chairman THOMAS. Does the gentleman from Louisiana wish to inquire, Mr. McCrery?

Mr. MCCRERY. Yes, thank you, Mr. Chairman. Mr. Secretary, we often hear this debate framed in terms of either pay down debt or have a tax cut. I hope to illustrate that it is not an either/or choice, that we can do both.

If we go by the CBO baseline, which does not include a tax cut, and we go to the year 2006, only 5 years out, not 10 or 30 or 60, 5 years out, we would have our publicly held debt as a percent of our national income down to 9.4 percent. That is the lowest since 1917, since World War I. If, though, we assume, and I think rightly so, that we are going to use some of that surplus for a tax cut and probably some of it for increased spending in several areas, and we use only the Social Security surplus and the Medicare surplus to buy down the publicly held debt, debt as a percent of GNP would be 15.1 percent in 2006. And guess what? That is the lowest percent of our national income held by the public in debt since 1917.

If we only use the Social Security surplus to buy down publicly held debt in 2006, that debt as a percent of our National income will be 16.6 percent, again the lowest since 1917. My goodness, since 1917 we have been through the end of World War I, the Great Depression, World War II, the boom time of the fifties, the sixties. And during all of that time, our publicly held debt in this country as a percent of our National income was higher than it will be in 2006 if we use only the Social Security surplus to buy down that debt and we spend or give in a tax cut every one other penny of income to this government.

In fact, Mr. Secretary, if we don't buy down any more of the publicly held debt, if we spend or give in a tax cut every penny of on-budget and off-budget surplus between now and 2006, the publicly held debt will represent 25.7 percent of our National income, and that will be the lowest since 1975. And if you take out 1974 and 1975, it will be the lowest since 1931. So we are doing pretty well, is my point, on getting the debt down.

In the last Clinton administration budget, it stated, quote, The amount of unified budget surplus available to repay debt held by the public is estimated to be greater than the amount of debt that is available to be redeemed in 2006 and subsequent years, the differences assumed to be held as, quote, excess balances and to earn interest at a Treasury rate. These excess balances would start at $289 billion in 2006 and exceed $2.9 trillion by 2011.

Two economists writing in the Wall Street Journal recently estimate that if we take those excess balances and invest them in equities, which is about all we could do with them, that by the year

2020 the United States government would hold approximately one-fifth of all domestic equities.

Now, Mr. Secretary, in your view, is that wise for our Federal government to hold that large a share of private equities in this country?

Secretary O'NEILL. That is a very easy no. I would say one other thing. Alan Greenspan and I have been talking about these numbers and looking at them together. And I think we both believe that thinking about the zero debt held by the public is not very realistic for two reasons. One, we think savings bonds are not capable of early purchase, that there are people out there who are going to hold on to savings bonds. For countries who use the U.S. as a reference point, we believe you can't afford to buy back some of the debt that they hold because they are willing to hold it even if the coupon is zero or even if the coupon is negative, so that there is what we would call a fractional amount of debt held by the public that may be one trillion or one and a half trillion that we wouldn't buy back if we wanted to. So the problem is even sharper than what you suggest.

Mr. MCCRERY. Well, thank you, Mr. Secretary.

Mr. Chairman, I would suggest that this Committee and the Budget Committee and others in this Congress ought to concentrate not on debt, paying down the debt, but growing the economy, creating jobs, and that is best way for us to solve the long-term problems of this country after you come back to us with your Social Security and your Medicare solutions. And I am also interested in that great health care solution I heard you talk about.

Secretary O'NEILL. Thank you.

Chairman THOMAS. Thank the gentleman. The gentleman from Pennsylvania, Mr. Coyne, wish to inquire?

Mr. COYNE. Thank you, Mr. Chairman. Welcome, Mr. Secretary, and thank you for your testimony. And I also want to thank you for the outstanding public service that you provided to the people of Pittsburgh and western Pennsylvania during your time serving with Alcoa.

Secretary O'NEILL. Thank you.

Mr. COYNE. You indicated earlier that 50 percent, there would be a 50 percent decrease in the amount of taxes that would be paid by low income tax brackets. Could you elaborate a little bit more about that, about how that is going to work?

Secretary O'NEILL. If you look at the consequence of the President's tax proposals for a four-person family with income of $50,000 a year, they are now paying about $4,000 in Federal income tax, and the President's proposal would cut their tax by 50 percent to $2,000 a year.

Mr. COYNE. Now, how high in the tax brackets would that go?

Secretary O'NEILL. At $75,000 a four-person family would have their tax cut by 25 percent. And it moves up. At the highest rates that tax rate reduction would be from 39.6 to 33 percent after it was fully phased in.

Mr. COYNE. As you know, President Reagan had indicated and spoke many times about the earned income tax credit and called it the best antipoverty program that he had ever come across. Why can't we spend more of the surplus to bolster up and increase the level to which people would be able to earn and still qualify for the earned income tax credit?

Secretary O'NEILL. I remember being in this, in a way it is amusing, I remember being here where we couldn't say negative income tax out loud. Now we have $32 billion earned income tax credit. It is interesting how the labels change the possibilities. I think it is a perfectly legitimate question to say should we reconsider what we are doing for low income families. But I don't think it is an issue that is pertinent to the question of whether we should give taxpayers money back they sent in that is in excess of what is required to run the government.

And so, I do think if you all decide you want to do something else about Medicaid for low income families or housing subsidies or food stamps or food assistance and all the SSI, all the other devices, it is a perfectly legitimate question. But I don't see it directly related to the issue that the President has put on the table that we should fix the structure of the tax system for people who pay Federal income taxes.

Mr. COYNE. Well, does that indicate that you are not really high on the mechanism of the earned income tax credit?

Secretary O'NEILL. No, I didn't say that. I certainly didn't mean to imply that. I think it is just ironic that what we couldn't say out loud 30 years ago because it was politically out of bounds is now a $32 billion program.

Mr. COYNE. Thank you.

Chairman THOMAS. The gentleman from Michigan, Mr. Levin, wish to inquire?

Mr. LEVIN. Thank you very much and welcome, Mr. Secretary. In your testimony you say there is a strange attitude around this town that once the money gets here it doesn't belong to the taxpayers anymore; it belongs to some amorphous thing called government. And let me just suggest respectfully that is the attitude of any of us. And I think we need to debate these issues in a less rhetorical way. I really think that is a straw man, if I might say so.

You say that we can't vote maybe. But for us the question is whether we can vote prudently. So let me ask you a few questions that relate together. The budget surplus is predicted to be $5.7 trillion, as I understand it. You need to subtract from that the Social Security and I think the Medicare surplus. So when you do that, that subtracts $3.1 trillion. Is that correct?

Secretary O'NEILL. If you give me an exam I would have said $2.9, but fine. If you have, $3.1 that is all right with me. Two-hundred billion.

Mr. LEVIN. So that leaves under that calculation $2.6. The President's proposal is for $1.6 trillion over 10 years. And I think you have to add to that the addition of Federal borrowing costs. So you end up using for the tax cut and the related borrowing costs $2 trillion of the $2.6.

Now, let me just ask you since we want to vote, at least some of us, prudently, how do you justify that?

Secretary O'NEILL. Well, I think two things, Congressman Levin. First of all, the President didn't say $2 trillion, he said $1.6. But the thing I find really curious and I have been reading this in the newspaper, this business about while the interest costs are going to be higher, I didn't know anybody was in favor of dynamic scoring.

Mr. LEVIN. I am not sure that is dynamic.

Secretary O'NEILL. Well, it suggests that we are going to look at feedback effects. If we are going to look at feedback effects, should we look at what the consequences are for the economy operating at a higher level than it otherwise would because we have more savings and investment in the economy?

Mr. LEVIN. So you don't think there are likely to be any borrowing costs as a result?

Secretary O'NEILL. I didn't say that. But the other way to attack the question is to say, as I guess I would say on behalf of the President, the number is $1.6 trillion. That is how much money we think is a prudent amount of money to give back to the taxpayers. And if it is necessary, as you are suggesting, that we should reduce that $1.6 trillion by $400 billion because of the dynamics, the one-way dynamics of adding back interest costs, then it reduces the amount of money you have got to deal with because the President said $1.6, he didn't say $1.6 and whatever else you want to do.

Mr. LEVIN. All right. So you acknowledge there are likely to be some borrowing costs. So whether it is $2 trillion of $2.6 or $1.8 trillion of $2.6, non-Social Security, non-Medicare, 75 percent or more of the non-Social Security non-Medicare surplus goes for this tax cut.

Let me just ask you, then, you know in 1981, we were told pass the tax cut—I wasn't here at the time, the Congress was told—and the budget deficit will be eliminated in 3 or 4 years. Tell me, and I know you are a congenital optimist, but I don't think we can pass bills based on congenital optimism. Tell me why you are so sure this won't be a repeat of the 1981 experience?

Secretary O'NEILL. Well, I think a couple of reasons. You know, I was outside the government when all of that transpired, and it was actually clear to me that what was going to happen was in the cards. And maybe you weren't here but other Members were here. This was the year of the famous flying asterisk, when we had $42 billion worth of unidentified budget reductions that no one ever put together. And as a consequence of enacting the tax side without dealing with the spending side, we put ourselves in a ditch that was horrendous. I would stipulate it was not a good thing to do.

Today we find ourselves in a position, and I am not sure I followed all of your numbers, but my view of where we are is to say that if we lock box Social Security, that the President said we should do, effectively use it to pay down the public debt and you all want to do Medicare too, that is fine. We still have got after implementation of the President's proposal $1.5 trillion available, or more than 25 percent of the total projected surplus available as a cushion against the prospect of running ourselves back into a deficit ditch.

And again I would submit to you we have never had a time like this where we had so much free margin. Now, I would also say to you my assumption presumes that the Congress and the administration are going to discipline themselves when it comes to spending money. What I just said to you won't come true if people insist on piling on with additional targeted tax cuts and additional spending programs. Then we can't do all these things. But going into it with one and a half trillion dollars of unobligated money over the next 10 years seems to me to be the best safety life preserver we have ever had available to us as a society.

Mr. LEVIN. My time is up. I think we better go back over the numbers, because it is hard for me to see where the one and a half trillion comes from.

I close with this, in the years that I came in 1982 and thereafter, the Congress appropriated less money than the Reagan administration requested.

Chairman THOMAS. The gentleman from Michigan, Mr. Camp wish to inquire?

Mr. CAMP. Thank you, Mr. Chairman.

And thank you, Mr. Secretary for being here, particularly for your background and experience, especially in the job creating private sector and manufacturing. You had said in your written testimony that evidence of an economic slowdown makes this tax relief all the more compelling. Could you outline for us some of the economic indicators or economic factors that you see that show this economy is slowing?

Secretary O'NEILL. Well, if you look—let me use an industry to make the point. If you look at the automobile industry and you look at how it was running, what its final demand-sales numbers looked like through last summer and I guess through the middle of last summer, they were running at an 18-plus million final sales rate of light trucks and cars, which was a very, very good rate for our industry and it is good for our people and employment and everything else that we care about.

When we got to November and December, the rate was running 15 or 15 and a half million units. And the consequence of that change, major shift down from 18 million to 15 million was obvious and it is apparent what that meant in dealer show rooms, not so obvious and apparent what it means out there in the supply chain. What it means in the supply chain are the numbers that were suggested by one of the Members about layoffs that are now being reported.

When final demand slows down like it did at the end of the fourth quarter, it is a depression for people out there in the supply chain. And what we are seeing right now is a push back down into the economy of the consequences of final demand for things as important as automobiles pushing their way into the economy. And in this economy that we have now, the supply chain is so carefully and closely integrated so that "just in time" is not a slogan, it is the way business is really conducted. So that if final demand slows down and you are an employer and you don't have any orders, you don't get to spend a lot of time softening the blow. You have got to deal with it right now or you are going to jeopardize your own financial capacity.

So we are in the abrupt phase of what I hope is only an inventory correction. But there should be no doubt that we have slowed down very appreciably from where we were. And if you go talk to the execs like I have from across the breadth of our country, what you find is some people in the supply chain—and now this is, let me say, the high tech supply chain of providing telecommunications solutions to major producing companies—the order rates for them have slowed down a lot. Because when the automobile companies don't have orders, they start pulling back on investment and reinvestment and modernization and all those other things. So it starts filtering out into the rest of the economy. And that is what we are seeing now.

The importance of acting quickly, which Chairman Greenspan has done, is that we don't get the negative snowball effect and it pushes down into the economy. An interesting insight from a conversation with a major supermarket owner last week in New York, he told me that as they look at past contractions in the economy, they can tell when we are into a serious phase because people start going to the grocery store three times a week instead of once a week and they buy staples instead of impulse items. He said up to now he hasn't seen what you might characterize as an individual inventory correction as Americans get concerned about the sustainability of their income levels. I think that is a positive sign that it hasn't backed up into the individual level at the supermarket.

But there is no doubt that we are in a contraction, a slowdown period, and it is important not only for ourselves but the rest of the world that we return to rates that are in the 2 to 3 percent range as quickly as we can.

Mr. CAMP. Would a slowdown be the only reason we should pass the President's tax plan?

Secretary O'NEILL. Absolutely not. As I said earlier, the President's tax plan was crafted in the context of what should a tax system look like for the American people, and it was crafted independent of the question of cyclical economics. The cycle that we are in now just suggests that we should act on it more quickly than perhaps we would have if we had been still today at a 3.5 or 4 percent rate of growth. Then it would be hard for me to say to you it is worth thinking about retroactivity or acceleration. But given the slowdown, it does seem to me there is a reason to do retroactivity and maybe some acceleration and to do it quick enough so that it gives heart to consumers out there. One of the things you need to look at as an economic matter is what is the level of consumer confidence, because how people feel about their job security and their future prospects has a lot to do with whether or not you have a consumer led demand level that is consistent with 3 or 4 percent real growth.

So if you can all give them more confidence than they currently have about flow of funds that are disposable for them to pay off their credit card debt and buy new goods could really be helpful to having this be a shallow dip and back to higher growth rates.

Mr. CAMP. Thank you, Mr. Secretary.

Chairman THOMAS. The gentleman from Minnesota, Mr. Ramstad, wish to inquire?

Mr. RAMSTAD. Yes, Mr. Chairman. Thank you. Thank you, Mr. Secretary. It is refreshing indeed the President has been able to attract the best and the brightest to his cabinet. You certainly personify that description. We all look forward to working with you.

Would you say in following up on my friend from Michigan's line of questioning that were you to prioritize the elements of the tax package, that marginal—in terms of simulating the economy, that marginal rate reductions are the most important?

Secretary O'NEILL. Yes, without question.

Mr. RAMSTAD. And then I want to follow up on my other friend from Michigan, Mr. Levin's line of questioning. Isn't it true that in the 80's, and we are hearing much from the critics about the experience of the 80's, isn't it true that tax revenues more than doubled under President Reagan's tax cuts but at the same time Federal spending tripled? And even this Norwegian can understand that if you double revenues but triple spending you are going to have deficits.

Secretary O'NEILL. Absolutely.

Mr. RAMSTAD. Isn't that the lesson we should learn in terms of holding the line on spending while we produce these tax cuts for the American people?

Secretary O'NEILL. That is certainly what I believe.

Mr. RAMSTAD. And also in that line of questioning, critics have said this tax cut is too large. But again, in looking at it relative to the size of the economy, to the Gross Domestic Product, isn't it true that President Bush's tax relief package is smaller than both President Kennedy's and President Reagan's?

Secretary O'NEILL. Yes. I think it is true that it is one-third the size of what President Reagan recommended and one-half the size of what President Kennedy recommended and implemented.

Mr. RAMSTAD. Is it accurate to say that President Bush's, in total, the tax relief package is about 1.5 percent of GDP?

Secretary O'NEILL. Exactly.

Mr. RAMSTAD. Finally, I want to ask about the—there has been much talk in some quarters about a so-called trigger that would stop the tax relief if the budget surplus does not materialize. Wouldn't this result in uncertainty and make business planning, individual financial planning virtually impossible?

Secretary O'NEILL. I have seen the comments about the trigger. In fact, Alan Greenspan and I have talked about it quite a bit. I can't imagine that any of you really would like to have a trigger that in the event that say in '06 that we had a downturn, that you would have a trigger that would raise taxes on the American people when the economy was in difficulty. But I tell you there is a concept of a trigger that I frankly like quite a bit and it goes like this: After we have done what the President proposed, and I hope you all will see a way clear to do that, and let's assume that maybe I am correct about my optimism about the tax system throwing off even more excess revenues, going forward, I would love a trigger that said in the future when we have substantial revenues left over after we paid for agreed public purposes that 60 or 75 percent of it would be automatically sent back to the American people the day after we close the books. It seems to me that would really be a wonderful trigger and the people would like it a lot, because when their economy did well they would be a clear and present beneficiary and they wouldn't have to wait for us to contemplate it. We just send it back.

Mr. RAMSTAD. Well, that is my kind of trigger as well, Mr. Secretary. Thank you very much, Mr. Chairman. I yield back the balance of my time.

Chairman THOMAS. I thank the gentleman. The gentleman from Maryland, Mr. Cardin, wish to inquire?

Mr. CARDIN. Thank you, Mr. Chairman, I do.

Mr. Secretary, we welcome you on both sides of the aisle. We very much appreciate your willingness to serve. I would like to just check one of the math figures that you use. You have said twice that after the President's tax proposal we have $1.5 trillion available as a cushion. I think that includes the Medicare money. As the Chairman has indicated, we intend to pass on a bipartisan basis a lock box which will take the Social Security and Medicare money off the table from being spent because the same problems we have in Social Security we are going to have in Medicare. Am I correct then that the cushion if we take Medicare off the table is $1.1 trillion, not $1.5 trillion?

Secretary O'NEILL. I would stipulate that, yes.

Mr. CARDIN. I just wanted to make sure we had the right numbers.

Secondly, if I understand your position, the administration's position, you believe there is $1.6 trillion available over 10 years for the tax number. If we change the tax bill, if we make it retroactive, if we deal with alternative minimum tax, if we make provisions for the interest costs, if we deal with some of the business tax issues that we have been lobbying for including extenders, that all has to be fit into the $1.6 trillion, is that the administration's position?

Secretary O'NEILL. Conceptually I would say yes to you, but I would say this as well: The President has really been strong and I have done the best that I could in talking to the many people you might imagine who come around to tell me they want to be on this train, get away from the table. This is a time for tax relief for individuals and not for the host of other things that are important. It is not that I would say these other things are not important and worthy of consideration. Certainly the work that you did last year considering IRAs, and you can listen to people make a compelling case for a capital gains taxes and health insurance. We could make a list of 40 things that are worthy of consideration. The President has said these are the things to deal with now. It is not that we should never deal with some of these other things, but not now.

Mr. CARDIN. I understand that. I have been with the President and he has said on numerous occasions it is his responsibility to suggest and to lobby Congress but it is Congress' responsibility to act. And if Congress decides that it wants to change this bill, it is your position and the administration's position that we need to stay within the $1.6, that we can't——

Secretary O'NEILL. Absolutely.

Mr. CARDIN. If you could just help me with one other point if you might, and that is we all are starting to talk that our economy might be slowing down. Yet when I look at the revenue projections, we are projecting surpluses based upon a stronger economy. Last year, 1 year ago, we had based projections on an overall growth rate of about—real growth rate around 2 percent. We have changed that to now a 3 percent growth rate. If we were to go back to the 2 percent, we would have about $2½ trillion less in surplus. 1 percent difference is about $2½ trillion over the 10-year period.

So I guess my question to you is that if we are concerned that we would have a slowdown in the economy, why are we making our projections based upon basically a 50 percent growth rate above where we were last year from a 2 percent to a 3 percent?

Secretary O'NEILL. The outside estimates, these are not either administration or CBO estimates, the best estimates I know for next year is a growth rate between 3 and 3.4 percent. Now, you may say economists don't know anything, we shouldn't look at any of their numbers, we ought to just make them up ourselves. But if you use as a reference point what the economics profession thinks, and this is an international thing, it is not as though American economists have something wrong with them, if you go look at the whole world of professional economists, they would tell you they believe next year's real growth rate is going to be over 3 percent because this year is going to be under 3 percent and that we are going through a mild correction. It is not a systemic problem, and therefore we are going to be above what most economists would say is trend line real growth rate in 2002 and then tapering back to something like 3 or 3.1 in the out years.

Mr. CARDIN. Well, I appreciate that, and we all hope that those projections hold true. I just find it somewhat difficult to understand why we believe we have a softening in the economy that needs a stimulus but on the other hand we use long-term projections that are more rosy than we did 1 year ago.

I yield back the balance of my time.

Chairman THOMAS. Thank the gentleman. The gentleman from Texas, Mr. Johnson, wish to inquire?

Mr. JOHNSON OF TEXAS. Thank you, Mr. Chairman. You know, I think everybody is talking about us not having a big surplus, but in fact, the CBO's forecast in their recent years have been consistently underestimated. Is that not your opinion also?

Secretary O'NEILL. It is true. It is a matter of fact.

Mr. JOHNSON OF TEXAS. True fact of history. So we can expect the numbers that some of the outside economists are forecasting to be true and our surpluses will be there. As concerns a trigger mechanism which you spoke to a few minutes ago, I like your idea, by the way, perhaps we ought to have a trigger mechanism on big government spending bills, too, to keep it down. But wouldn't such a trigger mechanism as has been proposed, that you don't like, I know, be an invitation to those who oppose tax relief to increase government spending?

Secretary O'NEILL. I think so, yes.

Mr. JOHNSON OF TEXAS. I am glad you agree with me. Let me ask you another question. We spoke to the death tax relief, and I know that we are worried about a declining economy at this point, and somehow we need to stimulate it. Could you talk to the idea of a stimulation by providing fairly quick repeal of the death tax? I am told that it might produce as much as $35 billion into the economy.

Secretary O'NEILL. I think that is right. But as I said earlier, if you look at a tradeoff between the distributional effects of what the President has proposed for marginal rate cuts and even for the child credit and compare it to the distributional effects of repeal of the death taxes, there is no question that you get a much better diffusion of tax relief through these other devices. But saying that doesn't deal with a fundamental conceptual point that says once people have paid taxes on their income they shouldn't be subjected to taxes again when they die. It is a fundamental point of what we as Americans think about how our tax system should work.

Mr. JOHNSON OF TEXAS. So if we pass your trigger then we can come back with complete death tax relief, is that true?

[Witness nodded.]

How about marriage penalty? Would you tell me why we are doing partial marriage penalty relief and not full? Is there a limitation on the dollars available?

Secretary O'NEILL. Yes. We have—the President—I should be careful and not say "we" because he designed this idea in the past couple of years. But I think it is the right thing to do. It provides marriage penalty relief for what I would consider to be the most egregious cases, and it doesn't go as far as some proposals would go. But in looking at the trade between marginal rate cuts and the child credit and the estate tax, where the President has come out and where I recommend that we come out is with what he has proposed, which I know doesn't go as far as you all decided last year you wanted to go.

Mr. JOHNSON OF TEXAS. I appreciate those comments. I hope you will agree with me we need to get this money out of town so we won't here in the Congress spend it.

Thank you, Mr. Chairman. Yield back the balance of my time.

Chairman THOMAS. The gentlewoman from Washington wish to inquire?

Ms. DUNN. Thank you very much, Mr. Chairman. Welcome, Mr. Secretary. I think you are doing a great job in your first opportunity to come before us, and the clarity of your thoughts is very helpful to us.

I appreciate on the issue of death tax repeal the strong position of the administration. It has been in the President's tax plan for some time now, and I am delighted to see the intent of including that in our tax package, and not just relief but repeal.

There is a group of folks who claim that the death tax repeal would affect only 2 percent of people who are filing taxes each year. I think that they forget about the folks who have to comply with the death tax. They forget about sometimes hundreds of thousands of dollars that one individual has to pay, for example, to provide for himself liquidity through life insurance policies or for estate planning.

And I have some concerns along that line because we see groups of people opposing the repeal of the death tax who represent that sort of required investment out of a very bad law. The debate has come around to the fairness issue, and I think that is very important, what you just mentioned to Congressman Johnson about having paid taxes once on the dollar you shouldn't have to continue to have to do that. As in the case of death tax the third or fourth time sometimes a dollar is taxed once again.

There is a group of folks out there who have raised some question on the altruistic thread that people in the United States have always exhibited as far back as the 1800's when de Tocqueville talked about our threat of altruism. These are the-fund raisers for charitable organizations. They don't always agree. The National Committee on Planned Giving, an organization of 111 charitable groups and 11,000 gift planning professionals, takes the following position: It is clear that charitable gift planners have not reached consensus on this question. While some predict disaster, others are convinced that the elimination of the estate tax could actually improve the quality of charitable gifts by eliminating false pretenses in charitable giving. And it is my sense that as we saw no decline in the number of dollars in the political system when we took deductibility away from those, nobody complains that there are too few dollars in politics today, I think that that threat of altruism runs very deep. I would like to hear your thoughts on the effect on charitable giving of the repeal of the death tax.

Secretary O'NEILL. I must say I quite agree with you. I think an interesting thing has happened in our country in the last 20 or 30 years. More and more people have entered the charitable giving process. And you know having served as a trustee for the fund that has very large amounts of money and looking at what individuals are doing in terms of giving away their income and wealth, it really is quite amazing how deep that charitable instinct runs.

And I honestly don't think that the nonprofit institutions should be concerned, as some of them seem to be, that suddenly that instinct will get turned off if we eliminate the estate tax. I guess I am not one who believes that all people are Adam Smith's economic human beings and that they only do things because of what you all write into a Tax Code. I just don't believe it. You know, too personal maybe, but whether you don't do the estate tax has nothing to do with what I do with charitable giving. I know we shouldn't be personal about that.

But in addition to that, the President has said we should allow people who don't file a long return to claim deductions or credits for their charitable giving, and I think that cuts the other way. So the prospect is going forward if we do all of these things, especially if we keep up the high rates of real growth that we have experienced. I think the well spring of good intentions and well-meaning by the American people will be a flood of additional money to work on the social things that we all care about.

Ms. DUNN. I agree with you, Mr. Secretary. I thank you for your answer. It seems to me when people have more dollars in their pockets, as they will with the repeal of the death tax and these other important issues that the President has sponsored, that we will see more giving, not less giving to charitable givers.

Thank you. I yield back my time.

Chairman THOMAS. I thank the gentlewoman. Gentleman from Washington, Mr. McDermott, wish to inquire?

Mr. MCDERMOTT. Thank you, Mr. Chairman. Welcome, Mr. Secretary. Since I don't know all those people behind you I want to ask a request first before I ask a question. And that is Congressman Crane, Congressman Rangel 5 years worked on the Africa and CBI trade bill. The customs agency is implementing it in a way that guts the effect on both the Caribbean and Africa. I would ask you to look at that. I know that you are new in the job, and I don't know which of your people I should call. If they want to get in touch with me, that would be fine.

The second thing is I have a couple yes and no questions.

Secretary O'NEILL. May I say one thing about that? You know, I don't know the details of this but I was told that the way these regulations are being formed cuts against the intent of fostering and helping with free and fair trade. I guarantee you we will fix that problem if it is truly characterized in what I have heard.

Mr. MCDERMOTT. Good to hear you are on top of the problem. You have got it straight.

As I listen to this other testimony, I think you said that there is no plan to use either Social Security surplus or Medicare surplus or government pension surplus in this tax cut.

Secretary O'NEILL. Absolutely right.

Mr. MCDERMOTT. If that is true that $5.6 goes down to $2.3 trillion, and that is based on $2.4 out of Medicare and $390 out of Medicare—Social Security is $2.4, Medicare $390, and $419 in government pensions.

Secretary O'NEILL. But the government piece never enters this equation. It is covered in the—no, it is not. I don't think that is right. It is not part of the surplus.

Mr. MCDERMOTT. These are CBO figures.

Secretary O'NEILL. That is not part of our surplus calculation.

Mr. MCDERMOTT. I want the chairman to know that it is in the CBO figures that we got. That is what I am quoting there.

Do I also understand you have no intention to fix the AMT?

Secretary O'NEILL. No, I didn't say that. I said——

Mr. MCDERMOTT. What figure are you using as an AMT?

Secretary O'NEILL. What I said is if we don't do anything to the AMT, no one will pay more taxes. In fact everyone will be benefitted compared to where they are now——

Mr. MCDERMOTT. I heard your answer.

Secretary O'NEILL. With the implementation of the President's program. And I further said that 85 percent of the AMT effect would happen to people with incomes over $100,000 a year. I know some of you are worried that the President's proposal is going to give too much money to higher income people. So you shouldn't be too alarmed that they are going to pay more as a consequence of the AMT than what you otherwise would expect. So there is a population, that is a fairly small population with incomes below $100,000, that we are prepared to work with you all to figure out. If you want to fix a problem that has been there for 30 years now, we will work with you to fix it, if that is what you want to do.

Mr. MCDERMOTT. One other part of this budget that is pretty clearly not being acknowledged is that there is no reflection of the increase in population. The CBO says that that is going to cost $418 billion. Do you accept a figure in that area?

Secretary O'NEILL. No. I have no idea what that has to do with anything.

Mr. MCDERMOTT. OK. Well, I think you ought to check when you come up here. Because they say that you have to subtract $418 billion simply for the increase in population in the various programs. But let me move on to one other thing. That is Joint Tax Committee. The Joint Committee on Taxation says that the tax cut is $1.5 trillion, $1.6. So we agree on that. The President is now talking about advancing that number, is that correct, taking in this year?

Secretary O'NEILL. He is talking about what he considers to be the desirability of making it retroactive to January 1st, 2001, yes.

Mr. MCDERMOTT. That adds $400 billion to the tax cut?

Secretary O'NEILL. No, it doesn't.

Mr. MCDERMOTT. That is not what the Joint Committee on Taxation says.

Secretary O'NEILL. That is because they didn't listen to the President. The President says the number is $1.6 trillion. And if we advance and do retroactivity, then it seems it is a logical tautology that you are going to have to change something else in the back end of the program if you are going to front end part of the program. But the President has been really clear. I have heard him say it over and over again the number is $1.6 trillion. I have heard him say over and over again the number is $1.6 trillion.

Mr. MCDERMOTT. That is all. No business tax——

Secretary O'NEILL. $1.6 trillion. This is what the President thinks is right for the American people.

I must tell you I hope I don't sound disrespectful. I know the President is not disrespectful. He understands, as I do very well, it is up to you to decide what the American people will get. I want to be really clear that I am trying to communicate the firmness of the President's intention that we not spend more than $1.6 trillion of this $5.6 trillion for these changes in the way the tax structure works and to the degree that we working together decide that we should have some aspect of retroactivity and/or some aspect of acceleration that we are going to have to work together to figure out how we stay within $1.6 trillion.

Mr. MCDERMOTT. Will the President veto if we go above $1.6 trillion?

Secretary O'NEILL. I think more likely than that he will throw me out. So I think my job is in your hands. If I can't convince you that we should stay at $1.6 trillion, then I have failed, and you need a different Secretary of Treasury to help you work the numbers. But I think it is likely that we can work together to achieve the numbers the President will sign.

Mr. MCDERMOTT. If you do retroactivity, where do you want to make the cuts to stay under the $1.6?

Secretary O'NEILL. I don't have any recommendation except the one the President has proposed to you, which is $1.6; and the program has developed features in it which we have sent to you and it is a place to begin. We would say it is a place to end. And if you join the President in thinking that it could make some sense to provide retroactivity, then we need to work together and come to a common agreement about how we do this. If you let me be king for the day, I could do this; but I presume you are not going to really let me do that so we are going to have to work together to see how we accommodate the interests.

Mr. MCDERMOTT. So the retroactivity was not part of the proposal that the President sent up here the other day?

Secretary O'NEILL. The retroactivity is not assumed, that we are going to add $400 billion, absolutely not. In fact, I don't even—I can't imagine where you got $400 billion. Because fully phased in the President's—the value of the marginal rate cuts for a 10-year period is $750 billion. I can't imagine where you got $400 billion in the first year. There is no way.

Mr. MCDERMOTT. We are going to have, obviously—not in the first year. That is over 10 years. And we will have a long discussion I think with the Joint Committee on Tax because they are the ones that gave me these figures. That is not something I dreamed up. I think it is good for us to talk about it.

I thank you, Mr. Chairman.

Chairman THOMAS. I thank the gentleman.

I am pleased to note that if in fact we decide to do something there is room for the Ways and Means Committee. We have a future and we can deal with trying to fit the numbers into the President's suggested total amount.

The Chair would like to announce that the next panel of the economists, since several of them are over on the Senate side, will resume at 1 p.m. I promised the Secretary I would try to get him out at noon. We came fairly close for government work. But the Committee will begin the questioning following the Chair and Ranking Member with the gentleman from Georgia, Mr. Collins, and the gentleman from Wisconsin, Mr. Kleczka, so that we could give, hopefully, everyone an opportunity to ask a question today.

With that, the Committee stands in recess.

[Recess.]

[Statement submitted by Mr. Herger, and Secretary O'Neill's response, are as follows:]

Statement from Mr. Herger to Treasury Secretary O'Neill

Mr. Secretary, on September 29, 2000, then candidate George W. Bush announced a Comprehensive National Energy Policy plan, and published the specifics on his Internet site. On page 19, the plan contained a proposal to "Support Tax Credits for Electricity Produced from Alternative and Renewable Resources," which included "an open loop biomass credit."

Please know that the President's open-loop biomass credit is essentially identical to that which I have been advocating, along with a number of my colleagues in the Ways and Means Committee, for several Congresses. Because such a credit is vital to the survival of biomass plants in my District and around the nation that provide valuable national benefits in terms of renewable energy and waste disposal, I was pleased my proposal was included in the Bush Energy plan.

Now, as you and your staff move forward to draft the President's tax proposals into a FY 2002 Budget submission, I would very much appreciate it if you would work with me to ensure that this open-loop biomass tax credit is included."

Treasury Secretary O'Neill's Response to Mr. Herger

Yes, the administration's Budget will include a proposal to expand the credit for electricity produced from alternative and renewable sources to include open loop biomass. We look forward to working with you and the Members of the tax-writing committees in fashioning the details of this proposal as the legislation proceeds.

[Questions submitted by Democratic Members, and Secretary O'Neill's response, are as follows:]

1. In your Senate confirmation testimony, you stated that you supported the aggressive pursuit of the purveyors of corporate tax shelters. Do you agree with your predecessor, Larry Summers, that abusive tax shelters are

“the most serious compliance issue threatening the American tax system today?”

The United States income tax system largely has been based upon a long and enviable tradition of self-assessment. A perception that some taxpayers can and do engage in questionable transactions poses a threat to the integrity of our tax system and must be taken seriously. I understand that over the last several years the Congress and the administration have examined the effect of corporate tax shelters on the tax system and have addressed certain specific transactions.

Over the next several months, I envision that Treasury and the IRS will continue to address abusive schemes as we become aware of them. After a careful review of the comments submitted by taxpayers, we will work toward finalizing regulations issued last year under sections 6111 (dealing with confidential corporate tax shelters), 6112 (dealing with list maintenance by promoters), and 6011 (relating to corporate disclosures) as well as the modifications to Circular 230 (dealing with opinion writing and standards of practice before the IRS.)

When we believe that legislation is the appropriate remedy to deal with a problem, we will come to the Congress with suggestions. And we welcome the opportunity to work with the tax-writing committees to address that concern them.

2. Do you also agree with your former Secretary Summers that transactions without economic substance and with no discernable non-tax business purpose should be subject to a higher penalty for avoiding tax?

It is well-established law that tax benefits claimed from transactions without economic substance and with no discernable non-tax business purpose are not allowable. Current law also provides that taxpayers and promoters that engage in such schemes may be subject to penalties. Some have questioned whether these current-law penalties are sufficient in order to deter inappropriate behavior. We welcome the opportunity to work with the tax-writing committees to examine the effectiveness of these present-law sanctions. However, any response to perceived abuses has to be appropriately measured so as not to affect legitimate business transactions.

3. Do you agree that a full repeal of the estate and gift tax may create certain opportunities for tax avoidance, with losses to the Federal treasury yet to be assessed? With repeal of the estate and gift tax, would not it be possible to:

(a) Allow one person to give appreciated stock to an elderly family member, and receive a higher basis, tax free for that same property when it is willed back after death to the original owner;

(b) Allow a person to give appreciated stock to a tax-indifferent party, who could sell the stock tax free, and return the proceeds to the original person;

(c) Allow a person to give appreciated stock to lower-income relatives who could sell the stock at a lower capital gains rate and return the proceeds to the original owner.

Does the administration support allowing such transactions as outlined above? If not, what legislative language do you recommend to prevent such tax avoidance?

It is true that repeal of the estate and gift taxes may provide an incentive for some taxpayers to modify their behavior and transactions and investments in order to minimize their income tax liabilities. The Administration’s Budget proposal on death tax repeal and H.R. 8 as passed by the House of Representatives this year contain provisions that seek to address this potential revenue loss. For instance, both legislative proposals generally provide that an heir will take the decedent’s tax basis in the property inherited at death. This preserves any built-in gain in the property. A limited step-up to fair market value is allowed so that estates not currently subject to estate tax will not be disadvantaged under the income tax upon death tax repeal. In addition, other provisions in the legislative proposals address specific potential income-shifting and tax avoidance transactions. Finally, H.R. 8 directs the Treasury Department to further study this issue and report to Congress whether any other provisions may be needed. As full repeal of the estate and gift taxes is phased in under both our Budget proposal and under H.R. 8, we should have sufficient time to further examine this issue and address any additional concerns.

4. Do you disagree with the finding of the Joint Committee on Taxation that the numbers of taxpayers paying add-on tax due to the AMT will almost double and that the President’s plan uses the AMT to take back nearly $200 billion of his reductions in the regular income tax over 10 years? If you disagree, what are the Treasury Department estimates and explain in detail how and why they vary?

The Treasury Department estimates that the administration's tax cut proposals would (1) increase tax receipts from the AMT by $262 billion over the 2002–2011 period, and (2) increase the number of taxpayers in 2011 who have additional tax liability because of the AMT from 20.4 million to 34.7 million.

Even people who will go into the AMT after enactment of the tax package will have a lower tax rate than they otherwise would have experienced under the current system.

5. Please advise the Committee as to why the President's proposal to address the marriage penalty does not address this penalty within the earned income tax credit (EITC)?

Restoring the two-earner deduction would reduce marriage penalties among many couples who currently experience marriage penalties due to the EITC.

First, the two-earner deduction would reduce marriage penalties for some couples who currently receive the EITC but whose income falls in the EITC phase-out range. These couples are eligible for the EITC under current law, but they receive a smaller credit filing jointly than they would if they could file as unmarried. Thus, they incur a marriage penalty due to the EITC. The two-earner deduction reduces their marriage penalties because one of the definitions of income used to reduce the EITC in the phase-out range is modified adjusted gross income (AGI). By reducing adjusted gross income, the two-earner deduction would increase the EITC for many couples.

Second, the two-earner deduction would also reduce marriage penalties for couples whose income exceeds the current law EITC income thresholds (up to $32,121 for taxpayers with two or more qualifying children). These couples are ineligible for the EITC because their combined income is too high, but they would be eligible for some credit if they filed as unmarried. Over half of EITC-related marriage penalties are attributable to couples with incomes between $30,000 and $60,000. The two-earner deduction would reduce total marriage penalties due to the individual income tax (including the EITC) by about 20 percent among couples in this income range.

6. Do you agree that during the next 5 years, the substitute proposal on estate tax relief offered by Mr. Rangel last year would provide more relief to family farms and businesses than they would receive during the same period from the President's proposal?

The President's proposal would provide relief to 1.8 million farms and 17.5 million businesses. I am pleased Mr. Rangel believes estate tax relief is important. Whether a particular family would pay lower taxes under the amendment proposed by Mr. Rangel on June 7, 2000 or under the President's proposal depends upon the particular circumstances of the decedent and the heirs. Some estates consisting primarily of qualifying family-owned business interests would be subject to less tax between 2002 and 2006 if the qualifying family-owned business interest (QFOBI) deduction were immediately increased to shelter $2 million (rather than $1.3 million). However, the amendment offered by Mr. Rangel also converted the QFOBI deduction to an exclusion amount, reducing its value for some estates. The factors that determine who would be better off under the proposal include the size of the estate, the portion of the estate (if any) that qualifies for the QFOBI deduction, and the marital status of the decedent.

Some larger estates would obtain a greater benefit from the rate reductions in the administration's plan than they would from an increase in the QFOBI deduction. In addition, under current law and both of the proposals, a married decedent can pass an unlimited amount of property to a surviving spouse free of tax. Under current law and Mr. Rangel's amendment, the estate of the second spouse would be subject to tax (to the extent that her estate exceeds the amounts exempted by the unified credit and QFOBI provision). But under the Administration's plan, the estate of the second spouse would not be subject to any estate tax, if the spouse died in 2009 or thereafter. Therefore some married couples would be better off under the President's plan than they would under Mr. Rangel's amendment, regardless of the size or composition of the estate.

The QFOBI deduction does not free farm and business owners from the estate tax entirely. The QFOBI provision was designed to apply to a narrow class of estates. In order to qualify for the deduction, the business interest must pass to a Member of the family or long-term employee. The heir must then remain active in the business over a 10 year period after the date of death, or the benefit of the estate tax deduction is recaptured. During the 10-year period, the business is subject to a special lien for potential additional estate taxes, which can limit the business' ability to raise capital. For this and other reasons, the administration prefers to eliminate the estate tax entirely, rather than to create or increase exemptions that apply only to certain kinds of property.

7. You have testified that eliminating the estate tax will have no significant adverse effect on charities, even though the estate tax charity deduction can be worth up to 55 cents on the dollar for charity. On the other hand, the administration argues that extending the individual income tax charity deduction to users of the standard deduction will significantly benefit charities even though most taxpayers will at most get 15 cents of tax reduction on a dollar for charity. How do you reconcile these views? Does not your testimony undermine the rationale for the administration's proposed non-itemizer charitable tax deduction?

It is my personal belief that a substantial portion of charitable giving is not tax motivated, and thus would not be diminished by repeal of the estate tax. This does not mean that charitable giving would be entirely unaffected if the estate tax were repealed. Economic research suggests that repealing the estate tax, while making no other changes to the tax system, would result in some decrease in charitable giving. However, the Administration's proposal also would replace the step-up in basis at death with carryover basis. Therefore some individuals who inherit appreciated property will be encouraged to make charitable gifts to reduce their capital gains taxes. In addition, the administration has proposed to allow non-itemizers to deduct charitable contributions on their income tax returns, to permit charitable contributions from individual retirement accounts by persons over age 59 and to raise the cap on corporate deductions for charitable contributions. These proposals would tend to increase charitable contributions. Thus taken as a whole, the administration's tax plan is not expected to have a detrimental impact on charitable giving. Furthermore, to the extent that the Administration's plan contributes to real economic growth, it will increase the funds available for charitable giving.

8. You have indicated that what you contend is the $1.6 trillion cost of the President's recommended tax cut represents the absolute ceiling which the administration will approve without your resignation. However, the cost of the one bill already approved by the House already exceeds the cost of the same component in the President's tax cut by about $100 billion and many other tax cuts are being advanced by Republican leaders, such as additional tax relief for this year, capital gains cuts and pension changes like those offered by Reps. Portman and Cardin. The marriage penalty related legislation advocated last year by Republican Congressional Leaders cuts taxes much more than the marriage penalty provision in the Bush plan. Please identify specifically your priorities for trimming the President's recommendation to accommodate the change already made and any changes that are likely to occur during the legislative process.

The Administration expects to work with Congress to fashion tax relief proposals that follow President Bush's proposals, in order that we may return the excess tax collections to the American taxpayers as expeditiously as possible.

9. Please describe those changes in taxation of businesses that the Administration considers most appropriate following approval of any legislation concerning individual taxation.

There are several tax proposals in President's FY 2002 Budget that directly relate to the taxation of businesses. For example, the Administration proposes to make the research and experimentation tax credit permanent and to extend other provisions that are scheduled to expire in 2001. Other tax proposals that are targeted toward businesses would raise the cap on corporate charitable contributions; exclude from income the value of certain employer-provided computers, software and peripheral equipment; establish FFARRM Savings Accounts; extend permanently the expensing of brownfield remediation costs; extend and modify the tax credit for electricity produced from certain sources; and modify the treatment of nuclear decommissioning funds. The President's plan also calls for extension of provisions in the Tax Code that are set to expire this year. This is a priority. They include the work opportunity tax credit, the welfare-to-work tax credit, the exclusion for work provided educational assistance, alternative minimum tax relief for individuals, active financing, percentage depletion for oil and gas wells and qualified zone academy bonds.

Moreover, many of the provisions targeted toward individuals will have a significant effect on business activity and investment. A substantial portion of small businesses are structured as sole proprietorships, partnerships, and S corporations, and are subject to tax at the individual tax rates. The President's proposed reduction in individual tax rates would increase the cash flow of these businesses and provide them with incentives to re-invest profits and expand.

After enactment of the President's plan we will look forward to additional tax simplification and reforms that affect businesses and individuals. We look forward to working with Congress on these proposals.

10. The President's budget submission shows planned use of the projected unified budget surplus of $5.644 trillion on the following: $1.620 trillion for tax cuts, $153 billion for "Helping Hand" and Medicare proposals, and another $20 billion in other changes. This surplus, according to your budget, also will be reduced by $417 billion in additional debt service, totaling a $2.210 trillion reduction in the surplus over a 10-year period. How much of this $417 billion in increased debt service is caused by the three previous items—the tax cuts, Medicare and "Helping Hand" expenses, and the other proposed changes? Is it true that $373 billion of the $417 billion in extra debt service is due to the tax cuts? If so, is it not true then that the total cost of the tax cut package is really the sum of those two figures, or $1.993 trillion?

The Administration's April budget notes that the revenue cost of the President's tax proposal is $1.612 billion over the 10-year budget window. It also lists the $420 billion interest cost associated with all of the President's tax and spending initiatives—it does not provide a breakdown of the debt service for each individual initiative. It has been standard practice for a number of years to report the cost of a tax proposal by detailing its revenue costs alone.

11. Do you agree that it is appropriate, as reflected in the tables of the President's budget submission, to show the interest expenses associated with paying off the debt more slowly? Do you agree that it is appropriate, as is done in the President's budget submission, to measure budget proposals relative to a baseline projection of existing law? Is it correct that the estimate of a $5.6 trillion surplus over a decade is based upon no changes in existing law?

The President's budget pays off the maximum amount of debt that it is possible during the budget window. Thus, there is no tradeoff between his initiatives and the important goal of paying off the debt.

Baselines (which are constructed upon the assumption of a continuation of existing law) can provide a useful starting point for fiscal planning, although they have certain weaknesses. For example, the present baseline assumes permanent extension of one-time funding needs (like the Decennial census) and assumes that the Federal government is able to earn interest on excess cash balances even when these balances would likely overwhelm the legally permissible investment instruments available to house them.

Chairman THOMAS. The Committee will reconvene.

In the morning session we heard from the Secretary of the Treasury and had what I thought was a useful and lively interchange between Members of the Committee, at least as far as we were able to get in the time frame, and the Secretary over the President's tax plan, in particular, specific areas of the tax plan. This afternoon it is my pleasure to present to you a panel of economists who we hope provide a broad enough spectrum that we will be able to cover anyone at least on this Committee's concerns about ramifications and manifestations of mixing and matching on the President's income tax revision proposal.

In alphabetical order—and since I had to live with that all my life, I am always thinking about doing it in reverse alphabetical order, but that is OK—Dr. Feldstein, who is a well-known commenter on the economy from Harvard University, and we are very pleased that you are able to be with us. Robert Greenstein, the Executive Director of the Center on Budget and Policy Priorities, and we thank you for joining us. And Dr. Kevin Hassett, who is a resident scholar at the American Enterprise Institute.

Prior to calling on the panel, I believe the gentleman from Georgia wants to make a comment. I know he is pressed for time because of the Budget Committee assignment.

Mr. COLLINS. Thank you, Mr. Chairman. As part of my assignment to the Ways and Means Committee, I am on the Budget Committee, and we are having a hearing that began at 1 o'clock, but I would ask unanimous consent to enter into the record some of the comments based on the testimony of Secretary O'Neill this morning.

Chairman THOMAS. Thank you. And if the gentleman from New York had any opening comments they certainly would be placed in the record as well.

[The information follows:]

Statement of the Hon. Mac Collins, M.C., Georgia

Today's change in the economy is a cashflow problem. This slowdown reflects a shift in spending among wage earners which in turn affects the cashflow of businesses—our Nation's job creators.

To provide evidence to this argument, I recently contacted the Columbus, Georgia Chamber of Commerce, located in the Third District of Georgia. At my request, Toya Winder contacted several small businesses in the area to determine the state of local economic changes and conditions.

Small business after small business told her they were feeling a cash flow squeeze because Americans are caught in the vice of tight credit, high debt and increasing energy costs.

For example, a janitorial firm reported last year's business was so good, it gave its workers two raises. Since the first of the year, however, costs are up, but business is slow and payments are delayed because clients are having cashflow problems.

A local construction firm said business was down, but again costs were up. Fuel is more expensive, and so are building materials which are affected by higher transportation costs. In addition, competition for the remaining jobs is fiercer, so margins are tighter. The firm has had to lay off workers.

High fuel prices and tighter credit is also hitting the sales of new Class 8 trucks. That coupled with a drop in value for used trucks, transportation firms are finding their margins squeezed tighter and tighter.

A family-owned drugstore reported that costs are up and sales are down, because many customers are not buying their drugs. The drop is attributable to individuals having to choose between purchasing medications and meeting the monthly demand on their budget caused by increased heating costs.

A service station reports that sales seem higher because gasoline has become much more expensive. But people are not filling up their tanks as much and overall, profits are down.

A few businesses, however, are reporting brisker business. An accounting firm reports an increasing number of customers are getting their taxes filed early in hopes of faster refunds. Wage earners are trying to offset their cashflow problems.

A car repair shop reports business is booming as families keep their old cars longer. That is good news for mechanics, but bad news for car dealers and workers on auto assembly lines where a significant drop in domestic production is causing plant closures.

Even more telling are the last two categories of companies that are seeing business expanding. A repossession business reports it cannot keep up with demand. This is a sign that families cannot keep up with payments on cars, furniture and appliances, reinforcing the fact that there is a cashflow problem.

Finally, a collection agency reports business is great as more and more bad debts crop up.

All of these examples provide a clear indication that Americans are being squeezed and face a personal cash flow crunch. Congress must address this problem now.

An across the board income tax rate reduction, an increase in the child tax credit, providing relief from the complicated alternative minimum tax (AMT), and eliminating the punitive nature of the death tax will provide necessary relief for individuals, families and ultimately businesses.

With regard to the budget process, there has been a great deal of discussion about whether the tax proposals should be based on a 10 year forecast plan. Critics argue a long term plan is unnecessary.

However, as a government, we require private businesses to project five, ten, fifteen and even more than thirty years in the future for accounting purposes. Tax depreciation rules require this type of long term forecasting when accounting for capital investments. Often the depreciation periods required by the internal revenue code extend longer than a business can obtain financing for a particular capital investment.

Even individuals and families are required to plan on a ten, fifteen, twenty or thirty year basis when purchasing a home.

Like individuals, families and businesses, Congress must abide by the same long term planning principles. The authority of the Federal government, whether over Social Security retirement, Medicare or tax policy, affects the ability of every individual, every family and every business to meet their long term financial needs. Long term budget planning *is* necessary. Doing so will ensure that Congress both complies with the same standards required of the private sector, and is disciplined when it comes to accounting for the taxpayers' dollars.

Chairman THOMAS. The Chair doesn't feel the need for opening comments since this is a continuing panel, and I would much rather hear from the panel. So without any additional comments, I will tell the gentlemen your written testimony will be made a part of the record, and you can address us in the time you have in any way you see fit, and we will start in alphabetical order with Dr. Feldstein.

STATEMENT OF MARTIN FELDSTEIN, PH.D., PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY, CAMBRIDGE, MASSACHUSETTS

Dr. FELDSTEIN. Thank you very much.

Chairman THOMAS. Is your microphone on? Let me warn you, you have to get very close.

Dr. FELDSTEIN. That seems to do it. Thank you very much for giving me the opportunity to testify. I have testified before members of this Committee for about 20 years, and I have always stressed the importance of a sound fiscal policy. Until recently I stressed the importance of eliminating budget deficits, but today, fortunately, we are meeting in a very different fiscal environment in which it is going to be possible to have a substantial incentive-increasing tax cut and to combine that with strengthening Social Security and with shrinking outstanding national debt.

In my brief time I want to talk about five points. First the large current and projected budget surpluses give you all an unprecedented opportunity to strengthen and improve the American economy by substantially reducing marginal tax rates. Our budget surplus last year was 2.4 percent of GDP, and the Congressional Budget Office projects a baseline budget surplus of $5.6 trillion over the next 10 years, about 4 percent of projected GDP, unprecedented large numbers. It is useful to contrast this favorable situation with the large budget deficits that prevailed when President Kennedy and President Reagan initiated tax cuts.

Even after setting aside the projected Social Security surpluses, the projected 10-year on budget surplus is more than $3 trillion, or about twice the officially estimated cost of President Bush's tax plan. In other words, a $1.6 trillion tax cut is compatible with protecting Social Security, increasing outlays for Medicare and defense, and still having additional money left for further debt reduction.

My second point is that the true cost of reducing the tax rates is substantially smaller than the costs projected in the official estimate. Studies of past tax rate reductions show that taxpayers respond to lower marginal tax rates in various ways that increase their taxable income. They work more and harder and take more of their compensation in taxable form and less in fringe benefits.

At the National Bureau of Economic Research, we have used a large publicly available sample of anonymous tax returns provided by the Treasury to estimate how the actual revenue loss would compare to the official estimates that ignore most of these behavioral responses. Our analysis shows that when the proposed Bush tax cuts are fully phased in, the net revenue loss would be only about 65 percent, only about two-thirds, of the officially estimated costs.

Now, for a year like 2010, the Joint Committee on Taxation staff estimated a $233 billion cost of the tax plan. Our estimate implies that would be only about $150 billion. If you apply that same ratio to each year, the $1.6 trillion would be cut to only 1 trillion. Now, I think that because of the timing of the tax cut and lags in taxpayer responses, a safer and conservative estimate of the total 10-year revenue cost would be about $1.2 trillion, so substantially less than the officially estimated $1.6 trillion, which doesn't take any of these economic behavior responses into account.

Third, the distorting effect that I have been talking about of high marginal tax rates on individual behavior, on the way people work and the form of their compensation, causes substantial waste. If high marginal rates induce someone to work less or to work less productively, both he and the Nation lose. If marginal tax rates also induce someone to take his or her compensation in the form of fringe benefits or more expensive perks rather than in taxable cash, they lose even more. Economists call such weight the deadweight loss of a tax. And the proposed reduction in marginal tax rates will not just allow individuals to keep more of their income, they will reduce these distortions, and that will produce an enormous gain in national well-being.

Using those same tax return data that I mentioned a moment ago, we have calculated that the marginal tax rate reductions in the Bush plan would cut that waste by about 40 percent of the officially estimated revenue cost; that is, by about $600 billion over the next 10 years. That raises Americans' real incomes by $600 billion that would otherwise be lost to waste. That $600 billion makes taxpayers better off by as much as an additional $600 billion in cash. The gain from reducing distortions is a permanent gain and one that would continue as long as marginal rates are kept down.

My fourth point is that the distribution of President Bush's tax cut is essentially proportional to existing taxes. Those who pay more in taxes will get bigger tax cuts. But the proportional reduction is about the same in every group. If anything, the lower income groups get bigger proportional reductions in their income tax and will pay an even smaller proportion of the overall income tax burden than they do now.

It is useful to compare the marginal tax rate reductions also at the high-income level proposed by the Bush plan with those enacted by President Kennedy. The two highest-income groups in the

Bush plan would see their rates reduced from 39 and 36 percent to 33 percent, reductions of 17 percent and 9 percent respectively. In comparison the two top marginal rates were reduced under President Kennedy by more than 20 percent.

Now, in thinking about the distribution, I think you do have to think about the off-budget items as well, about the payroll tax, and I hope that Congress will pass the tax legislation quickly and then turn to Social Security reform. As many of you know, I have long been an advocate of a mixed Social Security system that would supplement the existing pay-as-you-go Social Security benefits with annuities paid from individual investment-based accounts. One of the major advantages of doing that would be to avoid the future payroll tax increases that, according to the Social Security actuaries would otherwise require raising the payroll tax from 12 percent to more than 18 percent. If that long-run saving of 6 percent of earnings up to the maximum taxable earnings for Social Security is seen as part of the overall fiscal reforms of this Congress, the combined effect is to reduce the relative tax burden on low- and middle-income families even more.

Finally, the large tax cut coming at this time will help to assure a stronger short-term recovery from the current economic slowdown. Although I don't believe that temporary increases and decreases in tax rates are useful for reducing business cycle fluctuations, and I think the economic evidence on that is quite strong, it is certainly convenient now to have a tax cut that is going to be made for other reasons. The increase in after-tax incomes and the expectations that such increases will continue in the future will boost confidence as well as spending power. Increasing the short-term effect by starting those cuts at the beginning of the current year would reinforce this favorable effect.

Thank you.

[The prepared statement of Mr. Feldstein follows:]

Statement of Martin Feldstein, Ph.D., Professor of Economics, Harvard University, Cambridge, Massachusetts

Thank you, Mr. Chairman. I am pleased to appear before this Committee again and to talk about President Bush's tax cut proposal. I have five points to make in this brief statement.

First, the large current and projected budget surpluses give Congress an unprecedented opportunity to strengthen and improve the American economy by substantially reducing marginal tax rates. Our budget surplus last year was 2.4 percent of GDP and the Congressional Budget Office projects a baseline budget surplus of $5.6 trillion over the next 10 years, about 4 percent of projected GDP. It is useful to contrast this favorable budget situation with the large budget deficits (both actual and standardized) when the Kennedy and Reagan tax cuts were enacted. Even after setting aside the projected Social Security surpluses, the projected 10-year on-budget surplus is more than $3 trillion or about twice the officially estimated cost of the Bush tax plan. In other words, a $1.6 trillion tax cut is compatible with protecting Social Security, increasing the outlays for Medicare and defense, and still having additional money left for further debt reduction.

Second, the true cost of reducing the tax rates is likely to be substantially smaller than the costs projected in the official estimates. Studies of past tax rate reductions show that taxpayers respond to lower marginal tax rates in ways that increase their taxable income. They work more and harder and take more of their compensation in taxable form and less in fringe benefits. At the National Bureau of Economic Research we have used a large publicly available sample of anonymous tax returns to estimate how the actual revenue loss would compare to the official estimates that ignore this behavioral response. Our analysis shows that when the proposed Bush tax cuts are fully phased in the net revenue loss would be only about 65 percent of the officially estimated costs.

That implies, for example, that the revenue loss in 2010 that the Joint Committee on Taxation estimated as $233 billion would actually be only about $150 billion. If we apply that ratio to each year's revenue loss, the total revenue loss would be cut from $1.6 trillion to only about $1 trillion. Because of the timing of the tax cut and the taxpayer's lags in responding to it, I think a safer estimate of the total 10-year revenue loss would be about $1.2 trillion, still less than half of the non-Social Security surplus.

Third, the distorting effect of high marginal tax rates on individual behavior—on the way people work and the form of their compensation—causes substantial waste. If high marginal rates induce someone to work less or to work less productively, both he and the motion lose. If high marginal rates also induce someone to take his or her compensation in the form of fringe benefits or more expensive perks rather than in taxable cash, they lose even more. Economists call such waste the deadweight loss of a tax. The proposed reduction in marginal tax rates will not just allow individuals to keep more of their income. It will also produce an enormous net gain in national well-being. Using the same tax return data that I mentioned a moment ago, we have calculated that the marginal tax rate reductions in the Bush plan would cut that waste by about 40 percent of the officially estimated revenue cost, that is, by about $600 billion dollars over the next ten years. That raises American's real incomes by $600 billion that would otherwise be lost to waste. While the President's proposed tax cut would save taxpayers about $1.2 trillion over 10 years it would increase their real incomes by $1.8 trillion.

The gain from reducing distortions is a permanent gain that will continue in the future if marginal tax rates are kept down. This gain is separate from and additional to any increase in the rate of economic growth that results from the improved incentives to save and invest and take risks with that capital.

Fourth, the distribution of President Bush's tax cut is essentially proportional to existing taxes. Those who now pay more in taxes will get bigger tax cuts. But the proportional reduction is about the same in every income group. If anything, the lower income groups get bigger proportional reductions and will pay an even smaller proportion of the overall tax burden than they do now.

It is useful to compare the marginal tax rate reductions at high income levels proposed by President Bush with the tax rate cuts enacted by President Kennedy. The two highest income groups in the Bush plan would see their marginal tax rates reduced from 39.6% and 36% to 33%, reductions of 17% and 9% respectively. In comparison, the two top marginal rates were reduced under President Kennedy by more than 20%.

I hope that Congress will pass the tax legislation quickly and then turn to Social Security reform. As members of this committee know, I have long been an advocate of a mixed Social Security system that would supplement the existing pay-as-you-go Social Security benefits with annuities paid from individual investment-based accounts. One of the major advantages of doing so would be to avoid the future payroll tax increases that, according to the Social Security actuaries, would otherwise require raising the current 12.4% OASDI employer-employees tax to more than 18%. If that long-run saving of 6% of earnings up to the maximum taxable earnings for Social Security (now $80,400) is seen as part of the current fiscal reforms, the combined effect is to reduce the relative tax burden on low and middle income families even more.

Fifth, the large tax cut coming at this time will help to assure a stronger short-term recovery from the current economic slowdown. Although I do not believe that temporary increases and decreases in tax rates are useful for reducing business cycle fluctuations, it is certainly convenient now to have a tax cut that is going to be made for other reasons. The increase in after-tax incomes and the expectations that such increases will continue in the future will boost confidence as well as spending power. Increasing the short-term effect by starting the tax cuts at the beginning of the year would reinforce this favorable effect.

Thank you.

Chairman THOMAS. Thank you very much, Doctor. Mr. Greenstein.

STATEMENT OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

Mr. GREENSTEIN. Thank you, Mr. Chairman. I would like to talk about two issues: the cost of the tax cut in relation to the available surplus and how various types of Americans would be affected by it.

Now, at first glance it looks quite affordable, a $3.1 trillion surplus outside Social Security versus a $1.6 trillion tax cut. The problem is the available surplus is actually significantly smaller than 3.1, and the tax cut would actually consume significantly more than 1.6 of it. Let me explain.

The 1.6 trillion figure is based on a Joint Tax Committee estimate done last May based on the economic and revenue forecasts of last May. That is two CBO forecasts ago. The current forecast is for a bigger economy with more revenue, and when you apply this tax cut to it, it would raise the cost of the tax cut, the Joint Tax Committee would estimate, by roughly $150 billion. In addition to that, when we ask not what is the cost of the tax cut, but how much of the surplus would it consume, we must include, as we must for any spending increase, as well the extra interest payments on the national debt, and those are 350 to 400 billion for this proposal. So when you add these items in, we are now at 2.1 trillion. That is before we get to any additional costs for accelerating the proposed tax cuts, and in particular it doesn't include the costs of dealing with the AMT problem.

As I understand the Joint Tax Committee estimate, the Joint Tax Committee actually said the Bush tax cut would cost about 200 to 300 billion more than this 1.6, but the AMT would cancel it out because if nothing is done about the AMT, it invades the middle class big time. I have every confidence this Congress will not allow the AMT to invade the middle class big time, but that adds another 200 to $300 billion to the cost, and if you do it just a couple years at a time in an extender-like manner, that doesn't change the fact that over the course of the decade another 200 to 300 billion out of the tax cut—out of the surplus would have to go to cover the tax cut's cost. So we are talking about more than 2 trillion.

Let's talk about how much there really is in the surplus. It is 3.1 trillion outside of Social Security. Today I believe you will vote on a lockbox that covers the Medicare Hospital Insurance Trust Fund as well, and that reduces the available surplus to 2.7. But 2.7 isn't the appropriate figure for you all to use because the 2.7—what CBO does in estimating the surplus is CBO has to assume current law is followed in every place.

CBO assumes that all roughly 20 extenders will all die, that you will not extend them. But of course you will extend them, as you should. CBO assumes the AMT will go from 1.3 million families under it today to 15 million in 10 years. You won't allow that to happen. You should not. The CBO forecast assumes that $10 billion a year on average that go to farmers under 1 year at a time rather than permanent legislation will end. It won't end. Neither party will allow that.

So when one does an assessment of the surplus outside Social Security and Medicare where you simply adjust for those items where maintaining current policy, continuing the extenders, keeping the AMT at the current level, continuing the payments to farmers at the current level and so forth, when you do that, that takes another 700 billion out, and that means there is about 2 trillion left. And I would urge that neither party should look at committing all

2 trillion. This is only a projection; 70 percent of it is in the second 5 years. We do not know for sure if it will materialize. We shouldn't commit 100 percent of what is projected to be available over 10 years outside of Social Security and Medicare now.

Now, the other area I wanted to cover was I will also add, although I won't take time to talk about it now, that there has been discussion of trigger mechanisms. I think they would be likely to be ineffective at dealing with this problem if the surpluses don't materialize.

The other issue is who would actually receive the tax cuts. Now, I would differ with Dr. Feldstein. I don't think this is a proportional tax cut, but it is important to understand the difference. When he says it is proportional, he is looking at the percentage of income tax that various income groups pay now and the percentage of the income tax cut in this bill they would get. I would argue that while it is a useful standard, that it is not the most appropriate standard. Americans pay other taxes as well: payroll taxes, estates taxes, gasoline taxes. The more appropriate question is what percentage of the total Federal tax burden that various groups pay, and what percentage of the total tax cut here would they get.

This is not just an income tax bill. Certainly it includes elimination of the estate and gift taxes, for example. When you look at those figures, you find the Treasury figures are that the top 1 percent of the population pays 20 percent of total Federal taxes and would get at least 36 percent of the total tax cuts in this package. When you look at the middle class, while many of them would certainly get significant tax cuts, it turns out that because many families either don't earn enough to owe 1,600 in income tax today, or do not have two children, that 85 percent of all households would get less than the $1,600 tax cut we hear mentioned. And of particular concern are the millions of families that have substantial tax burdens through the payroll tax primarily, but don't pay income tax, and who would be entirely left out.

The President mentioned a couple of Saturdays ago a waitress making $25,000 a year. It turns out that if she has just $170 a month in child care costs, she gets no tax cut from the plan, although her payroll tax, after adjusting for the EITC, is still $2,300 a year. Overall, 12 million families with 24 million children, a third of all children, would not receive anything from the tax cut; 55 percent of African American children and 56 percent of Hispanic children would not either.

There were ways of providing relief to those low-income working families who are taxpayers. You can improve the earned income credit. One could extend the child credit to families that pay payroll but not income taxes, as a recent Brookings Institution paper recommends.

And I was particularly surprised to find that the plan even leaves out something that was a bipartisan item for the last 18 months, and that is that if you do marriage penalty relief, you should reduce marriage penalties on low-income working families along with middle- and upper-income working families. Low-income families have some of the biggest marriage penalties because of the way the EITC works. The bills you twice sent to President Clinton that he vetoed had marriage penalty relief for lower income working families in it, but the Bush plan leaves even that out.

So I think the bottom line that I would—I also would note that when you look at all taxes, including estate and payroll, not just income tax, it turns out that the biggest percentage reduction in total Federal taxes is at the top and the smallest at the bottom.

So my conclusion is that this proposal runs the risk of absorbing the entire non-Social Security, non-Medicare surplus that is available when you take into account costs for things like the extenders and fixing the AMT, leaving little margin for error if the surpluses don't materialize fully, and squeezing out other priorities that I think should be a higher magnitude than this big a tax cut for the people at the top.

I do think you should do a tax cut, but Congress can provide relief that still provides substantial middle-income reduction, does more for lower income working families, families the President says he cares about, and does it at a substantially lower cost and is, therefore, more fiscally prudent than the proposal the administration has set up.

Thank you.

[The prepared statement of Mr. Greenstein follows:]

Statement of Robert Greenstein, Executive Director, Center on Budget and Policy Priorities

I appreciate the invitation to testify today. I am Robert Greenstein, executive director of the Center on Budget and Policy Priorities. The Center is a nonprofit policy institute here in Washington that specializes both in fiscal policy and in programs and policies affecting low- and moderate-income families. The Center does not hold (and never has received) a grant or a contract from any federal agency.

My testimony today focuses primarily on two aspects of the Bush Administration's tax proposal: the proposal's cost in relation to the available surplus, and how various types of Americans would be affected by the tax cut.

The Plan's Cost in Relation to the Available Surplus

At first glance, the proposal may appear to be readily affordable. If the non-Social Security surplus totals $3.1 trillion over the next 10 years and the tax cut costs $1.6 trillion, the tax cut would consume a little over half of the projected non-Social Security surplus. The problem is that neither of these numbers provides an accurate reflection of the fiscal situation: the proposed tax cut would consume substantially more than $1.6 trillion of projected surpluses, while the available surplus is considerably smaller than $3.1 trillion.

How Much Would the Tax Cut Cost?

Let's look first at the widely cited $1.6 trillion figure. In fact, there is no cost estimate that shows the tax plan to cost $1.6 trillion. The $1.6 trillion figure has been derived as follows.

- Last May, the Joint Tax Committee estimated the cost of the plan at $1.3 trillion over the 10 years *from 2001 through 2011.*
- This estimate showed no cost in 2001, because the plan wouldn't be in effect yet. Hence, the $1.3 trillion estimate was a nine-year estimate.
- The new budget period is 2002 through 2011. Adding the plan's cost in 2011, based on the assumption that the cost in 2011 is similar to the cost for the 2010 that the Joint Tax Committee reported last May, brings the cost to $1.6 trillion.

But there is no Joint Tax Committee estimate that the plan costs $1.6 trillion. If an estimate were done today of the amount of the projected surpluses that the proposal would consume, the estimate would necessarily be considerably higher—most likely about $2.1 trillion. This is the case for two reasons.

- The May 2000 Joint Tax Committee estimate was based on the economic and revenue assumptions in use at that time. The new CBO budget projections assume a larger economy that produces more revenues. When the same tax cuts are applied to a larger economy that produces more tax revenue, they result in a larger dollar tax cut. The change in the economic forecast is expected to add approximately $150 billion to the plan's estimated cost.

• The $1.6 trillion figure does not include the increased interest payments on the debt that would result from using projected surplus funds for the tax cut rather than for paying down debt. These interest costs must be included when determining how much of the projected surplus the tax plan would consume. The tax plan would result in $350 billion to $400 billion in added interest payments on the debt.

• This brings to $2.1 trillion the figure the Joint Tax Committee and CBO would likely estimate to be the amount of the projected surpluses that the plan would consume, if no changes are made in the plan.

Yet even this $2.1 trillion figure is low. It does not include several additional costs.

• The President has said he supports accelerating his proposed tax cuts and making some aspects of the tax cuts retroactive to January 1 of this year. The White House has not specified which aspects of the plan it wishes to see accelerated.

The proposed rate reductions would not take full effect until 2006 under the plan as it now stands. Making the rate cuts fully effective now would add $400 billion to the plan's cost over the 2002–2011 period, including the added interest payments on the debt.

Alternatively, making the doubling of the child credit and the establishment of a new 10 percent bracket fully effective now would add about $300 billion in cost.

• The $2.1 trillion cost is artificially low for a second reason—it is based on the assumption that Congress will *fail* to address key problems in the Alternative Minimum Tax. As this Committee knows, the AMT affected 1.3 million filers in 2000 but will hit more than 15 million filers by 2010 if it is not modified, including large numbers of middle-income families that are not engaged in heavy tax sheltering. The Joint Tax Committee has estimated that if no action is taken and the Bush plan is enacted as it now stands, it will cause an additional 12 million filers to become subject to the AMT by 2010, bringing the number of filers hit by the AMT to an astonishing 27 million. Clearly, this should not occur, and virtually all observers are confident Congress will not let this happen. At his confirmation hearing, Treasury Secretary Paul O'Neill took note of the need to address these problems in the AMT.

This matter directly affects the Bush plan. The Joint Tax Committee estimate of the cost of the Bush plan is artificially low because the Joint Committee had to assume the AMT would *not* be fixed (since there is no provision in the Bush plan to do so) and that the AMT consequently would cancel out several hundred billion dollars of tax cuts the plan otherwise would provide. Fixing the AMT problem so that the AMT continues to affect roughly the same number of taxpayers as it does today will increase the cost of the Bush plan by another $200 billion to $300 billion. If Congress chooses to address the AMT problem a couple of years at a time (in the manner of the "extenders"), that would not alter the fact that over the course of the decade, this full $200 billion to $300 billion cost still will have to be absorbed.

This means the Bush plan would consume approximately $2.4 trillion in projected surpluses if none of the tax cuts are accelerated (the $2.1 trillion figure cited earlier plus the additional cost the tax plan has once the AMT is fixed) and more than that if the tax cuts are accelerated. Furthermore, these costs do not include:

• The cost of extending the expiring tax credits, which Congress will surely do;
• The cost of various tax reductions that Congress passed last year, such as pension tax legislation and larger marriage-penalty relief than President Bush is proposing;
• The cost of various health-insurance related tax preferences that the Bush Administration is proposing separate and apart from its big tax proposal; or
• Any corporate or capital gains tax cuts.

The Available Surplus

Under the new CBO forecast, the projected surplus outside Social Security is $3.1 trillion over 10 years. However, as analyses issued over the past year by the Brookings Institution, the Concord Coalition, and our Center have noted, there is an important difference between CBO's estimate of the size of the non-Social Security surplus and the amount that actually is available for tax cuts and program initiatives.

In making its surplus estimates, CBO follows certain rules that require it to assume implementation of various tax increases and program reductions that would occur if current law is followed but that would be highly unpopular and that virtually all observers believe will not take place. For example, about 20 popular tax credits and other tax preferences, generally known as the "extenders," are typically renewed for only a few years at a time and are scheduled to expire in the next year or two. There appears to be little question that Congress will extend most or all of them. The CBO projections assume, however, that all of these tax credits will expire. Similarly, the CBO surplus projections assume the law governing the AMT will not be changed and millions of middle-class taxpayers will become subject to the AMT over the coming decade. The increased taxes those taxpayers are assumed to pay are part of CBO's surplus calculation. It is very unlikely, however, that Congress will sit idly by and let the AMT encroach heavily upon the middle class.

Similar issues arise on the spending side. The rules CBO uses lead it to assume that federal payments to farmers will be slashed deeply. In recent years, Congress has provided an average of about $10 billion a year in payments to farmers that are made a year at a time rather than provided under a provision of permanent law. Since these payments are not governed by an ongoing statute, the CBO surplus estimates assume these payments will terminate after 2001. Of course, that won't occur.

Questions arise with regard to discretionary spending as well. The CBO forecast assumes that funding for discretionary programs—including the defense budget—will simply remain over the coming decade at the 2001 level, adjusted only for inflation. For that to occur, discretionary spending would have to fall in purchasing power per U.S. resident (since the population is rising) despite almost-certain increase in areas such as defense, education, and health research. Since 1987, non-defense discretionary spending has remained constant as a share of GDP—which means it has risen by more than the inflation rate—and in the last three years, as surpluses have emerged and defense spending has started back up, total discretionary spending has stayed even with GDP. Observers such as Bob Reischauer and Rudy Penner, both distinguished former CBO directors, have warned there is little chance that discretionary spending over the coming decade will remain at current levels, adjusted only for inflation.

If one simply assumes that current policy (as distinguished from current law) is maintained in the area I've just discussed—that is, that the "extenders" are continued, the AMT is fixed so it remains at about current levels in terms of the proportion of taxpayers it affects, payments to farmers remain at current levels and discretionary spending remains at today's level in purchasing power per U.S. resident (which means discretionary spending would have to shrink as a share of GDP)—then $700 billion of CBO's projected surplus outside Social Security evaporates. To be prudent, policymakers should take this $700 billion off the table when estimating how much they have available for the cuts and program initiatives, since this $700 billion is unlikely to materialize. If policymakers assume these funds are available, they risk using the same projected surplus dollars twice. Removing this $700 billion reduces the available non-Social Security surplus to $2.4 trillion.

The portion of the projected surplus that would be in the Medicare Hospital Insurance trust fund also needs to be removed from the calculation. Both parties have appropriately said these funds should be set to the side and not used for tax cuts or other program expansions. Some $400 billion of the $3.1 trillion non-Social Security surplus occurs in the Medicaid HI trust fund. Removing these funds yields an estimate that $2.0 trillion over 10 years is available if the projected surpluses fully materialize.

Does this Mean the 107th Congress Should Pass Tax Cuts and Spending Increases of $2 Trillion?

Two trillion dollars still is a very large amount. But it would be unwise for Congress and the Administration to pass legislature this year that commits all of this amount. These figures are only projections. These large surpluses are not assured.

Any number of events—such as slower-than-forecast economic growth or faster-than-expected growth in health care costs—could cause the projections to be too high. As CBO has pointed out, its track record shows that its budget projections are subject to considerable error, even in the short term. Since 1981, the CBO forecasts for the fifth year out has been off by an average of 3.1 percent of GDP. This means that if CBO's projection for 2006 is off by the average amount that its forecasts for the fifth year have been off in the past, its projection of the surplus in 2006 will be off by $400 billion. A $400-billion overestimate would mean we were again running on-budget deficits.

Furthermore, more than 70 percent of CBO's projected surplus outside Social Security and Medicare would come in the *second five years* of the 10-year period. Projections made that far in advance are especially uncertain and prone to error. This means that if the full amount of the surplus projected outside Social Security and Medicare is consumed by actions the 107th Congress takes but the projections later prove to have been optimistic, sizable deficits outside Social Security and Medicare could return.

Another reason that it would be unwise to consume all of the $2.0 trillion in available projected surpluses is that even if the surplus forecast proves correct, acting now to commit all of the available surpluses for the next 10 years will leave no funds for subsequent Congresses to use to address needs that cannot be foreseen today but inevitably will arise. It is inconceivable that no such needs will emerge over the course of the decade. Such needs could be military, international, or domestic. While we cannot know today what these needs will be, we had better plan on some new problems emerging that will have to be addressed.

A final reason that consuming all of the projected $2.0 trillion would be imprudent relates to Social Security and Medicare. If legislation to restore long-term Social Security solvency is to be enacted, a transfer of non-Social Security general revenues from the Treasury to the Social Security Trust Fund (or to private, individual retirement accounts) almost certainly will be required. Without such a transfer, the magnitude of the reductions in retirement benefits that will be required—regardless of whether a solvency plan includes individual accounts—will almost surely make any plan impossible to pass. As a result, policymakers ought to set aside, or reserve, a portion of the projected non-Social Security surplus funds for this purpose. To be prudent, a minimum of $500 billion over 10 years should be reserved for this purpose. (If 70 percent of the solvency gap is closed by other means, including benefit reductions, and only 30 percent of the gap needs to be closed through additional revenues, $500 billion will be needed from the non-Social Security, non-Medicare surpluses.)

The Bottom Line on the Tax Cut's Affordability

The projected surplus outside Social Security and Medicare is $2.7 trillion over 10 years, of which $700 billion is likely to be noted simply to maintain current policies that command broad support. That leaves $2.0 trillion, some of which should be set aside to deal with the all-too-real possibility that the surpluses may not fully materialize and some of which is likely to be needed for Social Security and Medicare solvency legislation. This suggests that substantially less than $2 trillion should be committed now. Moreover, a portion of that amount will be needed for priorities in health care and other areas. Yet the Bush tax cut would consume well over $2 trillion of projected surpluses, or more than 100 percent of what is realistically available. The tax cut is substantially too large.

What About a Trigger?

Before turning to the question of who would benefit from the tax cuts, I would like to comment briefly on the idea of accompanying the tax cuts with a trigger that would stop the next phase of the tax cuts from taking effect if surpluses or the debt failed to reach some specified level. Such an approach may have initial appeal. Closer examination suggests, however, it has a significant risk of being ineffective.

In the 1980s, Congress passed the Gramm-Rudman-Hollings law, which established year-by-year deficit targets and required unpopular actions to occur (specifically, across-the-board program reductions) if the deficit target otherwise would be missed. The law proved largely to be a failure. When the deficit target would be missed by a significant amount, Congress and the Administration resorted to budget gimmicks and creative accounting to make it appear on paper as though the target had been reached, thereby avoiding the unpopular action that otherwise would have been triggered. When that was not sufficient, Congress simply raised the deficit targets. The odds are substantial the same pattern would emerge here.

Moreover, most provisions of the Bush tax cut would phase in fully by the fifth year, 2006. Seventy percent of the surplus that CBO projects outside Social Security, however, would come in the second five years, from 2007 through 2011, and it is the projections for these years that are the most uncertain and subject to larger error. A "trigger" would have little effect in undoing the fiscal damage if the budgetary picture in those years was considerably less bright than currently forecast; most of the tax-cut provisions would already be in full effect.

The much more prudent approach would be to enact a smaller tax cut now, place a portion of projected surpluses in a reserve available for neither tax cuts nor spending increases, and wait to see to what extent the projected surpluses materialize. Big tax cuts that will not take effect for several years do not respond to the current economic slowdown, so the danger here is entirely on one side—from overdoing it now and fostering fiscal problems down the road. If the type of surpluses that currently are forecast for future years do materialize, Congress can easily enlarge tax cuts and program initiatives at that time. Politically, it is far easier to come back and expand tax cuts than to reverse enacted tax cuts or enforce a trigger that may never be allowed to be pulled.

Who Would Receive the Tax Cuts?

In presenting its tax-cut plan, the White House has placed emphasis on the plan's effects in helping lower-income working families, such as waitresses making $22,000 or $25,000 a year, as well as the beneficial effects that provisions such as the proposed doubling of the child credit would have on such families. Analysis shows, however, that the plan would not do very much for these families and would concentrate an unusually large share of its tax-cut benefits on those on the upper rings of the income ladder.

Effects on Lower-income Families

The plan would provide no assistance to working-poor and near-poor families. The plan only affects families with incomes above about 150 percent of the poverty line. (The exact level at which the plan begins to help families with children varies from about 130 percent to 180 percent of the poverty line, depending on the number of children, the family's filing status, whether the family has child care costs, and other matters.)

The plan bypasses working families with incomes below these levels because it only affects families that owe income tax before the Earned Income Tax Credit is applied. This does not mean that the plan provides a tax cut for everyone who pay taxes. Millions of families owe no income tax but pay substantial amounts of payroll tax, as well as other federal taxes such as taxes on gasoline.

Thus, a single mother with two children who works full time and earns $22,000 pays no income tax but *owes* $1,234 in payroll tax (net of the EITC). She would receive no tax reduction under the plan. A waitress with two children who earns $25,000—an example the White House frequently cites—would receive no tax reduction if she incurs $170 a month in child care costs, not an unusual amount for such a single working parent. The waitress pays $2,325 in payroll tax net of the EITC.

Overall, 12 million families with 24 million children—one of every three children in the United States—would receive no tax reduction. Some 80 percent of these families have workers. Some 55 percent of African-American children and 56 percent of Hispanic children live in families that would receive nothing from the proposed tax cut.

There are a variety of ways to provide relief to low-income working families. These include improving the Earned Income Tax Credit and extending the child credit to such families by making it partially refundable, as a recent Brookings paper by Isabel Sawhill and Adam Thomas recommends.

Some other low-income working families would receive small tax reductions. A family of four that earns $26,000 would have its income tax liability eliminated. That family, however, pays only $20 in income tax now. The family's principal tax burden comes from the payroll tax: it pays $2,689 in payroll taxes net of the EITC. Although some proponents of the Administration's tax proposal would describe such a family as receiving a 100 percent tax cut because its income tax liability has been eliminated, the family's overall federal tax burden would be reduced by less than three-quarters of one percent.

Marginal Tax Rates

Some supporters of the Administration's proposal have noted that while such a family might get a modest tax cut in dollar terms, the family's "marginal tax rate" would be reduced by 15 percentage points. Presidential economics advisor Lawrence Lindsey has observed that many families in the $25,000 to $30,000 range face higher marginal tax rates than the wealthiest Americans do. If, however, the Administration's goal is to reduce marginal tax rates on the low-income working families that face the highest rates in the nation—surely a worthy goal—the plan falls short. Conservative and liberal analysts alike have long recognized that the working families that face the highest marginal tax rates are those with incomes between about $13,000 and about $20,000. For each additional dollar these families earn, they lose up to 21 cents in the Earned Income Tax Credit, 15.3 cents in payroll taxes (including the employer's share), 24 cents to 36 cents in food stamp benefits, and additional amounts if they receive housing assistance or a child care subsidy on a sliding fee scale or are subject to state income taxes. No other Americans in any income bracket have as large a share of each additional dollar they earn "taxed away."

Ways to reduce marginal tax rates for such families are available, well known, and not especially expensive. One can raise the income level at which the Earned Income Tax Credit begins to phase down as earnings rise and/or reduce the rate at which the EITC phases down. Bipartisan Senate legislation that Senators Rockefeller, Jeffords, and Breaux and legislation introduced last year follows such a course, as does legislation that Rep. Cardin introduced in the House. The proposal that Sawhill and Thomas outline in their new Brookings paper to make the child credit partially refundable for low-income working families also would lower marginal rates substantially for such families. The Administration's plan contains no such features.

Furthermore, the Bush plan departs from a bipartisan consensus that formed in Congress over the past two years to reduce marriage tax penalties for low-wage working families, along with middle- and upper-income families. Some of the most serious marriage penalties in the tax code are those that can face low-income working individuals as a result of the way the phase-out of the EITC is designed. Tax bills that Congress passed and President Clinton vetoed in both 1999 and 2000 contained EITC reforms to provide marriage penalty relief for low-income working families. Democratic alternative bills included such provisions as well; this issue had become truly bipartisan. The Bush plan contains no such marriage penalty relief, limiting its relief to families at higher income levels.

The often-cited $1,600 tax reduction for a middle-class family of four also has been subject to some misunderstanding. A large number of individuals and families do not have children or have one child and a substantial share of the families with two or more children owe less than $1,600 in income taxes and hence would receive less than $1,600 in tax reductions. A significant majority of households would receive less than $1,600 under the proposal.

I also would note that the $1,600 tax reduction for a family of four with a $50,000 income is not scheduled to occur until 2006 under the plan as now structured. For such a family, the tax reduction is $1,600 in 2006 dollars, or $1,400 in today's dollars. The purchasing power of this tax reduction would fall below $1,400 in today's dollars in years after 2006 because the child credit is not indexed.

Tax Reductions for Higher Income Filers

The average tax reductions for very-high income individuals and families would be quite large. It has been argued that such taxpayers would get a large share of the tax cut because they pay a correspondingly large share of the taxes and that low-income individuals and families would receive the largest *percentage* tax reductions. Neither of these statements turns out to be correct.

- The best data available on who pays what share of all federal taxes—including income, payroll, estate, excise, and other taxes—come from a major study conducted by Treasury career staff and released in September 1999. The study shows that the top one percent of families pays 20 percent of all federal taxes.[1]
- The top one percent of families would receive at least 36 percent of the tax cuts under the Administration proposal when the plan is fully in effect. The top one percent also would have the federal taxes it pays reduced by a greater percentage than middle- or low-income households, while low-income households would receive the smallest percentage tax cut of any group. These figures are discussed in the next section of this testimony.

The Data

The data presented here on how the benefits of the Bush tax cut would be distributed come from two sources: an analysis by Citizens for Tax Justice, using the Institute for Taxation and Economic Policy (ITEP) model, and the aforementioned Treasury study on how the burdens of various taxes are apportioned among various income categories.

The ITEP model that CTJ uses is a well-respected model developed in substantial part by former staff members of the Joint Tax Committee. CTJ tax distribution analyses, using the ITEP model, have been validated over the years by the fact that they generally have yielded results very similar to those the Treasury Department has produced.

The CTJ analysis of the effect of the Bush plan (when the plan's provisions are fully in effect) finds the bottom 40 percent of families would receive four percent of the tax cuts, with the average tax cut for this group being $115. The bottom 60 percent of families would receive 13 percent of the tax cuts. The 20 percent of families exactly in the middle of the income spectrum would receive eight percent of the tax cuts and receive an average tax reduction of $453.

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[1] Following Treasury usage, "families" includes single people as well as family units. All families are included whether or not any member of the family files an income tax return. The ITEP model uses a similar definition.

By contrast, the top one percent of families would receive 43 percent of the tax cuts, and their average cut would amount to $46,000. The top one percent would receive more in tax cuts than the bottom 80 percent of the population.

Some supporters of the Administration's proposal have cited alternative figures from the Joint Tax Committee that are said to show the proportion of the tax cut that would go to the top one percent of families would be significantly smaller. Those figures, however, really do not actually show that to be the case. The JCT figures in question include neither the effects of repealing the estate tax, which accounts for about one-quarter of all tax reductions in the plan when the plan is fully in effect, nor the effects of any provisions in the plan that do not take effect until after 2005. The part of the tax-rate reductions that would not take effect until 2006 is disproportionately beneficial to those in the top brackets. As a result, these JCT figures are not especially useful. The figures Citizens for Tax Justice has produced do not suffer from these omissions.

There has been some debate in the past about the best methodology to use to determine what percentage of the estate tax is paid by people in different income categories and thus what percentage of the benefits from estate tax repeal would accrue to each income group. Under the ITEP model that CTJ uses, 91 percent of the estate tax is estimated to be paid by the top one percent of families. Virtually all of the tax is estimated to be paid by the top five percent of filers. Such results should not be surprising. IRS data show that the estate tax is levied only in the case of two percent of all deaths and that in 1997 half of all estate taxes were paid by the 2,400 largest taxable estates—the estates of the wealthiest one of every 1,000 people who died.[2]

To help resolve issues related to how to measure the incidence of the estate tax, the Treasury study issued in September 1999 includes a major analysis of the distribution of the estate tax by income category.[3] Since publication of this study, Treasury has used its results in the distributional analyses it has undertaken.

The Treasury findings on who pays the estate tax are broadly similar, although not identical, to the estimates in the ITEP model, which was constructed before the Treasury study became available. The Treasury study estimates that the top one percent of families pay 64 percent of the estate tax (and thus would get 64 percent of the tax-cut benefits that would result from estate tax repeal), rather than paying 91 percent of the tax as the ITEP model estimates. The Treasury and ITEP figures on the proportion of the estate tax paid by the top five percent of families, however, are quite similar; the Treasury study estimates the top five percent of families pay 91 percent of the estate tax, as compared to 100 percent of the tax under the ITEP model. Under both sets of estimates, the top 20 percent of families pay virtually all of the estate tax, and the tax does not affect the other 80 percent of the population.

Accordingly, another way to estimate the effect of the Bush tax cut on different income groups is to take the CTJ estimate but to modify it by substituting the Treasury estimates on the incidence of the estate for the estimates in the ITEP model. Under this approach, the top one percent of the population is estimated to receive 36 percent of the tax cuts under the Bush plan, rather than the 43 percent the CTJ analysis estimates, and to receive an average tax cut of $39,000 rather than $46,000. The top 20 percent of families still is found to receive 71 percent of the tax cut, the same percentage as under the CTJ analysis. Similarly, the bottom 40 percent of families still is found to receive four percent of the tax cut.

Under either approach, the tax cut is found to be tilted heavily toward those with very high incomes and to provide only a modest percentage of its tax-cut benefits to the types of families the White House last week presented as major beneficiaries. Under both approaches, the share of the tax cuts that would go to the top one percent would be roughly double the share of the federal taxes this group pays, and the top one percent would receive more in tax cuts than the bottom 80 percent of the population combined.

Who Would Receive the Largest Percentage Tax Reductions?

White House officials have argued that lower-income families would receive the largest percentage tax reductions. These statements rest on data on the percentage reduction in families' *income tax* burdens. The most relevant data, however, are those on the percentage reduction in families' *overall* federal tax burdens. Since low- and moderate-income families pay more in other federal taxes—principally the pay-

[2] See Iris Lav and Joel Friedman "Estate Tax Repeal: A Costly Windfall for the Wealthiest Americans," Center on Budget and Policy Priorities, February 6, 2001.

[3] "U.S. Treasury Distributional Analysis Methodology," Department of the Treasury, OTA Paper 85, September 1999.

roll tax—than in income taxes and often have very small income tax liabilities, it is possible to eliminate those income tax liabilities without providing a family a substantial tax cut or reducing the family's total federal taxes by a very large percentage.

When the percentage reduction the Bush tax cut would make in total federal tax burdens is examined, a different picture emerges. Under the Bush plan, the top one percent would receive a much larger percentage reduction in the federal taxes they pay then would any other income group. The percentage tax reduction for low-income families would be only about half that which the top one percentage of families would receive. (See Table 1.)

Table 1.—Percentage Reduction in Federal Taxes Under the Bush Tax Plan

Income group	ITEP Model (Citizens for Tax Justice)	ITEP Model, but using the estimates on who pays tax
Bottom 20%	−5.5%	−5.5%
Second 20%	−6.5%	−6.5%
Middle 20%	−7.3%	−7.3%
Fourth 20%	−7.2%	−7.3%
Next 15%	−6.1%	−6.7%
Next 4%	−4.2%	−6.4%
Top 1%	−13.6%	−11.6%

The Child Credit and the 10 Percent Bracket

The figures that show the small percentage of the tax cut that would go to middle- or low-income families may seem surprising given the inclusion in the proposal of the provisions to double the child credit and to create a new 10 percent bracket. These have been presented as proposals designed in substantial part to benefit lower-income working families and help them enter the middle class. In fact, only a modest share of the tax-cut benefits from these two proposals would go to low- or moderate-income families; much larger shares would go to high-income families. And as noted, approximately one-third of children would not benefit from either proposal.

Consider the proposal to raise the child credit from $500 per child to $1,000. This proposal would cut taxes for families with two children that have incomes up to $300,000. Those who would benefit most are filers with incomes in the $110,000 to $250,000 range; they would receive the largest tax cuts under this proposal because the Bush plan not only would double the child credit but also would raise the income level at which the child credit starts to phase down from $110,000 to $200,000 and slow the rate at which it phases out so that families with two children and incomes up to $300,000 would benefit from it. Currently, filers with incomes above $130,000 are ineligible for the credit. For many of these relatively affluent families, the child credit would rise from zero to $1,000 per child. For millions of children in low- and moderate-income working families, by contrast, the child credit would remain at zero or at its current level of $500 per child or would rise to less than $1,000 per child (because their families would have insufficient income tax liability against which to apply the increase in the child credit). Faced with a choice between extending the credit to children in low-income working families that pay payroll taxes but no income tax and extending it to children in families in the $130,000 to $300,000 range, the Administration chose the latter course.[4]

As a consequence, when the increase in the child credit is full in effect:

• Some 82 percent of the benefits from the child credit proposal would accrue to the 40 percent of families with children with the highest incomes. Only three percent of the benefits from this proposal would accrue to the bottom 40 percent of such families.[5]

• The top 20 percent of families would receive 46 percent of the tax-cut benefits from this proposal, a larger share than any fifth of the population would receive.

The Estate Tax

The feature of the proposal that has the largest effect in making the plan so disproportionately beneficial to those at the top of the economic scale is the proposed

[4] For families with more than two children, the income range would extend even higher than $300,000.

[5] Institute for Taxation and Economic Policy, special data run for the Children's Defense Fund.

repeal of the estate tax. This tax is levied on the estates of only the most affluent two percent of individuals who die. Moreover, in 1997, the 2,400 largest estates—the estates of the wealthiest one of every 1,000 people who died—bore half of the estate tax. Had there been no tax, the estates of these very wealthy individuals would have received an average tax reduction of $3.5 million each.

Families farms and small businesses do not figure heavily hear. Of the approximately 2.3 million people who died in 1998, only 47,500—or about two percent—left estates that were taxable. Of those estates, there were just 1,418—or three percent of the taxable estates—in which a family business or family farm constituted the majority of the estate. This means that a family business or family farm constitutes the majority of the estate for only six of every 10,000 people who die. Furthermore, a Treasury analysis has found that such estates paid less than one percent of all estate taxes. Relief can be provided to such estates, and other reforms made in the estate tax, for a fraction of the cost of repealing it.

In addition, it is beginning to be recognized that repeal of the estate and gift taxes would open enormous loopholes in other parts of the tax code that could substantially increase the cost of estate tax repeal beyond the levels the JCT has estimated. The matter is explored in a recent issue of the journal Tax Notes by estate tax attorney Jonathan Blattmachr and Hofstra law professor Mitchell Gans. Similarly, a recent New York times article by David Cay Johnston reports that estate tax attorneys interviewed for the article generally concurred that repeal of the estate and gift tax would spawn major new tax-avoidance strategies.

For example, without the gift tax, a wealthy investor could transfer stock that has appreciated in value by $100 million to an elderly relative, who agreed simply to hold the stock. The elderly relative then would return the stock to the donor when he died, through a provision in his will. the investor would thereby escape capital gains tax entirely on the $100 million profit. This is just one of a number of gaping loopholes that repeal of the estate and gift tax threatens to open in the tax code.

Conclusion

The Bush tax proposal would likely absorb the entire projected non-Social Security surplus that is likely to be available, leaving little margin for error if the surpluses do not materialize fully and squeezing out other priorities that should rank higher than giving tax cuts of this magnitude to those who are at the pinnacle of the income scale, have done the best in recent years, and are least in need of a very large tax cut. Congress can provide relief that still provides significant tax reduction to middle-income families and is more favorable to the lower-income working families the President says he cares about at a far lower cost than the rather extravagant and lopsided Bush proposal.

Chairman THOMAS. Thank you very much, Mr. Greenstein. Dr. Hassett.

STATEMENT OF KEVIN A. HASSETT, PH.D., RESIDENT SCHOLAR, AMERICAN ENTERPRISE INSTITUTE

Dr. HASSETT. Thank you very much, Mr. Chairman, Minority Leader Rangel.

Mr. Chairman, we are in a period of enormous surpluses, and you may have noticed that those surplus estimates have been going up over time. There is a good reason for that. There is academic research that suggests that the revisions tend to be positively correlated with one another. That is kind of a technical thing to say, but practically what it means is that the odds are next year when we are sitting here, hopefully, and talking again about another tax cut, then we will have an upward revision of the surplus if everything goes as it usually does. Indeed, the effect of adding the last year, 2012, and taking away the first year, that in itself will probably add about $700 billion to the surplus.

And so while this plus is somewhat uncertain, there are risks. The risks, I believe, are very, very prudently balanced in the CBO forecast.

We should also, as we start to think about what we are going to do with these surpluses, keep in mind that it is not free money. It is not a surplus that happened just because the economy was booming. Indeed, millions of Americans have experienced in recent years and will experience in the forecast horizon something that economists have dubbed real bracket creep. Because of our progressive tax system, individuals are pushed into higher tax brackets as the economy grows. Since our tax brackets are only indexed to factor out inflation as the economy grows, everybody gets pushed to the right. These individuals are hit with automatic, if stealthy, tax increases.

Recently the boundary between the 15 and 28 percent brackets has begun to sweep through the center of the income distribution, hitting lots and lots of people. By an estimate that I performed recently, about 10 percent of taxpayers will move above the 15 percent bracket by 2010. So people are getting automatic tax hikes in this forecast, and if we provide tax relief, in some sense we are offsetting the tax hikes that are already entrained.

Now, I believe, Mr. Chairman, that the current situation is one where we should consider moving the President's plan forward into the current year. While it is impossible to know with certainty whether a recession is near, one thing is extremely clear: Fiscal policy which is racking up surpluses is tighter now than it has ever been this close to a recession. Bad medicine can make a sick patient worse. There is a significant risk that tight fiscal policy will be in the influence margin. It pushes the economy into recession or makes the recession a lot worse.

Indeed the last time we approached a slowdown with restrictive fiscal policy, the economy responded to high surpluses and a general weakening economy by posting the steepest decline in real GDP in post war history, dropping a whopping 10.3 percent in the first quarter of 1958. That is how far back you have to go to see something like the current situation. Now, currently—back then the surplus was forecast to be about 1 percent of GDP, and currently we are looking at something two to three times that size.

Now, there is no question that fiscal policy can help lower the risks of a repeat of that experience. While the theoretical response of the economy to a tax cut depends on monetary policy as well, macroeconomists who have analyzed the history of U.S. tax policy have generally found that the stimulus associated with a tax cut is from one to two times the size of the cut. Accordingly, if the President's plan were accelerated aggressively into this year, we could expect GDP to be higher, all else equal, by perhaps as much as 1 percentage point, with the effect taking five to seven quarters. Such a stimulus could significantly change the odds of recession.

That there is general agreement surrounding the positive effects of such a stimulus may be puzzling to those who have heard that economists generally agree that fiscal policy has had little effect on past recessions. Economists Christina and David Romer recently wrote an exhaustive study of the history of fiscal and monetary policy which clears up the mystery. They found that fiscal measures generally have failed to push the economy out of recession because they have typically been too small to have much of an effect. Indeed, large fiscal stimulus packages have generally not been passed near cyclical drops. Instead, they have historically emerged only because of slow recoveries, as was the case, for example, with the 1964 tax cut.

If the President's plan were passed today, it would be neither too slow nor too meek. Indeed, the economic data indicate that the economy posted positive growth at the end of last year. If a recession is under way, it is starting right about now.

Our current situation is unusual for another reason, Mr. Chairman. While the short-run forecasts show a significant surplus, long-run forecasts indicate that there is a large deficit, mostly because of the Social Security payments due when the baby boomers retire. Until recently almost every observer supported using a significant portion of even the on-budget surplus to retire government debt in anticipation of the coming deficits. However, surplus deficits have soared so much recently, by $2 trillion in the last year alone, that we must reexamine the effects of such a policy.

One of the main objections that I would raise toward allowing the surpluses to buildup, Mr. Chairman, is that they could build up to an enormous hoard in a relatively short time. Roughly half of the outstanding national debt is debt that we won't be able to buy back, and so relatively quickly the government is going to be in a position where it is going to have to invest these surpluses in private assets. Projecting forward, I have calculated recently that perhaps as much as $20 trillion of private assets will be held by the government if current policies remain unchanged by 2020. To put that in perspective, the current market value of all equities in the U.S. is about $17 trillion.

No, the best preparation for our long-run deficit is to put our tax house in order and use the Tax Code to stimulate savings and capital formation. On this basis the Bush plan has much to recommend it as well. There is, for example, a wealth of evidence that lower marginal tax rates stimulate entrepreneurship and economic activity. While I am unaware of a specific effort to provide estimates of these effects for the Bush plan specifically, I have taken two recent papers and amended them as best I can on the back of an envelope and calculated that aggregate output 10 years from now should be between 2 and 4 percentage points higher if we pass the Bush plan. If that happens, then we will have $700 billion extra to play with and use to address our important national problems at that time.

Thank you.

[The prepared statement of Mr. Hassett follows:]

Statement of Kevin A. Hassett, Ph.D., Resident Scholar, American Enterprise Institute

Chairman Thomas, minority leader Rangel, distinguished representatives and colleagues, it is a great privilege to be afforded the opportunity to speak with you today about the President's tax proposals. As an economist, I have been studying the effects of taxes on the economy for over a decade, first as a professor at Columbia University, then as a senior economist at the Federal Reserve, and now as a resident scholar at the American Enterprise Institute. I strongly support the plan proposed by President Bush, and appreciate the opportunity to share my reasoning with you.

Large Surpluses Make Tax Cuts Affordable

Currently, the CBO forecasts that the total surplus over the next ten years will be about $5.6 trillion, with $3.1 trillion of that "on-budget."[1] The President's relatively cautious plan is to dedicate a bit more than half of this surplus to tax relief. While there are significant risks to this forecast, the odds are that it will be revised upward in subsequent revisions. I expect this to happen for two reasons. First, academic research has shown that revisions tend to be positively correlated over time.[2] If there is an upward revision to today's CBO forecast, there is more likely to be another upward revision the next time as well. Second, we are currently in a period where compounding is making surpluses bigger and bigger over time, with the total surplus now estimated to be $889 billion in 2011 alone. Next year at this time the CBO's 10-year forecast will include 2012 and remove 2002, which should, all else equal, add approximately another $700 billion to the 10-year surplus estimate. Putting the two effects together, if the President's plan is passed as is, the odds are that next year the CBO on-budget forecast will still be in the neighborhood of $2 trillion. Relative to GDP, even that surplus would be remarkable by historical standards. Some observers have noted that there is also a downside risk associated with the possibility of recession. However, the two effects I just mentioned would likely dwarf any other developments. The CBO recently estimated, for example, that a recession would lower the current 10-year forecast by only $140 billion.[3]

As we consider options for the use of these surpluses, it is important that we remain aware that the surpluses are partly the result of marginal tax rate increases. Here I refer to what economists have dubbed "real bracket creep." Because of our progressive tax system, individuals are pushed into higher tax brackets when their incomes grow. When the economy expands, the incomes of Americans increase. Since our tax brackets are only indexed to factor out inflation, not real growth, a large number of taxpayers are pushed into higher tax brackets over time. These individuals are hit with automatic—if stealthy—marginal tax rate hikes. Recently, the boundary between the 15 and 28 percent brackets has begun to sweep through the center of the income distribution, and accordingly, this effect is becoming quite large. For example, extrapolating recent trends, more than 10 percent of taxpayers will move above the 15 percent bracket by 2010 with the majority of these individuals experiencing a 13 percentage point marginal tax rate hike.[4] While the complexity of this issue makes precise statements concerning the revenue effects of real bracket creep difficult, make no mistake, a good portion of the surplus is attributable to these automatic tax hikes.

These high surpluses occur at a time where we face significant short and long-run challenges.

The Tax Cut and a Slowing Economy

There are many signs that the economy is slowing. The widely followed National Association of Purchasing Managers survey index, for example, is in a range that in the past has always signaled negative economic growth for the economy as a whole. If a few quarters of negative growth are strung together, then we will be in recession and many will experience painful disruptions to their lives. If the recession is typical, for example, roughly 3 million Americans will lose their jobs.

While it is impossible to know with certainty whether a recession is near, one thing is extremely clear. Fiscal policy, which is racking up large surpluses, is tighter now than it has ever been this close to a recession. Bad medicine can make a sick patient worse. There is a significant risk that tight fiscal policy will be the influence, at the margin, that pushes the economy into recession, or a key factor making a recession worse. Indeed, the last time we approached a slowdown with restrictive fiscal policy the economy responded to high surpluses and a general weakening in consumer demand by posting the steepest decline in real GDP in post-war U.S. history, dropping a whopping 10.3 percent (annual rate) in the first quarter of 1958. At the time, the surplus was about 1 percent of GDP. Currently, it is forecast to be more than twice that high.

There is no question that fiscal policy can help lower the risks of a repeat of that experience. While the theoretical responses of the economy to a tax cut depends on

[1] Congressional Budget Office, 2001, "The Budget and Economic Outlook: Fiscal Years 2002–2011."

[2] Auerbach, A. February 1995, "Tax Projections And The Budget: Lessons From the 1980s," NBER, Working Paper #5009.

[3] Congressional Budget Office, 2001, "The Uncertainty of Budget Projections," in "The Budget and Economic Outlook: Fiscal Years: 2002–2011," chapter 5.

[4] For details of the calculations see: Hassett, K., October/November 2000, "A Tax Phantom is Stalking You," The American Enterprise.

monetary policy as well, macroeconomists who have anlayzed the history of U.S. tax policy have generally found that the stimulus associated with a tax cut is from one to two times the size of the cut.[5] Accordingly, if the President's plan were accelerated into this year, we could expect GDP to be higher, all else equal, by about 1 percentage point, with the effect taking from 5 to 7 quarters from the passage of the bill to run its course.[6] Such a stimulus could significantly change the odds of recession.

That there is general agreement surrounding the positive effects of such a stimulus may be puzzling to those who have heard that economists generally agree that fiscal policy has had little effect in past recessions. Economists Christina and David Romer recently wrote an exhaustive study of the history of fiscal and monetary policy which clears up the mystery.[7] They found that fiscal measures generally have failed to push the economy out of recession because they have typically been too small to have much of an effect. Indeed, large fiscal stimulus packages have generally not been passed near cyclical troughs. Instead, they have historically emerged only because of slow recoveries, as was the case, for example, with the 1964 tax cut.

If the President's plan were passed today, it would be neither too slow nor too meek. Indeed, the economic data indicate that the economy posted positive growth in the fourth quarter of 2000. If a recession is underway, it began in early 2001, and there is ample time to do something about it. If the tax cut plan is delayed or rejected, we run a significant risk of repeating past mistakes.

I should note that the view that a stimulus could now be effective is not an endorsement of Keynesian tax policy. Back in the 1960s, many Keynesians believed that economic fluctuations could be offset by tax policy. If consumers tend to consume too little in a downturn, then government could, it was thought, fix that with tax policy. A big tax cut, timed correctly, would boost spending and help push the economy out of the doldrums. The Keynesian theory applied on the upside as well. Tax increases in good times were recommended to stop a booming economy from overheating.

It was Nobel-laureate economist Milton Friedman who first pointed out the key problem with such policy regime: It only works if citizens are extremely shortsighted. Consider: If a temporary tax cut gives you $1,000 today, but you know that you will have to pay it back next year—with interest—how much will you change your behavior? If you're like most people, not very much.

This does not mean all government policies are ineffective. On the contrary, if firms and individuals are rational and forward looking, high taxes can have enormous negative effects on the long-run health of the economy. But if you just jigger taxes up and down from year to year, hoping to manipulate the economy, you will fail. Taxes can set the level of activity around which the economy fluctuates, but they have very little effect on the fluctuations themselves.

The President's tax cut is not Keynesian for one simple reason. He does not plan to raise tax rates as soon as the economy starts to boom again because the current surplus is large enough to accommodate his tax cut. Under the Bush plan, a taxpayer would pay lower taxes this year and again in the future. If experience is any guide, such permanent tax cuts are likely to have large positive effects. His plan takes us to a new and higher level.

Long Run Challenges

Our current situation is unusual for another reason. While the short run forecasts show a significant surplus, long run forecasts indicate that there is a large deficit, mostly because of the Social Security payments due when the baby boomers retire. Until recently, almost every observer supported using a significant portion of even the on-budget surplus to retire government debt in anticipation of the coming deficits. However, surplus estimates have soared so much recently—by $2 trillion in the last year alone—that we must reexamine the effects of such a policy.

According to the Treasury Department, total government debt held by the public is a bit more than $3 trillion. With no change in tax policy, projected surpluses would pay down the entire debt by around 2008. Government could not choose to just hold the cash, as that would decrease the monetary base and cause a potentially destructive deflation. It will have to decide what to buy with that money. As

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[5] See, for example, Blanchard, O., and Perotti, R., July 1999, "An Empirical Characterization of the Dynamic Effects of Changes in Government Spending and Tax On Output," NBER, Working Paper #7629; and Romer, C., and Romer, D., June 1994, "What Ends Recession?" NBER Working Paper #4765.

[6] The timing is taken from Blanchard and Perotti. Since the President's plan is a permanent tax cut, the multiplier should likely be larger than historical estimates based on an empirical analysis of the many temporary cuts in post-war U.S. history.

[7] Romer, C., and Romer, D., June 1994, "What Ends Recession?" NBER Working Paper #4765.

much as half of existing government debt may be almost impossible to retire, since savings bonds, for example, often aren't redeemed until maturity, and because many holders of long-term treasury bills will be unwilling to sell them back to the government. Adjust for these factors and we may well be building a sizable hoard of assets in just a few years.

How big could the hoard get? Investing that much public money would likely mean the government purchase of stocks, because only equity markets are large enough to absorb such inflows and still remain liquid. Assuming the Treasury begins to invest surpluses in the stock market as soon as it has retired all the debt that it can, and that these investments earn a 10% annual return, our government could be on a stock-market portfolio worth about $20 trillion in twenty years. To put that in perspective, the current market value of all equities in the U.S. is about $17 trillion, according to the Federal Reserve. Projecting forward, the U.S. government could own about one-fifth of all domestic equities.

Federal Reserve Chairman Alan Greenspan and others have cautioned against such a large scale intrusion by the government into the private economy and I concur. While it is possible to contrive conditions under which such investments could be neutral, the potential for disruptive influences to emerge is significant. The experience with U.S. state governments has not been reassuring. As Sebastian Mallaby wrote recently in the Washington Post, "the California Public Employees' Retirement System has no tobacco stocks in its $171 billion portfolio, and several states bend over to invest in local companies."[8] As soon as the government picks and chooses which things to invest in, it will change prices and the allocation of resources. Think, for example, of the increase in price that occurs when a firm is placed in the S&P 500 index. Making the government list would be much, much better. This argues against allowing the surpluses to build up in anticipation of the Social Security shortfalls.

The best preparation for our long run deficit is to put our tax house in order and use the tax code to stimulate savings and capital formation. On this, the Bush plan has much to recommend it as well. There is, for example, a wealth of evidence that lower marginal tax rates stimulate entrepreneurship and economic activity.[9] While I am unaware of a specific effort to provide an accounting of the dynamic benefits of the Bush plan specifically, two recent works identifying the likely benefits of tax reforms in general imply, by my calculations, that aggregate output will be between 2 and 4 percentage points higher ten years from now if the President's plan becomes law. While there is a substantial uncertainty surrounding so complex a calculation, if this estimate turns out to be correct, then the output of the United States may be as much as $700 billion higher in 2011 if the President's proposal is enacted than it would be otherwise. That extra national income will certainly help our country face the economic challenges of the next decade.

Chairman THOMAS. Thank you very much.

Dr. Feldstein, I think I heard a portion of your testimony dealing with the fact that the true cost of the tax cut would be the 1.6 that you would initially spend, but because of the value of spending it, you get something back, so it would only be 1.2. Isn't that a dynamic scoring approach?

Dr. FELDSTEIN. It is what has been called a dynamic scoring approach, but it is a very narrow construct. It is not about what happens to growth in general. It focuses just on two things: how much people earn and the form in which they take their compensation. And the historic record on what has happened after previous tax changes quite conservatively suggests that that is the kind of increase in taxable income, and therefore reduction in the tax costs that would come about, about one-quarter of the official estimate.

[8] Mallaby, S., February 5, 2001, "Greenspan on Going Private," The Washington Post.

[9] See the review in Judd, K., forthcoming, "The Impact of Tax Reform in Modern Dynamic Economies, "Transition Costs of Fundamental Tax Reform, Hassett, K. and Hubbard, R.G., eds. See also, Altig, D., Auerbach, A., Kotlikoff, L., Smetters, K., and Walliser, J., forthcoming "Simulating Fundamental Tax Reform in the United States." American Economic Review.

Chairman THOMAS. And I just wanted to lay that on the table before any of my other friends did, because I think we reached agreement in the earlier hearing that we were either going to be static on both sides of the legend, or we were going to be dynamic on both sides of the legend.

We heard Members earlier discussing the reduction of the money available in quite a dynamic way, but were unwilling to attribute any dynamism to the plus side. So I appreciate that, and I probably believe you, but I think we are going to check at least for the current time our dynamic guns at the door, and we will deal with the Congressional Budget Office and the others on the staff.

Dr. FELDSTEIN. At least when people go to bed at night, they should feel comfortable that they have that little hidden reserve there, or not so little hidden reserve, because they have not used all the artillery that is available.

Chairman THOMAS. Mr. Greenstein, I understand the way you responded to Dr. Feldstein's analysis of the proportionality of the income tax provision was that it was not the most appropriate way to look at Americans and Federal taxes. And you went into payroll, estate, gasoline and other taxes. Setting that aside, I would like to go back to the income tax aspect because that is what we are looking at today.

None of us would dispute the fact—in fact, I think the President will tell that you that one of the reasons he got elected, he believes, is because he faced the question foursquarely on Social Security in terms of needing to do something about payroll taxes. In fact, if you looked at a distribution chart on payroll taxes alone, you might see some interesting anomalies between high-income earners and low-income earners and return on investment being contributed to the Social Security fund.

But my question would be in terms of your analysis, setting aside the payroll taxes, the estate taxes, the gasoline taxes, the inheritance tax, because today we are just looking at the President's income tax proposal, if you were to look at it in terms of a distributional chart of Americans on income taxes, would you tend to agree with Dr. Feldstein or still disagree with him?

Mr. GREENSTEIN. Let me make two comments, Mr. Chairman. First, if this were only an income tax bill, I would agree that that would be the appropriate standard. If you were to announce—or the President, I should say, were to announce that he was removing the estate and gift tax provision from the bill, and that it were purely a bill to make changes in income taxes, then I think that the way Dr. Feldstein has proposed to look at it would be correct, but we are not only discussing income.

Chairman THOMAS. No, no, that is fair enough, although there may be some discussion that we may want to look at, marginal rates or other items, prior to the rest of the President's package. And my understanding is if we were to do that, look at marginal rates, for example, or maybe the child credit, that the proportionality that Dr. Feldstein talked about would indeed be there, at least in terms of that portion.

Mr. GREENSTEIN. If you look at the income tax alone from some incomplete tables, and I will explain in a minute why they are incomplete, the Joint Tax Committee did last year, it would suggest—and you could have two different ways of phrasing it, and they would both be right—it would suggest that the Bush plan would make the income tax slightly less progressive. You could say that the slightly was so slight that you were going to call it proportional.

The problem with that Joint Committee chart was that it only went through 2005, and as you know, the rate cuts, the child credit changes and so forth phase in through 2006, and it looks like—although I have not done a thorough analysis of this, it looks like the last year of the phase-in is big and maybe a little more geared toward the top, so we would really need figures through 2006.

But the point I want to come back to, Mr. Chairman, is that when fully in effect, 24 percent of this plan is the elimination of an estate tax. And if it is legitimate to talk about estate and gift tax as part of this plan, I don't understand why it also isn't legitimate to talk about easing some of the burdens on families that have significant tax burdens and do not pay income tax.

And I would say that I certainly favor the need—I—you know, I don't have the same views as to Dr. Feldstein as to the specifics, but I certainly agree we have a need to address Social Security reform, but given the shortfall in that system, it is hard to imagine that at least for decades to come that we are going to be taking a smaller percentage out of the paycheck than we do now. Maybe it all still goes to the trust fund, maybe some of it goes to individual accounts and some to the trust fund, but at least the same amount is still going to come out of each one of those paychecks. And if we are talking about 1.6, as I have mentioned, I think it is more than $1.6 trillion, it does seem to me the distribution is a bit skewed here.

One last point is Dr. Feldstein mentioned we have a cushion on the rate side because of his dynamic effect.

Chairman THOMAS. Our willingness to lay the dynamic numbers on the table gives some folks comfort at at night.

Mr. GREENSTEIN. I think you need to take your comfort away, unfortunately, because there is now growing evidence that complete repeal of estates and gift tax, this is amply covered in tax notes, would likely create major new tax avoidance strategies in other taxes like capital gains that are not included in the Joint Committee tax estimates.

I hope, whatever one favors doing on the estate tax, that this Committee will be concerned about the ability, for example, of an investor who makes maybe $100 million in the stock market to transfer the assets to an elderly relatively who is nearing death; no gift tax is levied. The elderly relative in the will bequeaths it back to the original investor, and the entire estate tax on the $100 million in profit is eliminated. This is a growing concern to attorneys that we could be creating major tax avoidance here, and that could easily eat up Mr. Feldstein's cushion.

Chairman THOMAS. I can tell you, sir, that those kind of points are not only going to be presented before this Committee and require to factor those changes in the estate tax, but it is my understanding that there is a debate currently going on in the Bush administration among appointees of the President about this approach. So that will be amply examined.

Just let me say, though, that when you said the extenders are coming up, and that we should go ahead and pass the extenders, I assume that you are in support of the chicken manure tax credit——

Mr. GREENSTEIN. Excuse me.

Chairman THOMAS. That is going to be up for extension. The chicken manure tax credit, that is one of those items that we should extend if we simply mindlessly extend the various credits—the gentleman from Maryland will have equal time in a minute for the Eastern Shore. You do not even have to respond.

The point I am making is you just automatically assigned a dollar amount and moved on and said that those extenders should be renewed. Frankly, I think this Committee is going to examine some of those extenders, and that we are not going to blindly renew those. And that is the case in other items that are simply added to the total, and you come to a conclusion. I am only glad that you survived last fall when we did not have the updated CBO numbers, and this Congress, as a price to conclude the last session of Congress, paid more than $600 billion in payments over the next 10 years to get out of town. If you had extrapolated some of those numbers under the older CBO projections, it is a wonder we are alive today.

Mr. GREENSTEIN. Could I make a comment?

Chairman THOMAS. Sure.

Mr. GREENSTEIN. A couple of points. First, the 600 billion——

Chairman THOMAS. Very briefly, because my time is up and I want to move to Dr. Hassett, Mr. Rangel is going to feed you a lot of good stuff.

Mr. GREENSTEIN. First off, the point I am trying to make is that when policymakers of both parties look at how much money is available, they need to be prudent and not assume money is available that will be used for other things, because it could be used twice. Surely I hope the Committee examines the extenders and does not mindlessly extend every one. However, past history is a couple drop out, a couple others get added. The past history is the total cost of extenders as a group doesn't tend to go down, and, therefore, if one is doing prudent budget planning, one wants to set aside an amount for roughly the current cost, even if you hopefully get rid of some that are not of value.

We did issue reports every few weeks last fall on precisely those points on spending that was going on. I would note that the $600 million figure which you cited includes the extra interest payments on the debt that accompanied that additional spending. You should include those.

I am trying to make a larger point. I would hope that Members, both sides, and on both taxes and spending, we need to start including the interest costs that go with either spending increases or tax cuts because they do consume part of the surplus, and my point is when you do that, that brings the tax cut to 2 trillion.

Chairman THOMAS. It was worthwhile today if we were reminded once again that one of the problems in the past has been that we always get carried away in terms of both cutting taxes and spending. And our job is to be prudent and to toe the line on both sides, and I appreciate that.

Very briefly, Dr. Hassett, you indicated that given the current climate, that it might be useful to do something in the short run; that, in fact, if we looked at the last quarter numbers, we may very well have bottomed out to zero now, but, of course, there will be a delay in collecting those numbers. If you look at the President's plan, could you give us some feel—or anyone else on the panel, could you give us some feel out of the President's tax package what might be the likely candidates to be moved early? My assumption is that based upon Mr. Greenstein's statements, the estate taxes couldn't make the cut in terms of looking at moving them relatively quickly to be a mild fiscal stimulus and to create a more proportional and fair Tax Code. What would be your nominees, for example?

Dr. HASSETT. Thank you for the question. I think that it is very important to think about stimulus if we are going to pull stuff forward into the current year. The bottom line of stimulus is that if you put the dollar in the pocket of a middle-income person, you will get more stimulus than if you put a dollar in the pocket of a very, very wealthy person in the short run because they will consume it. And so I think that a natural candidate to pull forward would be the President's 10 percent tax bracket. I think if we pulled that forward and maybe even phased it in quicker than in the President's plan, then we can get a significant stimulus in the short run.

Chairman THOMAS. Any additional comments before I——

Dr. FELDSTEIN. I would just emphasize that you get stimulus in this tax package even before people get extra money in their pocket. If this bill were passed in the next few months, individuals anticipating the fact that their tax burden is going to be permanently lowered or lowered for many years will feel more confident about spending in the near term. So I think it is very important that whatever you do in terms of trying to get some extra cash in there up front, that you are seeing it in the context of reducing rates going forward so that people at all brackets see that they have this more favorable tax climate for the future.

Chairman THOMAS. Well, you mentioned in the next few months. Without looking for any date that might be symbolic, around April 15 is a kind of a deadline for doing this.

Dr. FELDSTEIN. That would be very nice.

Chairman THOMAS. Thank you. The gentleman from New York.

Mr. RANGEL. Thank you.

Mr. Greenstein, you were trying to respond to the Chair in pulling out the payroll tax when we are just dealing with income tax. And I thought Governor Bush was eloquent on the campaign trail when he was trying to talk about relieving the fiscal burden of the low- and moderate-income workers. And we are supposed to be responding to our constituents and not to accountants, and to the average worker taxes is what the difference is of what his salary is and what he takes home. I don't know of too many people who talk about what their city's taxes, their State taxes, their FICA taxes. They just say, I am taxed too much.

And so it would seem to me that notwithstanding the fact that we call it income tax, that equity would indicate that what we are trying to do is to relieve the burden of taxation on the working person. So it would seem to me that you can't do it without at least discussing how you can make it easier on this very negative tax that the worker has; whether we talk about income taxes or not; whether we are talking about child credits or not. So I hope that you stay with us in trying to design some way that we can include this group of people that was excluded from the tax proposal in front of us.

But, Dr. Feldstein, in the 1993 tax increase that President Clinton had, did you have any observation to make as to what impact that would have on the economy at that time?

Dr. FELDSTEIN. I——

Mr. RANGEL. And this is not a hidden question because I don't recall if you did or not. I am just basing it on your past history and your testimony today.

Dr. FELDSTEIN. No. What I said then was in effect the same thing that I have said about this legislation, that is that it would affect people's behavior; that the higher marginal tax rates would cause some high-income individuals to change their form of compensation, to change the amount that they worked, and that that would have a negative consequence on overall tax revenue. I did not say that it would destroy the economy or push the economy into recession or anything of that sort.

Mr. RANGEL. Your background and reputation goes far beyond saying that if you cut people's taxes or raise people's taxes, that they are going to respond accordingly. Normally you are projecting some type of behavior that we politicians can be guided by, but I am convinced——

Dr. FELDSTEIN. Right, I did, and the numbers were similar to the kind of things that I am saying here.

Mr. RANGEL. Let me ask you this, were you right in whatever you suggested would happen; did it happen?

Dr. FELDSTEIN. The truth is we don't know. What we know is that a lot of things happened in the economy; that the economy, primarily because of technology, has grown much more rapidly throughout the income distribution. But we don't really know because we have not yet gotten the microdata to look at what happened to those top tax rates.

Mr. RANGEL. You know, I thank God every day for giving me the opportunity to study law, but the more I listen to you, Doctor, I wish I had gone into studying economics and being a consultant in this area because it really doesn't make any difference whether we know or do not know.

Tell me—and, Dr. Hassett, Chairman Greenspan has said that these projections, we have to be very careful about them because they are uncertain. And I wish we could structure a tax that would be just as uncertain as the forecast; that it gets lower as we find more surpluses, it increases as we find setbacks. But we cannot do that. As the Secretary of the Treasury said, we can't vote maybe; we can't vote we do not know. But as much as we want dynamic scoring and rosy scenarios and trust and hope for our country and our people, and the President suggests that the 5.6 may be just the tip of the iceberg in terms of what the real explosion of surpluses will be, and we hope he is right, can we expect that any of you experts might be able to give us some guidance if, God forbid, they are wrong, CBO, and given the 5.6 also added, we did not request it, a scenario where they made a mistake; and then if the same type of error was in their recent projection, that instead of this sharp increase in the surplus, we would have a deficit? They did not say that would happen, and they said in all likelihood it would not happen. They said it could happen. Could you tell us what we could do, Dr. Feldstein, if that did happen, since it is possible that it would happen?

Dr. FELDSTEIN. I suppose what you would do to be fiscally responsible, if it wasn't a short-term deviation, and certainly you would not want to respond to a cyclical downturn in revenue by raising taxes or cutting spending, but if the long-term projection turned out to be wrong, then you would want to cut spending, raise taxes or some combination of the two to bring the budget back in line. And that is something—if you look back over your years in Congress, that has happened from time to time. There have been years when you have cut taxes and years when you have raised taxes, and years when you felt you could spend more and years when you felt you had to be tough on spending.

Mr. RANGEL. We can only raise taxes every other year. You know that.

Dr. FELDSTEIN. I wouldn't want you to raise taxes every year.

Mr. RANGEL. We could never raise taxes in an election year. Even an economist would know that, right?

Dr. FELDSTEIN. Right.

Mr. RANGEL. But the alternative would be cutting spending.

Dr. FELDSTEIN. Hard to do in an election year also. But it is the longer term getting off track that would be a cause for a problem. If you found yourself with projections of several years of deficits that wasn't just cyclical, then you would have to do the responsible thing, both on the spending and on the tax side. You would have to look at the decisions you made in the past.

Mr. RANGEL. Or we could go into the Social Security money.

Dr. FELDSTEIN. You cannot go into the Social Security money. You cannot literally go into Social Security money. It is blocked in there as a trust-funded amount.

Mr. RANGEL. Who blocked it in?

Dr. FELDSTEIN. You did.

Mr. RANGEL. Who can unblock it?

Dr. FELDSTEIN. You wouldn't do that.

Mr. RANGEL. Okay. That is why you are an economist. Mr. Greenstein.

Mr. GREENSTEIN. If you look at the new CBO report, CBO says that on average its estimate of the surplus or the deficit for the fifth year out has been off by an average of 3.1 percent by GDP, which means that if its 2006 forecast is off by the average amount that it has been wrong in the past for the fifth year, that that estimate is either $400 billion too low or $400 billion too high. If it is 400 billion too high, we are in real trouble.

It seems to me that it is much harder for Congress to cut spending or raise taxes then to cut taxes or increase spending, and, therefore, the prudent thing to do is not to take the entire surplus outside Social Security and Medicare and commit it all in law this year through a combination of tax cuts and program increases, but to set some portion of it to the side kind of as a rainy day fund.

If the surpluses materialize, you will have an easy time coming back and enlarging tax cuts or doing a bigger drug benefit or whatever it is. But once you have passed the tax cuts and the spending, if things go south, it isn't so easy to pass the legislation to put it back in order. And since 70 percent of this projected surplus does not come until the second 5 years, I don't understand why the more prudent course is not to put some of it to the side now, and as it materializes, if it does, you can always come back and do more. You would still have room in doing that for a very healthy tax cut this year.

Dr. FELDSTEIN. You would be giving up something. You would be giving up the favorable incentive effects of lower marginal tax rates. If you say we are not going to come down with this roughly across-the-board reduction in marginal tax rates and the incentives that it brings, then you are going to be passing up—if you wait, as Mr. Greenstein suggests, if you wait, then you are going to delay the favorable effects on the economy of those lower marginal tax cuts.

Mr. GREENSTEIN. On the other hand, if you proceed, you will have less national saving and more consumption; and you will forego the favorable effects on the economy of more saving. And it isn't clear—economists disagree in the economic——

Mr. RANGEL. It is possible that Mr. Stockman, who was the manager—the director at OMB, indicated that one of the ways to reduce programs is just not to have the money there to fund them.

Thank you, Mr. Chairman.

Chairman THOMAS. Thank you very much. Gentleman from Ohio, Mr. Portman, wish to inquire?

Mr. PORTMAN. Thank you, Mr. Chairman. On behalf of the second tier we would like to thank you all on the top for giving us some time. We do appreciate it.

Thank you, Dr. Feldstein, Mr. Greenstein and Dr. Hassett, for being here and for your testimony. I think it has been a very balanced panel. I think it is complementary to the testimony we heard this morning from Secretary O'Neill.

I have a number of questions, but if I could just start by talking about CBO for a second. Dr. Hassett, I am interested in your testimony in that regard. Mr. Rangel seems to be saying, and Mr. Greenstein seems to be agreeing that we have these projections of surplus, but we just can't trust the projections. But even though now we are out of deficits, even though now we have these tremendous surpluses projected, even though they are based on 2, 3 percent growth, we just cannot have room for tax cuts.

Your testimony talks a little bit about the CBO estimates. Can you tell us what CBO said about a recession in the next 10 years, how it would change the estimate?

Dr. HASSETT. Certainly, Mr. Portman. Better turn my mike on.

The CBO has calculated that a recession would knock about $140 billion out of the 10-year number. That $140 billion is significantly smaller than the upward revision to the forecast that I expect at this time next year, both because the forecast provisions tend to be positively correlated over time and because we are adding this year at the end where the surplus is going to be much larger. So even if we do have a recession this year, I would expect that, all else equal, we would see an upward revision next year.

I think the CBO forecast is a very, very cautious forecast; and it is their best, most prudent guess of what number you should base policy on. There are certainly uncertainties. They never hit the number exactly. But I think the notion that uncertainty means that the number is going to come in lower is a false one.

Mr. PORTMAN. Exactly. That has been certainly the implication this morning earlier with testimony by the Secretary of the Treasury. There were a lot of questions asked of him about the forecast and how can you trust these forecasts. The implication was these forecasts are too rosy. In fact, what has happened in the last few years? In your experience, what has happened in the last few years with regard to these CBO estimates? Have they been low or have they been high?

Dr. HASSETT. They have tended to be too low. We have been—upward revisions on budget surplus is about $2 trillion higher than it was——

Mr. PORTMAN. Two trillion dollars higher than the last year. As these projections have gone up as there has been more surplus, what has happened to those surplus dollars in the last couple of years?

Dr. HASSETT. We have seen more surpluses.

Mr. PORTMAN. And we see more spending.

Dr. HASSETT. But the surpluses are not fantasy. I mean, even the 2001 surplus estimate is almost $300 billion, the 2002 is above $300 billion. So their surplus, a unified budget surplus now and on-budget surplus as well, that could be targeted towards tax cuts.

Mr. PORTMAN. I think that that is an important point to make. We are not talking about some theoretical surplus. It actually happened in the last 2 fiscal years, and we have actually seen a great increase in spending. In the last 6 months alone, we have probably spent enough to provide for significant tax relief along the lines of allowing more IRA contributions or 401(k) contributions or maybe even something with regard to the marriage penalty. But we have eaten it up because we have increasingly spent above and beyond the caps that we set for ourselves.

You know, interestingly, this morning the Secretary of the Treasury talked a lot about the fact we can't vote maybe, we have to vote yes or no based on the best information we have. The best information we have is that here we are not in deficits as we were in 1993, and in fact we have tremendous surpluses. In 1993, the tax rate was raised. Where was it prior to President Clinton raising the tax rates at a time that we were at deficits?

Dr. HASSETT. I believe it was at 33.

Dr. FELDSTEIN. Thirty-one.

Mr. PORTMAN. It was 31 percent. So, actually, interestingly before 1993, when President Clinton raised taxes in order to get the deficit down, the annual deficit, he raised taxes higher than we are talking about now. In other words, lowering it. The rates were 31 percent. They are now up to 39.6 percent. The Bush proposal takes it down to 33 percent, still 2 points higher.

You are shaking your head, but it is true. It is still 2 points higher. And yet there are no annual deficits now, are there? Are there any deficits this year in the Federal budget?

So one would think even logically if we can go back to '93 and say, okay, let's take Mr. Rangel's argument and say that had an effect on the economy to get the economy straightened out, although I would argue that the Republican majority coming in and a balanced budget had a lot more to do to with it, but now we are back to where we were. So why wouldn't we take the rate down to 31 percent?

Mr. GREENSTEIN. May I make a comment?

Mr. PORTMAN. Maybe that is a rhetorical question. Let me ask a more specific question.

I would also say, with regard to your comments, Mr. Greenstein, on the size of the tax bill, it is very plain that President Bush wants a $1.6 trillion tax bill over 10 years, wants to make sure he takes care of certain priorities, including being sure there is tax relief for everybody, primarily focused on middle-income, lower income Americans, but he also has said very clearly that Congress shall legislate.

So I have looked through your testimony. You talked about the extenders, you talked about the phase-ins and so on. Those are not in the bill. And if they were to be part of the bill there would have to be other adjustments. Secretary O'Neill has made it very clear this morning that if there is going to be retroactivity it would have to come out of the bill somewhere. So there would be other adjustments probably in the later years.

So I would just say it is an interesting argument that, gee, the President's tax bill is not what he says it is, but it is what he says it is in the sense that he says this is what he is going to stick with.

Mr. GREENSTEIN. Mr. Portman, can I respond, please?

Mr. PORTMAN. Yes, absolutely.

By the way, I thought you would be more complimentary of the tax bill since it doesn't have the 401(k) or the IRA contributions in it to allow people to save more for their own retirement, which I know you also have major problems with.

Mr. GREENSTEIN. I knew you couldn't resist that.

Mr. PORTMAN. Well, you haven't been able to resist it either. But I think this is a very fair bill. I would be happy to hear your comments.

Chairman THOMAS. Mr. Greenstein, you may go ahead and comment on his expended time—answering.

Mr. GREENSTEIN. I will be very quick.

The key point I was trying to make is the $1.6 trillion figure does not include the interest payments on the debt. I didn't—I am not clear if Mr. O'Neill is saying that it should be $1.6 trillion inclusive of the interest payments on the debt that goes with that. I would think that would be a very important statement. It was not what I understood the administration's position to be.

The other part of this is that my fear, Mr. Portman, is that in thinking about how much money is available that the Committee will do the extenders for another 2 years, that it will be the AMT problem for 1 or 2 years, and the Bush tax cut creates—it makes the AMT fix cost 2 to 300 billion more over the next 10 years. If you don't do it this year and you do it in five segments every 2 years over the next 10 years, the cost is still the same. I would consider that an unfunded liability of the Bush tax bill, and we need to consider that as part of the cost even if you don't happen to pass it all in this session or in that bill.

Mr. PORTMAN. If we would have a conversation about that later I would love to address those points, but my time is up. Thank you, Mr. Chairman.

Chairman THOMAS. Thank the gentleman. The gentleman from Pennsylvania, Mr. English, wish to inquire?

Mr. ENGLISH. Thank you, Mr. Chairman.

This has been a most interesting discussion, and I very much appreciate the testimony of all three of the expert witnesses. I guess what I find missing from some of the discussion of distributional effects is how, if this is a policy aimed at growing the economy, if this is a policy which successfully could grow the economy faster, create more wealth, create more jobs, that the beneficiaries of that growth are likely to be people at the middle income and at the lower end.

What this distributional discussion doesn't seem to take into account is that people at the bottom of the economic ladder have an enormous stake in a successful pro-growth policy that this might make a significant contribution to. But I realize as we discuss these tax policies we need to tackle the distributionals, whether they are a central issue or a marginal issue.

To that point, Dr. Feldstein, with regard to the distributional effects, you have described this as a proportional tax cut. In my research, I found that in 1998 the top 1 percent of earners paid 35 percent of the total personal income tax; the top 5 percent paid 54 percent; and the top quarter paid 83 percent, according to the IRS.

In your view, would this data change in an adverse way under the Bush tax plan or would, for that matter, the burden be shifted upward specifically under the President's plan? Wouldn't high-income Americans potentially shoulder more of the tax burden in the income tax system?

Dr. FELDSTEIN. Yes, they would. Bob Greenstein raised the point about what happens when it is fully phased in, and we have done some calculations using these tax return data for a fully phased-in set of tax rates of the sort that President Bush has proposed. I will give you just two numbers.

For people with incomes between $20,000 and $50,000, the share of the tax that they would pay would fall from 11.6 percent to 10.7 percent; and for individuals in the top bracket that we looked at, people with more than $400,000 of income, they would see their share rise from 27.2 percent, to 28.8 percent. So the first group gets about a one-tenth cut in their share of overall taxes, while the top group sees their tax share rise.

Mr. ENGLISH. That is extraordinary, and I think that is something that has to be central to any discussion of the distributionals that we have.

I know my time is limited. Dr. Hassett, your testimony indicated on page 4 that the permanence of the President's marginal tax rate cuts would stimulate the economy because taxpayers would know what to expect in the future. We are putting incentives in the Code that are presumably going to affect behavior. Would conditioning income tax cuts on some sort of budget trigger or passing only temporary tax cuts have potentially the opposite effect?

Dr. HASSETT. Thank you for the question, Mr. English. Indeed, you are exactly right. There has been a wealth of evidence in the academic literature that has studied the effects of uncertainty both on the behavior of firms and on the behavior of individuals, and it is generally found that when people don't know what to expect they tend to hold off things. They tend to not buy, for example, a car because you don't know if your taxes are really going to be low enough so that you can afford the payment next year. So if we introduce explicitly a higher level of uncertainty then we will certainly subtract from the positive effects from the Bush plan.

Mr. ENGLISH. Dr. Hassett, is it your professional opinion that the longer we wait to reduce marginal income tax rates the longer it will take to stimulate the economy? And how important is it to move quickly to reduce the marginal rates?

Dr. HASSETT. I believe, Mr. English, that right now we are at a period where there is a significant risk that we will enter a recession, but it is not a sure thing. And I think that the current period is unusual because we are running such a high surplus at such a time.

You know, economists for years have measured the tightness of fiscal policy by the full employment surplus which is pretty much our estimate of the surplus right now. If you use that measure then we are running about the tightest fiscal policy near the start of a potential recession that we have ever run, and I think that that is a very risky position to be in.

Mr. ENGLISH. Thank you.

My time has expired. I want to thank the panel again for the excellence of their testimony. I think it is important that everyone understand that we are looking for an economic policy that will encourage growth and keep us out of a recession and, in doing so, presumably also long term boost our revenues beyond what we are currently projecting.

I will yield back the balance of my time.

Chairman THOMAS. Thank the gentleman. The gentleman from Wisconsin wish to inquire? Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Mr. Chairman and Members, I think most if not all Members of Congress support a tax cut at this point in time, especially meshed against the size of the surplus. So I think to start the debate at that point is not adequate. I think the debate that we want to engage in on this Committee and in other Committees of Congress is the size and the distribution of that tax cut.

Let me start out by restating, Dr. Feldstein, a point you made that you indicated that the tax cut was proportional. The figures that I have, and this is in conjunction with the CBO and the Center on Budget and Policy, they indicate that when fully phased in the Bush tax cut for the top 1 percent—or of the Bush tax cut the top 1 percent gets 36 percent of that tax cut. However, based on their income tax burden in 1999, only the income tax, it shows that that population group, that income group paid only 29 percent of the taxes. So to state that the tax cut is proportional flies in the face of these figures, which I assume is accurate; and I wonder if you want to respond to that.

Again, the share for the top 1 percent of the Bush tax cut is 36 percent, compared to them putting 29 percent into the pot.

Dr. FELDSTEIN. Those are not consistent with the numbers that I quoted to you. Tell me again the source of the numbers?

Mr. KLECZKA. The income tax burden comes from CBO, and the share of the tax cut comes from the Center on Budget and Policy. What percentage——

Dr. FELDSTEIN. I don't know how they estimate those numbers, so I can't comment.

Mr. GREENSTEIN. I would be happy to explain the numbers, how we got them.

Mr. KLECZKA. Oh, they are yours. That is better yet. What numbers are you using? Twenty-nine? Twenty-nine?

Dr. FELDSTEIN. The numbers that I quoted to you were not in terms of the top 1 percent. They were phased in number—I will give you the number for the top. For people with incomes over $400,000 on a fully phased in basis it went from roughly 27 percent to 29 percent of——

Mr. KLECZKA. After the income tax cut and the inheritance tax repeal?

Dr. FELDSTEIN. No. No. No. No. It is just the income tax. I don't have any attempt to attribute the estate and gift tax to——

Mr. KLECZKA. If you are going to make——

Dr. FELDSTEIN. That may be why these numbers——

Mr. GREENSTEIN. If you make the difference.

Dr. FELDSTEIN. Let's be clear, then, on the income tax it is proportional or slightly less.

Mr. KLECZKA. We are looking at a $1.6 trillion tax cut. I think if you are going to make an argument that is proportional you have to use the whole tax cut and not bits and pieces of the tax cut to make your argument. Clearly, since the death tax, the inheritance tax goes to the top 1 percent or 2 percent of the filers in this country, you clearly have to attribute that 80 plus billion dollars to them in some form or fashion.

Mr. Greenstein, do you want to expound on that somewhat?

Mr. GREENSTEIN. There have at various points been discussions of how to attribute the incidents of the estate tax. The best study on this now available is a relatively recent study which was conducted by the highly respected career staff at the Treasury Department. It was published in September, 1999, as part of a major Treasury study on the distribution of taxes. That study found that the top 1 percent pays about 64 percent of the estate tax. The top 5 percent pays about 91 percent of the estate tax.

What we did in coming up with the figure that the top 1 percent would get 36 percent of this tax cut is very straightforward. We simply—for the estate tax part, we simply used the Treasury incident. Since this proposal entirely repeals the estate tax, that means you simply use the Treasury on who currently pays the estate tax.

The figure, by the way, in the same Treasury report, the Treasury reported that the top 1 percent pays 20 percent of all Federal taxes. The figure is higher than that for the percentage of the Federal income tax they pay. But if you are comparing apples and apples, you are saying, what percentage of all Federal taxes does the top 1 percent pay? Answer, 20 percent. What is the percentage of this tax cut the top 1 percent would get? Answer, about 36 percent.

Chairman THOMAS. If the gentleman would yield briefly, it won't come out of your time.

You described a procedure that in fact could occur if we remove the estate tax in which someone would bequeath to an elderly and rotate—none of that is taken into consideration here. Your comments earlier about the way in which you gain the estate tax, do you recall that?

Mr. GREENSTEIN. I am sorry. I didn't understand the question.

Chairman THOMAS. The statement that you made earlier about how you could gain the estate tax if it was repealed?

Mr. GREENSTEIN. That is not reflected in these figures.

Chairman THOMAS. That is not reflected.

Mr. GREENSTEIN. Correct.

Chairman THOMAS. Thank you.

Mr. KLECZKA. Finally Mr. Greenstein, the exercise you went through in your testimony was to try to indicate the true cost of the tax cut versus the true surplus that we are dealing with—I think that is what you tried to do. If I followed you correctly, you indicated that the true tax cut that we will be addressing here is about $2.5 trillion versus an available surplus of about $2 trillion. Is that somewhat accurate?

Mr. GREENSTEIN. Yes. Now if, as the Secretary said this morning, things like accelerating the tax cut are accommodated within the initial cost, then it wouldn't be as much as 2.5, but it would still be more than 2.0 when you take into account the interest——

Mr. KLECZKA. That might not be the job of this Committee to do the entire exercise, but it will be the job of the Budget Committee. Because clearly when we look at the tax cut which we will plug into the budget resolution we are going to have to make a provision there for the additional interest, the debt service cost. So at that point we are going to come up with a figure. And even using Dr. Feldstein's—what did you call it—the actual tax cut being 1.2 versus 1.6, dynamic tax cut, even using that figure and the other dynamic numbers, we are still very close to using the entire surplus on the tax cut.

I guess that is the caution that I have to my other colleagues and that I will be sharing with my constituents is that when you add up all these other things, like the alternative minimum tax, the thing we found out yesterday in the Budget Committee hearing for the Democrats was, and I think my figures are pretty close, currently the alternative minimum tax affects about 11 million tax filers. If we do nothing, if we do nothing, another 17 million filers are affected.

So by just not even calculating a change in the alternative minimum tax, which we all know is going to have to occur, we are talking about 28 million tax filers who will wake up 1 day and find out, hey, I am in this situation; and clearly Congress years and years ago didn't have the-did not intend that that be an effect of the AMT.

Mr. Feldstein, then I am done.

Mr. FELDSTEIN. Just one quick point on that. I agree that the complexity of the alternative minimum tax should not be placed on the vast number of taxpayers. But that doesn't mean that in getting rid of that complexity you have to lose the revenue. That is, you have to sit down and rethink what you want to do about deductions and the rules of the Tax Code.

Mr. KLECZKA. OK. But one of the changes will be to shift the focus of the ATM away from the middle tax and higher middle tax income owners. That is going to be a loss of revenue.

So thank you, Mr. Chairman. We will talk about this another day.

Chairman THOMAS. I thank the gentleman. We certainly will. Does the gentleman from Missouri, Mr. Hulshof, wish to inquire?

Mr. HULSHOF. I do, Mr. Chairman; and I will accept your kind reminder this morning that there may be a larger audience than just those assembled here. I hope not to bog down in taxspeak.

If I could summarize each of your testimony it would be, Dr. Feldstein, you see this as an unprecedented opportunity for us; Mr. Greenstein, your summary would be that President Bush's plan is not fiscally prudent; and, Dr. Hassett, yours would be stimulus, stimulus, stimulus.

I would also applaud the fact that you pointed out, Dr. Hassett, that the Congressional Budget Office, which is our official scorekeeper, has always undershot the mark—at least in recent memory since 1995, that they have undershot the mark.

Mr. Greenstein, you have made some assumptions based on past history this morning. I don't know if you gentlemen were here during Secretary O'Neill's testimony. But there was some discussion about 1981. And I will confess to you and to the world that, as I was ending my first year of law school in 1981, I was much more focused in surviving Dr. Cochrane's constitutional law class rather than what was happening in Congress. But as I understand what happened in 1981 with the Reagan tax cut was that it grew to huge proportions. There was a lot of piling on, and there was a strong penchant for spending that overwhelmed this tax cut that President Reagan had put forth.

I don't know that. You all can argue that. What I do know is recent history. And recent history from 1997 through '98, '99 and the year 2000, having served on this Committee, is that this Committee and the full House have passed tax relief measures each one of those years.

In '97, the tax cut was signed into law by then President Clinton; '98, stymied by the Senate, the other body; 1999, the $792 billion tax cut—which, by the way, Mr. Chairman, was the first time that the House got away from a 5-year projected window and we started talking about these 10-year projections—and then again in the year 2000 with targeted tax relief, each of those latter—the tax cuts that the House passed ended up being vetoed by then President Clinton.

I want to focus on 1997. In 1997, as this Committee was talking about cutting capital gains tax rates, as we talked about creating a $500-per-child tax credit, as we talked about raising the exemption on the death tax to shield family businesses and particularly family farms from the death tax, do you recall in 1997 we had deficits? We were borrowing—Congress was borrowing from Social Security. The scenario back then was not even near the rosy projections we are getting now from the official scorekeeper.

Mr. Greenstein, I mean no disrespect. If you are throwing red flags up when we have a $3 trillion projected surplus outside Social Security with this tax cut, you must have been violently objectionable do the tax cuts we were talking about in 1997. Let me ask, do you believe that the '97 tax cuts that we passed, that the President signed when we had deficits, did they contribute to the economic expansion, did they contribute to the economic slowdown that we see, or something in between. Mr. Greenstein?

Mr. GREENSTEIN. Mr. Hulshof, in 1997 you actually passed an overall budget package of which the tax cut was just one part. There was restraint on discretionary spending. There were changes in Medicare provider payments. The overall package was thought at the time to be a net deficit reducer. In the end, it probably wasn't a net deficit reducer because we then gave back some of the Medicare savings; and the discretionary caps were unrealistic from the day they were written and never were going to be really complied with.

We now have surpluses, I think, neither despite nor because of the '97 tax cut in large measure but because we had a continuation of something we have had throughout much of the past decade, which is this tremendous economic growth, higher productivity rates than we are forecasting, so forth.

Mr. Hulshof, what I would say is if you go back to the eighties the CBO forecasts were consistently off year by year on the other side. They consistently underestimated deficits. The deficits kept being bigger than CBO forecasted. The fact of the matter is, these are educated guesses and we have had years in which they were—they significantly underestimated deficits. We have had years in which they significantly underestimated surpluses. And we don't know that we won't have a period again where the forecasts are too rosy.

All that I am suggesting is that you not shoot 100 percent of the whole wad this year and put some of what is only a projection to the side. I am not saying spend it. I am saying put it to the side, and then if it really materializes you can use more of it.

Mr. HULSHOF. I appreciate that, your lengthy answer.

I see my time has expired. If the chairman would indulge me just for a second.

Your points are well taken. The point is, however, that we are not consuming the entire projected surplus.

And, quickly, the criticisms of the past and especially those on the other side of the aisle, often these tax cuts passed this Committee on a party line vote, which was unfortunate. We heard on the floor that our tax cuts were going to overheat the economy. We heard those arguments as recently as not many months ago. I think it will be interesting now to those that object to the tax cuts when they get to the floor to see how they reconcile present positions with positions of the past.

The criticisms in the past have been that targeted these tax reliefs. President Bush's plan is very across the board. If you pay income taxes, you get income tax relief.

Finally, I think it addresses in a positive way simplification of the Code. An Old Farmers Almanac saying says that if Patrick Henry thought that taxation without representation was bad, he ought to see it with representation.

I think the fact that we are going from five brackets consolidating into four I think strikes a blow for simplification. I think a $1,600 return in the pockets of an average family of four is something that should be supported.

I appreciate, Mr. Chairman, you allowing me a few extra seconds. I yield back.

Chairman THOMAS. We will pause for a moment. We will turn to the gentleman from New York, Mr. McNulty. Do you wish to inquire?

Mr. MCNULTY. Thank you, Mr. Chairman.

Mr. Chairman, I am concerned. We had 30 years of deficit spending in this country, and we saw the national debt go from less than $1 trillion in 1980 to $5.7 trillion today. And we have heard a lot of different numbers from the time the President first made this proposal. We have heard a lot of different numbers today. We have had three economists here, very well respected, and three different points of view. But I am trying to get a handle on what we should do as Congress with regard to this tax cut proposal.

I just want to try to simplify the numbers that we are looking at. Now, we have this projection of a $5.6 trillion surplus over the next 10 years; and I must tell you I am a little bit nervous about 1-year projections, let alone 10-year projections. But let's use that as the figure and assume that is going to come true.

Now this afternoon on the floor of the House of Representatives we are going to have a vote. It is going to be an almost unanimous vote on this lockbox legislation which, roughly translated, says we are going to stop stealing the Social Security and Medicare money. We are not going to do that anymore. And both parties are making that pledge today. We are going to put our votes on the line in that regard.

Let's assume that we do that. Now, other folks think when we are doing these calculations—one of my colleagues this morning said we ought to add to that figure the money that has to be projected in government pensions and so on, and there is a debate over that. Let's not use that. Let's use Secretary O'Neill's number. That is the one he used. That gets us down to 2.7.

Then we get to the tax cut, which at face value is 1.6. I must say that Dr. Feldstein is the first person that I have heard say it is going to actually cost less than that. Because about everybody else says it is going to cost more, if we do retroactivity and the interest and all that other, everything else that we might add on to it in business or anything.

But let's go with the Chairman on that one. Let's go with the President and the Chairman—1.6. We use static figures. Now, under the best of all scenarios, to my way of thinking we get down to what is left would be $1.1 trillion over 10 years to do everything that we want to do.

Now, let me also point out, as a nonpartisan critic of some of the people in Washington, D.C., that a lot of people around this town, both Democratic and Republican, are going around saying that we are going to eliminate the national debt in the next 10 years. We are not going to eliminate the national debt in the next 10 years. If we devoted that entire bottom amount there, 1.1 trillion, to the national debt, we would reduce it, we would only take care of less than one-fifth of the national debt, leaving nothing for new spending, nothing for what the President proposed today with regard to military pay, nothing for SDI, nothing for education, nothing for prescription drugs, nothing for other health care programs, nothing.

Now we all know that in the real world of Washington, D.C., we are going to spend some money over the next 10 years. So you can subtract that from the 1.1, and the rest would go to deficit reduction.

All of which is to say that I am concerned. I don't want to go back to the days of deficit spending.

Now I am 53 years old, and I'm going to get through the rest of life okay. But I am getting a little bit more philosophical as I get older. I have got four children. I have got three grandchildren. I am going to have four before the week is out. And when I think about them and their future, and the prospect of going back to deficit spending, frankly it scares the hell out of me.

My question is, and I would like each of you to answer it briefly, if you could, is this: Wouldn't it be more prudent to have a tax cut but to have a smaller tax cut so that we guard against the prospect of going back to deficit spending?

Dr. FELDSTEIN. Let me first comment on your comment about the size of the tax cut. The $1.2 trillion—the $1.2 trillion number that I cited does not include interest. So you can't compare it with the numbers that include interest. And I think that, as the Chairman pointed out, it does take into account behaviorial responses and I think quite modest ones.

The size of the national debt that you quoted is the entire size including debt held by the Federal Reserve and debt held in other government accounts, particularly Social Security. So if you look at the publicly held national debt, the debt held outside the government, it is $3.4 trillion. The combined lockboxes of Social Security and Medicare that you had on your card is $2.9 trillion. So over the 10 years that would remove from the publicly held debt, from the debt held outside the government $2.9 trillion of the $3.4 trillion. So the size of the debt held by Americans and foreigners in other than government accounts would be down to $500 billion. Now that may not happen because of Social Security individual accounts and all of that. But if we set that aside and just look at the numbers that you gave us, it would indeed eliminate most of the national debt.

Mr. MCNULTY. Mr. Greenstein.

Mr. GREENSTEIN. My answer to your question is, yes, I share your concern.

Mr. MCNULTY. Dr. Hassett.

Dr. HASSETT. The gross debt number that you cite isn't the number that concerns me and I believe Chairman Greenspan as well. Because if we pay off all of the debt then we won't have Treasury certificates, Treasury bonds and so on to trade in private markets, and it will be much more difficult to manage financial affairs in that type of a world.

Moreover, the government will be faced with a challenge of deciding what to do with the money. Because once we have bought back all the debt that we can buy then we are going to have to go out and buy something else, and the odds are it is going to be a private asset, and figuring out how we do that without disrupting economic activity significantly is a significant challenge.

Mr. MCNULTY. Paying off the national debt is the kind of a problem I would like to have.

Chairman THOMAS. Is the gentleman through?

Mr. MCNULTY. Yes. Thank you, Mr. Chairman.

Chairman THOMAS. I thank the gentleman. Gentleman from Kentucky, Mr. Lewis, wish to inquire?

Mr. LEWIS OF KENTUCKY. Yes. Thank you, Mr. Chairman.

Dr. Hassett, would you expand on the problems with reaching the point when the surpluses grow over and beyond our concern with paying off the national debt or the public debt? What are some of the specific problems that we would face?

I know, of course, as you said, the investing in private assets and of course the other problem that I think could certainly step forward in Congress would be more spending. But what would be the problems with amassing enormous amounts of surplus dollars and what would the government do with those dollars?

Dr. HASSETT. Thank you for the question, Mr. Lewis.

First, we have to understand that the government does already place money now and then in private hands. The government, for example, deposits your tax checks in a bank; and then the bank is required to securitize those deposits until they sort of end up coming to Washington and getting spent. So the government already with little amounts of money is sending money out into the private sector.

The issue here is that, if no policy changes, going forward in about 20 years the government might well own 20 to 25 percent of the entire stock market; and if the government owns that much of the market then there is a significant chance that it could do things that would disrupt economic decisions. For example, if a firm is drawn into the S&P 500 right now, then we see that their price goes up a lot. Well, imagine what might happen if a firm makes the government's preferred investment list. So I think that is why Chairman Greenspan cautioned against allowing surpluses to rack up, because it is going to be an intrusion of government into private life, and I share his concerns.

Mr. LEWIS OF KENTUCKY. Without significant tax cuts, when would those surpluses start to grow above and beyond our payment on the debt?

Dr. HASSETT. Mr. Lewis, we don't know for sure, because we don't know exactly how much of the privately held debt we will be able to buy back. I have seen some estimates that suggest perhaps $2 trillion of it is debt that we could retire, perhaps $1.5 trillion.

The problem is that, for example, savings bonds are sitting in safety deposit box, and maybe people forget that they own them. So how are you going to get at that?

Moreover, more people might have a very aggressive love affair with their long-term treasuries and be unwilling to sell them back to you except at a very high price, a price so high it wouldn't really be prudent for us to pay it. So perhaps as soon as $1.5 trillion in accumulated surpluses from now we will have to decide what we are going to do with the money. I am sure that you are going to be holding a hearing about that. That could be in 4 or 5 years.

Mr. LEWIS OF KENTUCKY. I want to follow up on Mr. Hulshof's question a little while ago that Mr. Greenstein answered. What is your take on the 1997 Balanced Budget Act, that the specific tax relief that was in that—how much about that had to do, do you think, with creating surpluses or balancing the budget and then creating surpluses?

Dr. HASSETT. I think it is just too difficult to know. There have been so many changes outside of the tax sphere that have been so important. Productivity growth is absolutely flying. That certainly didn't come about exactly because of tax policy.

The thing I like to keep in mind when I am looking at the boom of the 90's and attributing credit is one of the biggest things the government did it didn't step in and mess it up. If we had started regulating the Internet back then and so on, then we might have well messed up the boom. The tax cuts certainly helped, but how much I don't think we can tell for sure.

Mr. LEWIS OF KENTUCKY. Thank you.

Mr. MCCRERY. [Presiding.] Mr. Jefferson, my good colleague from Louisiana, would you like to inquire?

Mr. JEFFERSON. Thank you, Mr. Chairman. I recognize the distinct accent you have, so I looked over to see if Mr. Thomas had adopted it. Thank you, Mr. Chairman.

To the Members of this panel, I share some of the concerns that have been expressed by members on our side; and I want to raise a few of those with you. There have been many bases on which this tax cut has been purportedly justified. The most recent one is it will be stimulative of the economy, and there are some concern about the doldrums to which the economy will be subject in the next—in this year in the short term and that this could help—the tax cut could help.

The trouble I have with it is this: If it is true that a tax cut will stimulate the economy and that therefore the Congress needs to approve one, wouldn't it follow from that that if we are to have a stimulation now that—two things, first, we ought to do a tax cut that has as much weight as we can on the front end of it and that has the effect of stimulating the economy now, as opposed to one where we project the big bang in the tax cut to take place after the fifth year when it will be largely irrelevant to simulating the economy. Second of all, if we believe that the stimulation will come from increased spending, ought we not then do as much as we can on the lower end and the lower to middle ends where people are more likely to spend money if we get money, rather than on the high end where people aren't likely to spend money at all but to save and invest it?

So it is confusing to me the way this is set up. Because the objectives that are purported to be the ones to be realized if a tax cut takes place now in the magnitude of which we are talking doesn't seem to make any sense, first, as I said, because the large part of it, if it is to be stimulus, takes place in the sixth year when only 29 percent of the projections take place in the 5 years and 71 percent takes place in the last 5 years. Therefore, we are not going to have much going on this year so why don't we front-load it and then wait and see if these surpluses take place and then go forward with some more of it.

On the other hand, which I really don't understand, if we do believe that spending is going to be the thing that stimulates it, how in the world do we do that if we don't address the issues of folks who work every day and don't pay income taxes but who pay a lot of payroll taxes and who are more likely to spend more on the economy than folks who are at the top of the income ladder? Could you please comment on that for me, please? Anybody or everybody.

Dr. FELDSTEIN. Well, I would stress that we ought to do—you ought to do income tax reform in terms of the fundamental structure of the tax and not because of its short-run stimulative effect, that you are looking at a long-run change in tax rates that have favorable incentives.

Now, having said that——

Mr. JEFFERSON. When you say long run, when will the favorable incentives show up?

Dr. FELDSTEIN. It will show up immediately. But they are not spending incentives. I am distinguishing the incentives about how people work, how they choose to work, how they choose to save, how they choose to take their compensation, things that will reduce waste in the economy and contribute to economic growth.

But I think it is a fortunate by-product of passing a tax at this time that it will help to reduce the risk of the economy slipping into recession. So I wouldn't advocate a tax cut at this time for that purpose. If you weren't going to have a tax cut for other reasons, if we didn't have these large budget surpluses, I wouldn't come to this Committee and say let's have an old fashioned Keynesian tax cut, pass it today, turn it off a year from now and hope that that helped the situation. But I would say, given that there is general agreement that there is to be a significant tax cut designed to provide better incentives for the economy, then we are lucky that it is coming at a time where we can take advantage of that for general stimulus.

Mr. JEFFERSON. Are you talking just about tax reform, is that it?

Dr. FELDSTEIN. I am talking about tax reform and I am saying that——

Mr. JEFFERSON. Well, that's a different debate than I heard the other day when I was at the White House. The President talked about putting money in people's pockets so they could spend it and pay bills

Dr. FELDSTEIN. Well, you asked me, not the President; and what I say is——

Mr. JEFFERSON. Well, you are here supporting his package. So I just want to know if you are in line.

Dr. FELDSTEIN. I am supporting the package, and I am saying that that package was designed to be a long-run improvement in the tax structure. And it also has the effect that it will make people say my income, my spendable income, over the next 10 years is going to be higher, and one of the things I can do knowing that is take on some more spending today. And so even before the cash flow improves, some households are going to spend more money because they know that Congress—once Congress has done it, they know that Congress has increased their future take-home pay.

I think there is a case that says as long as we are going to do this, moving some of it up closer to the front end in order to get extra bang in spending today would be a good thing.

Mr. GREENSTEIN. I would give a very different answer. I think the supposed benefits, both from an antirecessionary standpoint and from a long-term growth standpoint, have been substantially overdone. From the standpoint of the recessionary issue, the fact of the matter is the Senate is probably not going to be able to take up this legislation until after there has been an approved congressional budget resolution that can use the reconciliation process. That means that by the time any checks actually go out, it is probably going to be sometime this summer.

William McDonough, the President of the New York Federal Reserve, has said their forecasts indicate the economy probably will be recovering by that point.

Now, it is certainly possible that the economy doesn't recover by that point and we go into a prolonged problem, but if we do, that raises some questions about the surplus forecasts we are then using for the next 10 years.

In terms of the long-term growth, while the economic evidence would suggest that lowering rates would have some effect, we shouldn't overstate it. It is a modest effect. It is small. It cumulates over time, but it is not huge, and the tradeoff is that if instead of doing a tax cut of that magnitude we saved more of it, then we would have a larger pool of national savings. A substantial part of this tax cut will go right into consumption, not into saving, and economists generally view increased saving as promoting long-term growth.

So the tax cut has both a plus and a minus in terms of long-term growth from that standpoint, and the net effect isn't clear. I think the economic benefits are being substantially overstated.

Mr. JEFFERSON. Let me ask, would you agree that if there is to be some benefit from increased consumption or increased spending, that it is more likely to take place among groups who are at the lower to middle lower income levels than folks who are at the very top of things?

Mr. GREENSTEIN. Well, the tax cut as a whole is oriented far more toward the top. I do think—I would agree with something Mr. Hassett said earlier, that if you are going to accelerate parts of the tax cut for an antirecessionary effect then I still think you are unlikely to be able to accelerate them soon enough to have much impact, but were you able to do that it would make a lot more sense to accelerate parts that are oriented more toward moderate and middle income workers like the 15 to 10 percent bracket than parts that are primarily oriented toward people at higher income levels.

Dr. HASSETT. I think that you have raised an absolutely crucial point, and I am surprised that you said that you were confused by all this because I think you went right to the key question.

I would just disagree with Mr. Greenstein that the stimulus effects are exaggerated. There is a very, very big literature, some of it cited in my testimony which I have handed in, that explores the stimulative effects of fiscal policy, of surpluses and tax cuts and so on, and finds significant short run and long run effects.

I think that having the very, very tight fiscal stance that we do right now is a pretty risky position to be in and it argues for pulling things forward, especially at the low end of the Bush plan.

Chairman THOMAS. [Presiding.] Thank you.

Mr. JEFFERSON. I am out of time, Mr. Chairman?

Chairman THOMAS. Yeah.

Mr. JEFFERSON. Yes, sir. I wanted to ask—well, I am out of time but the folks in my State, if I might say this little teeny-weeny bit, in my State 35 percent of the people in my State cannot benefit from the plan because they don't pay income taxes. It is not because they don't work. They pay payroll taxes. In my State where folks are basically working on farms and working in hotels and motels and working in a restaurant, they are out making $14,000, $15,000 a year. They are not ever going to pay income tax. Therefore, they could never benefit from this, and I admit we ought to pay some attention, it seems to me, to those folks who are working every day and paying payroll taxes as a way to help this whole issue of consumption and spending if it is to be stimulating or any other thing we can do. That's the part I wanted to have you hear about but I didn't kind of get from you.

Mr. GREENSTEIN. I would agree with you on that.

Chairman THOMAS. The gentleman's time has expired, and as we have indicated, this is on income taxes. We are obviously going to be looking at payroll taxes, and we will be looking at some solutions in part to deal with that issue as we move forward.

This Committee has an enormous agenda in front of it and it would be nice to put everything on the table the very first day we have the Secretary of the Treasury in front of us, but we have got to apply some order to what we are doing.

The President has looked at income taxes first. He has a Social Security plan, a Medicare plan, and we will be looking at those.

Does the gentlewoman from Florida wish to inquire, Mrs. Thurman?

Mrs. THURMAN. I do, Mr. Chairman, and thank you.

I want to make one comment very quickly because I think that this really is a core issue for all of us, and that is what Mr. Greenstein actually responded to Mr. Hulshof and the idea of what happened in 1997.

I think all of us recognize that there needs to be a budget reconciliation so that we can see how every piece fits and not just go off on this, well, we could do this today, we can do this tomorrow, we can go over here, there, and then all of a sudden at the end of the day we are looking at either more spending, more tax breaks and we are really looking at some issues that could be a big concern for this Congress and what happens in our future.

So, first of all, you are shaking your heads so you all agree that we should do a budget reconciliation first. Is that what I am seeing?

Mr. GREENSTEIN. You should definitely do a budget resolution. The tax cut is part of the larger question of national priorities. You have got to look at how much money do you have, how much for the uninsured, how much for the drug benefit, how much for the tax cut. If you go forward with one before you deal with the others, you may not have enough money and you could go over the top and bring back deficits.

Dr. FELDSTEIN. The key thing is not to let this drag on forever. So, yes, do it quickly and do it within a context in which you have got all the pieces laid out.

Dr. HASSETT. And I would just add that it is important to make sure that everything fits, and exactly how you progress legislatively is not something that an economist should advise you on, I think.

Mrs. THURMAN. OK, in keeping with the spirit of the chairman earlier this morning when he said, well, we should stop talking about CBO, AMT, OMB, which actually we haven't heard today.

One of the things that I keep hearing over throughout this is there is going to be about a $1,600 average tax cut. Now, in the spirit of Mr. Jefferson's comments and the amount of people in his State that actually will pay no income tax, I think if we listen to what is being said, the other part of this is that only if you have a tax liability will you be a participant in this stimulus program. Correct?

Dr. FELDSTEIN. It is an income tax cut, so if you don't pay income taxes you don't get a tax cut.

Mrs. THURMAN. OK.

Mr. GREENSTEIN. But 85 percent of all households would get less than $1,600. That includes both people who owe less than $1,600 in income tax but it also includes a lot of people who owe more than $1,600 in income tax but don't have two children, and a lot of those would get less than $1,600.

So we need to be—when it is carefully said, it is the family of four at $50,000 that does get $1,600. But it is not correct——

Mrs. THURMAN. Say that again. Say that again.

Mr. GREENSTEIN. A family of four at $50,000 does get $1,600, but some people have been acting as though the average filer gets $1,600. That isn't correct. Eighty-five percent of the units would get less than $1,600.

Mrs. THURMAN. And I—go ahead, Dr. Hassett.

Dr. HASSETT. I will be very quickly. I don't want to eat your time up, but I would add that the "don't participate" phrase that you use I think could be conceived as an oversimplification because, for example, if we have a recession then the 3 million or so people that will lose their jobs, because that's what happens typically in a recession, will not be at the top of the income distribution and may well come disproportionately from folks who don't pay taxes right now, any income tax.

Mrs. THURMAN. But I believe even in your testimony, though, you talked about the fact that—which I found very slow if you are talking about trying to move in to be even a part of this tax—that about 10 percent over the next 10 years would actually move into the next bracket, 10 percent of the entire population. So there is not a lot of people moving up very quickly that actually would get a benefit from this.

One of the concerns I have, and this was even from the testimony this morning, and I will—in talking about the child tax credit, this is the impression, if I were a parent sitting home today listening to this dialog that we are having, I would be like Dr. Feldstein, going, oh, yes, I have a new behavior in spending because all of a sudden I am going to get $1,000 for each child, and it doesn't matter whether I make $22,000 or whether I make $100,000. That is my point.

Please let's not—I don't want to have to go home and face angry people in our districts that feel like they are getting something today and tomorrow it is not there. And I am very concerned that we are setting all of ourselves up for a real problem when we get home, and I think I would like you all to talk about that.

Then I want to also ask, how do you stimulate an economy with an estate tax that hits 48,000 people with about 60, whatever that amount is, over a period of a year's time, when you are actually bringing those monies to one group of people? I don't know how that stimulates, because those people aren't going to spend that money.

Mr. GREENSTEIN. Could I quickly note on the child credit, I think this ties together, Congresswoman, a number of your points, and Congressman Jefferson's as well. Today the child credit goes to families, let's say married families between like the low twenties and $130,000 a year. There are millions of families that pay payroll tax and not income tax that don't get the child credit, and there are families with kids above $130,000 that don't get the child credit. And the question is, if you are going to extend it to an additional group of families who should come first?

I respectfully disagree with the administration's choice. The administration is extending the child credit to families between $130,000 and $300,000 a year. It is giving the largest increases in the credit to families between $110,000 and $250,000 and it is leaving out the family of $20,000. I would rather extend the child credit to that family first. It can be done by making the child credit refundable against payroll taxes or something of that sort, and those people also will spend it.

So, I mean, that is kind of an example of, you know, we could improve the distribution and still do a child credit expansion. Lord knows, the people with $250,000 and $300,000 are going to get a lot from other elements of this tax cut. They don't need the child credit expansion. The families at $15,000 and $20,000 do need the child credit expansion.

Dr. HASSETT. Mrs. Thurman, I believe that you may have been referring to something else, the fact that the Bush plan is phased in and that we are saying that they are going to have a thousand dollar child credit but it is only going to be $600 in the first year and then it goes up $100, but I would say that you are correct that if we look at the end points and then tell people that is what your tax cut is, you are going to have your rate go from 15 to 10 and so on, and that we don't let them know about the phase-ins in the Bush plan, then that could be a political problem. But I think that it argues, and the stimulus arguments also move in this direction, for pulling things forward and starting sooner.

Mrs. THURMAN. OK. Thank you.

Chairman THOMAS. Thank you. The gentlewoman's time has expired.

The Chair is constrained at this point to point out that it is possible to have Mr. Jefferson's constituents or anyone else's at that level be subject to an income tax rebate. If we pulled down the income tax rate level to where it was historically, all of those people would now be paying income taxes. One of the reasons they aren't is because we raised that level. No one wants to lower it. But let's be mindful of the fact that we have recently raised it and therefore they are only subject to the payroll taxes, which we will be adjusting.

The Chair is also constrained to say I find it remarkable that any comments are now being made about the phasing in of the President's tax program when less than 6 months ago I was hearing from my friends on the other side of the aisle about the President's prescription drug proposal, which didn't phase in until 8 years, and that every comment that was made was made on the entire package as though it was available on day one.

I am pleased to say that if we can create some balance of understanding that any program cannot be made completely enacted on any given moment, but at least at some point we ought to remember what we did in less than 6 months ago in terms of discussions and not hold other people responsible for the very same things that we did.

Does the gentleman from Texas, Mr. Brady, wish to inquire?

Mr. BRADY. Thank you, Mr. Chairman. I am please that you took my comments and stated them much more succinctly than I would have.

Following Mr. Hulshof's comments, let me make two brief points and ask for your comments from the panel. The first point is that the American people are smarter than many in Washington give them credit for. First, they know the best way to pay down the debt, our public debt, is to keep our economy strong, and that is what this tax relief plan does.

They know also that Washington shouldn't be picking winners and losers when it comes to tax relief. They understand income tax relief should be shared by those who contributed to the income tax surplus. And contrary to Senator Daschle's comments, and I respect him greatly, but most families I know don't worry about and are not concerned about someone else who can buy a new Lexus. They worry about paying the note on their own Ford, on their own truck, or on their own van. While $1,600 doesn't seem like a lot up here, it is real money to a lot of real families and we ought to keep that in mind.

The American people also know that this bill isn't just about numbers; it is about fairness. They know it is unfair to tax people more simply because they are married. They know it is unfair to tax someone's nest egg, and we are finding more and more minority and women-owned businesses, people who are building wealth for the first time in their family who are now faced with the challenge of trying to pass that wealth and all their hard work down to their children and grandchildren who are now caught up in that, and that they have found that the death tax, which has ruined lives for four generations, is patently unfair.

Finally, American families know that it is not right to pay more than $5,000 over the next decade to Washington, money that Washington doesn't truly need to run its business. And while we all have different roles of what our American government should do, at the very least the American government should be fair and that is what this bill is greatly about, making our Tax Code more fair.

The second point addresses the myth that cutting taxes is the easiest vote to cast. It is just the opposite. The fact is, having served on a city council and the State legislature and now in Congress, the easiest vote to cast is to spend more money.

Now, government behavior is such that if you can't spend more money you borrow money so you can spend more. If you spend every dime and borrow it, you then find budget gimmicks to allow you to spend more and then only, and only if you can't do any of the above, will you then try to live within your means and once in a great while you will deny yourself extra money in order that you are not able to spend more.

Make no mistake, that is one of the reasons there are hundreds of votes cast to raise spending around here and very few to ever deny yourself the money to spend more.

So I think a big part of the Bush plan is to pay down the debt by strengthening the economy; restore a measure of fairness; and in the future to provide some responsibility to Washington to deny us in the future additional spending; force us to prioritize and to do more with the dollars that we have.

And I would open it to the panel for comment. Doctor.

Dr. FELDSTEIN. I thought that was very eloquent. I don't think there is anything I would want to add that I haven't already said in my opening remarks or in answer to other comments.

Mr. BRADY. Mr. Greenstein.

Mr. GREENSTEIN. I would respectfully disagree, Congressman. In my view, what the Tax Code—what the tax cut is not is fair. When Senator Daschle did that little skit last week, I think what he was talking about was some of the waitress-type families that have been talked about a lot don't get $1,600; they get nothing or they get $100 or $150.

There has been talk about families getting 100 percent of their income tax eliminated. A family of four who makes $26,000 pays about $2,700 in payroll taxes and $20 in income taxes and gets a $20 tax cut, but that is less than 1 percent of its total tax bill.

When you look at the tax cut as a whole, about 4 percent of it goes to the bottom 40 percent of the population. About 13 percent of it goes to the bottom 60 percent of the population.

Mr. BRADY. Mr. Greenstein, I appreciate the focus on numbers but if you look at real people that family of four that saves $1,600, that is real money for them these days; and for the 3 million Americans who could lose their job in a recession that is real income to those folks. And while it is good to stand here and debate the numbers, and statistically we can prove you can hang an elephant from a cliff by a thread, but the fact of the matter is for a lot of working Americans with this economy that we are facing and the high cost of living this tax relief is very real to a person to them.

Mr. GREENSTEIN. And I am for giving those families tax cuts, but the typical filer doesn't have—isn't a married family with two kids, and the typical filer exactly in the middle of the income scale would get an average tax cut of about $450. The typical person in the top 1 percent would get $25,000 just from the income tax. If you average in the estate tax, it is $39,000. I think it is too tilted and too expensive.

We could do as much for people in the middle. We could do more for the working families that pay payroll but not income tax at a lower cost if we didn't have so much at the top.

Mr. BRADY. So you don't believe income tax relief should go to those who pay income taxes?

Mr. GREENSTEIN. As I stated earlier, one of my concerns here is that the top 1 percent pays 20 percent of total Federal taxes and would get 36 percent of the tax cut.

Mr. BRADY. I don't mean to press you, but do you believe income tax relief should go to those who pay income tax?

Mr. GREENSTEIN. Income tax relief obviously can only go to those who pay income tax, but in providing that income tax relief one can make some of these tax credits refundable for families that also pay the payroll tax and provide that relief through the income Tax Code. And I think one can reform without eliminating the estate tax and make the tax cut substantially smaller as a result.

Mr. BRADY. I will take that as a yes. Dr. Hassett.

Dr. HASSETT. Mr. Brady, I applaud your remarks and would like to add that there are two reasons why economists generally don't stop at the level of analysis that Mr. Greenstein is presenting.

The first is that it is not allowing for any economic impact, as you said, the 3 million people that you referred to. And the second, more importantly, is that if you bunch Social Security into the tax side when you are doing an incidents analysis like this, then basically you are assuming that the Social Security money that folks are putting in is not going to come back to them at some point. Most of us believe that the objective of the system is to give people back money when they retire. And so if you put a dollar into your Social Security fund now, then you will get something higher than that hopefully in the future.

So thinking of that conceptually as a tax that should be bunched together with the taxes that we pay that pay for our defense and something, I think it is a stretch.

Mr. BRADY. Thank you, Doctor.

Thank you, Mr. Chairman.

Chairman THOMAS. I thank the gentleman. Does the gentleman from Texas, Mr. Doggett, wish to inquire?

Mr. DOGGETT. Thank you so much, Mr. Chairman. Dr. Feldstein and Dr. Hassett, at this late hour, in order to ask both of you several questions, I will respectfully ask you to give me one of three answers: I agree; I disagree; or I need to explain, and then if time permits I will ask you for your fuller explanation.

The first thing I would like to inquire about is whether you agree with Treasury Secretary O'Neill's testimony this morning that if any part of the President's tax cut proposal is made retroactive that we must either reduce or eliminate some other portion of the President's tax cut proposal so as to hold the overall costs to what he calls the "Goldilocks," just right level of $1.6 trillion. Dr. Feldstein?

Dr. FELDSTEIN. I think we could have a larger tax cut than that.

Mr. DOGGETT. Excuse me, but do you agree or disagree or do you want to explain some more?

Dr. FELDSTEIN. I want to explain some more.

Mr. DOGGETT. OK. Dr. Hassett?

Dr. HASSETT. Yeah, I would need to explain a little bit, too. I am sorry.

Mr. DOGGETT. All right.

Chairman THOMAS. Doesn't Greenstein get to play?

[Laughter.]

Mr. DOGGETT. If you will give me another 5 minutes, I would love to have that opportunity.

Chairman THOMAS. You will get the same time everybody else does.

Mr. DOGGETT. Do you agree with Treasury Secretary O'Neill's indication that while the President's tax cut may offer little help in stimulating the economy, "it won't hurt," and that the likely economic effects should be compared with the many American men who each morning add a pair of suspenders to their belt to be safe in case their belt fails and their pants fall off? Do you agree with that?

Dr. FELDSTEIN. I would need more time to answer that.

Mr. DOGGETT. Dr. Hassett?

Dr. HASSETT. I guess you have cornered us with I need to explain.

Mr. DOGGETT. All right. Well, let me give you an easier one. Do you agree with Treasury Secretary O'Neill's testimony this morning that the huge deficits of the Reagan era, "put ourselves in a ditch that was horrendous"? Dr. Feldstein?

Dr. FELDSTEIN. Yes.

Mr. DOGGETT. You do agree with that?

Dr. FELDSTEIN. Yes, at the time.

Mr. DOGGETT. Dr. Hassett.

Dr. HASSETT. Well, I would just probably have to explain every one of them.

Mr. DOGGETT. You would have to explain that one?

Dr. HASSETT. Yes.

Mr. DOGGETT. All right. Let me ask you next, do you agree with Treasury Secretary O'Neill that the record of fiscal discipline and economic stability of the previous administration was, in Secretary O'Neill's words, wonderful? Dr. Feldstein?

Dr. FELDSTEIN. No.

Mr. DOGGETT. You don't agree with him?

Dr. Hassett, do you agree with Secretary O'Neill?

Dr. HASSETT. Yes.

Mr. DOGGETT. Thank you. Let me ask you then whether you agree with Dr. Greenspan, that, "it is important that any long-term tax plan include provisions that would limit surplus-reducing actions if specified targets for the budget surplus and Federal debt were not satisfied"? Do you agree with Dr. Greenspan on that?

Dr. FELDSTEIN. If that means a formal rule, no, I do not agree.

Mr. DOGGETT. Dr. Hassett?

Dr. HASSETT. I disagree as well.

Mr. DOGGETT. One of the principal architects of the wonderful economic record of the previous administration was former Treasury Secretary Bob Rubin, who has condemned President Bush's proposed tax cut as threatening our economy and who wrote in the New York Times yesterday, or Sunday, I believe, that there is broad agreement amongst virtually all mainstream economists that a tax cut this year is unlikely to provide meaningful economic stimulus and that if a tax cut is desired for short-term stimulative purposes the vast preponderance of one proposed by the President is largely irrelevant. Do you agree with Secretary Rubin on those points, Dr. Feldstein?

Dr. FELDSTEIN. No.

Mr. DOGGETT. Do you, Dr. Hassett?

Dr. HASSETT. I will explain quickly. If the President pulls it forward—if we pull the President's plan forward, then I disagree. But the President's plan as proposed doesn't have something happening now, and so therefore the statement is true.

Mr. DOGGETT. Since my red light is not on, Dr. Feldstein, let me go back to my first question and ask you if you would like to explain your disagreement, if there is some, with Secretary O'Neill on limiting this overall tax package to $1.6 trillion, the "Goldilocks" Locks level.

Dr. FELDSTEIN. From a political point of view, I can see the reason to put down a number and say that is it, neither more nor less. From an economic point of view, and that is the context in which you asked me, from an economic point of view, since I think that the actual cost of that is substantially less than $1.6 trillion, I think that one could have a more—one could go beyond the President's specific proposal.

Mr. DOGGETT. Do you feel that without jeopardizing our obligations under Social Security and Medicare and to provide educational opportunities for our children and our other needs here, that we can afford a $3 trillion tax cut?

Dr. FELDSTEIN. I do not.

Mr. DOGGETT. Over 10 years?

Dr. FELDSTEIN. No, I do not think we can have a $3 trillion tax cut.

Dr. HASSETT. No.

Mr. DOGGETT. What do you think the limit is?

Dr. HASSETT. I can't answer that question.

Mr. DOGGETT. What do you think it is, Dr. Feldstein?

Dr. FELDSTEIN. I don't have a number but I think that in terms of the static way that these numbers are estimated, we could have substantially more than $1.6 trillion within the budget window that is available, but I don't want to put a number on it.

Mr. DOGGETT. You can't tell us how high we can go?

Dr. FELDSTEIN. It depends on what you get for it. It depends on the form of the tax cut because that affects the behavioral response and therefore the net cost.

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

Chairman THOMAS. I thank the gentleman. Does the gentleman from Wisconsin, Mr. Ryan, wish to inquire?

Mr. RYAN. Thank you. Mr. Chairman, I guess I will just borrow on the Goldie Locks analogy and just say that I like my porridge pretty hot.

I am one of those who believe that this current tax proposal is relatively modest.

I noticed some of my colleagues here discussing this tax proposal have been surprised at some of the estimates. I notice, Dr. Feldstein, I think you said—you estimate it to be about $1.2 trillion. The WEFA model, which is a Wharton model that Heritage uses, says it is $939 billion. I think the Institute for Policy Innovation, former treasury analysts, I think their model says it is about $1.1 trillion.

So the point is we are using static analysis. We agreed to that, but realistic, reality-based scoring shows that there is positive economic behavior that is induced from this tax cut and that it actually probably won't end up costing what we are measuring that. So I think that is just an important perspective.

I also think it is important to take a look at this tax cut in the whole scheme of things. The Federal government is going to take, give or take a little bit, about $30 trillion in revenues over the next 10 years. We are talking about returning 6 cents on the dollar back to taxpayers, $1.6 trillion out of $30 trillion.

It is important to put this in perspective. Ronald Reagan came in in 1981 in the beginning of a recession, pushed an economic stimulus plan, a tax rate cut which actually grew revenues. It is only the problem that expenditure growth exceeded that of revenue growth at that time, and I think that is an important point to make for the record. But the point is, this tax cut is less than half the size of the Reagan tax cut of that year, relatively speaking. It is smaller than the Kennedy tax cut relatively speaking, when you take a look at the size of the economy versus what we are doing now.

What I would like to ask is, in my part of the world that I represent, southern Wisconsin, we have lost over 5,000 jobs just in the last year. You know, just between Motorola and Chrysler, we have lost about 2,500 jobs just in southern Wisconsin. People, I believe, in the Midwest are at the front end of this downturn. Our household demand for energy is up 17 percent. We have had a pretty tough winter this year. Our price of natural gas to heat our homes is up over 300 percent.

I was just speaking to a small business man yesterday, in Elkhorn, Wisconsin, who does heat treating of metal parts. To fund—the money he takes to fuel his furnaces has been running about $20,000 to $15,000 a month. His energy bill just went from $20,000 a month to $65,000 a month on a very small business, with just a handful of employees. He is a subchapter S corporation, as are most of the employers in the area I represent.

This income tax rate cut is almost like expensing. It is helping them pay for the cost of these high energy prices. This income tax cut helps people by giving them more money in their paychecks now.

So what I would like to ask you, taking a look at the economic feedback, taking a look at the benefit we see to the economy, by bringing people's withholdings down, by helping small businesses keep more of the money they produce to reinvest in their businesses or just absorb some of these energy cost spikes that we in our area see, what do you think will occur in the beginning of this?

The other question I have is, you know, I have a concern which may be viewed as critical of this tax package, that slowing the phase-in of rate cuts can actually be somewhat harmful, can build a hesitancy in the marketplace. You can have sort of a staggering effect. I believe hopefully this will become retroactive to January 1. It would be preferable to speed in the rate cuts faster, and I think that we could do that within the confines of static analysis.

Do you have a concern that the phase-in of these rate cuts might induce some kind of adverse economic behavior, number one? Number two, are the rate cuts going to produce economic growth? Do you believe that the rate cuts will help stimulate the economy? Will the rate cuts help induce a buttressing of consumer demand and confidence?

Dr. FELDSTEIN. Yes, I think they will. I testified to that in my opening statement. I think that the sooner people begin to sense that this is for real, the more they will believe the outyear cuts, and it is the outyear cuts that are the big part of this, and it is that which are going to make people who are not cash constrained in every payment they make, is going to make them say I can afford to buy that new car or I can afford to buy that consumer durable, and that that will contribute to spending in the current year.

Mr. RYAN. And the phasing in, do you think that the phasing in——

Dr. FELDSTEIN. So I think that if you phase it in more rapidly, if you phase it in more rapidly, you can get that stimulative effect; not just from the people who get some cash in their pockets sooner but from everybody who says aha, this is a real tax cut. They have passed it. It is going to start now. I can be more confident about it than if it were something that was over the horizon.

Dr. HASSETT. I think, Mr. Ryan, that what matters in the long run is how much money are folks going to be taking home in their paycheck. And so if they see a rate reduction coming in the future then they might well respond to that now.

But you raise a genuine concern. I have heard some talk that there was quite a bit of action at the end of last year, that in December people took their vacations in December and moved the income into January because they felt there was a good chance they would get a tax cut this year, and I would expect that as we march down with rates that we will see some of that action again.

Mr. RYAN. Dr. Greenstein.

Mr. GREENSTEIN. If I could just comment on it. As I have said before, I think the economic benefits are being overstated. The economy has slowed right now. I don't see how, particularly given the pace of the Senate, the checks are going to go out much before next summer. The CBO forecast you are operating on shows that by 2002 we have a full scale recovery from the recession.

I think we do have a problem right now, and our best mechanism right now is interest rates. I hope the Federal Reserve lowers them further. I think that is going to have a much bigger effect than anything you do on taxes because I don't think—it is not that tax policy can't have a stimulative effect. It is very unlikely even this year to occur in time to make much difference.

Dr. HASSETT. I would just like to add, Mr. Ryan, that the economists who studied this were quite surprised to find that fiscal policy in recessions was reasonably effective. It is just that folks tried a first punch that was too light and that generally we didn't get big measures until well into the recession. So the reason that in the past fiscal policy hasn't pushed us out of recession is that we delayed.

So I think that Mr. Greenstein agrees, and he is saying it is not likely that we would pass it soon but I would argue this is why we should.

Mr. RYAN. That is precisely my point. That is why I like my porridge hot. I think we ought to have this income tax cut fast, deeper, retroactive to January 1st, to make sure we get a good punch into the economy, juice the economy to make sure that we can avoid a hard landing.

The concern I have around here is that everybody is talking about let's wait and see, let's see if they materialize. Well, $1.5 trillion have already materialized in the surplus since then-Governor Bush proposed this tax cut in the first place. The economy has soured. The growth of the projections of the surpluses are higher. So we have waited and we do see, and it is my concern that if we keep waiting and seeing we won't give the economy the boost it needs right now.

The other thing is whether people are going to buy Lexuses; it is my hope that they buy Tahoes and Yukons and Dodge Intrepids and Cherokees because 7,000 jobs in southern Wisconsin are tied exactly to those models.

So if this tax——

Chairman THOMAS. And with that?

Mr. RYAN. And with that, I yield back the balance of my time.

Chairman THOMAS. I thank the gentleman.

Does the gentleman from North Dakota, Mr. Pomeroy, wish to inquire?

Mr. POMEROY. Mr. Chairman, I do wish to inquire. This is the first time I have had a chance to inquire as a Member of your Committee, and although I am the last to present no one has been happier to be here than me.

Chairman THOMAS. I tell the gentlemen you are on the train, and that is what counts.

Mr. POMEROY. Okay. Thank you.

I hope the gentleman from Wisconsin, my friend from Wisconsin, also has some muffler manufacturers in his district, because that is where really the dollars that we are talking about for more Americans would fall under this.

Let us deal with the stimulative question for a second. I thought that Dr. Hassett made a very interesting point earlier in your testimony when you indicated if you put a dollar in the pocket of the broad middle class you are going to get more of a stimulative effect than adjusting the rates at the very top end.

Dr. HASSETT. In the short run.

Mr. POMEROY. In the near term. So to the extent we talk about it as stimulus to ward off this recession, give us a soft landing, we ought to really contemplate whether or not we are doing enough at the marginal rates at the low end.

Much has been talked about about the 15 to 10 percent rate cut. I don't think nearly as much thought has been given to actually the ranges of income that fall within that reduced rate. Only the first $6,000 of an individual taxpayer's income would come from the 15 to the 10; for a married couple, only the first $12,000.

Now, that range for the couple that will get a $12,000 income tax reduction, they are going to be paying income tax at the 15 percent rate all the way up to roughly $47,000. Maybe it would make sense, given what you say about getting more to the broad middle so they can stimulate the economy, we ought to expand the ranges of that lower end marginal rate cut if we are going to deal with this package. That might be some tweaking that this Committee would be well advised for purposes of stimulus effect. Your response, Doctor?

Dr. HASSETT. The Committee certainly has the ability to move into that range. I would argue that within—even within the parameters supplied by the President, that there is a golden opportunity to take the bottom bracket move, 15 to 10, which phases in over some time and starts in 2002, and just lump it in as quickly as possible. It seems to me that as a handicapper at least that that would be something that one ought to be able to acquire a lot of support for.

Now, it doesn't mean you don't move the marginal rates as well, but if you want stimulus then that is the area to target.

Mr. POMEROY. More at the lower end, more stimulative effect?

Dr. HASSETT. Because folks consume more of the dollars that you give them and that is where you get it, at the bottom, in the short term.

Mr. POMEROY. Exactly right. I think that is a very important point.

Mr. GREENSTEIN. Of course, lowering the—establishment of the new 10 percent bracket affects everybody all the way up through the top of the income scale. So if your only test were short-term stimulus and you were even thinking that maybe you would do a temporary piece now and then have other permanent changes in the Tax Code, 15 to 10 percent would not be the one that would have the most stimulative effect.

The larger stimulative effect would come from, for the same amount of money as that let's say, something where you had some kind of—what many Governors, both Republican and Democrat, have done with State budget surpluses, you have a flat dollar amount for all married families, half of that for single filers, in between for heads of households, you put it out as like a surplus dividend and you provide it to families also that owe significant payroll tax that don't pay income tax. It wouldn't have to be a permanent change in the Code, but that would actually, for the same amount of money, have more stimulative effect; would put a larger proportion of the dollars in the low and middle income ranges.

Mr. POMEROY. I am going to be short on time. I would love to have you comment on this because you and I have——

Dr. FELDSTEIN. I would say don't design the tax reform for stimulative purposes. Design the tax reform for long-term purposes. You might change the timing of the phase-in and the form of the phase-in with stimulus in mind, but basically go for a structure of tax rates that gives you the incentive effects that you want long term.

Mr. POMEROY. And is that because it is your belief that the stimulative effect is somewhat nominal of a tax cut, in the near time?

Dr. FELDSTEIN. The stimulative effect, I think, is a favorable by-product of making these long-term changes, and a lot of the effect is not just in the cash flow. We keep coming back to saying, well, if the lower income family gets a little more to spend that will help.

The middle, the upper middle income family, that for all the reasons we have talked about is going to get the bulk of whatever tax cut there is because they pay the bulk of the taxes, if you tell them now that they are going to start getting that and that they are going to get that for the indefinite future, that is going to affect their spending plans even now.

Mr. POMEROY. I find that quite implausible, Doctor, that I am a—that my wife and I will say, by golly, as we read the paper, Congress has acted, this is going to phase in in 2007 and, honey, I think we can go ahead and make that car payment now. I think that that just really stretches credibility beyond the point of belief.

I have one final point. I know my time is about at an end. The notion that we are going to take these surpluses and pay off the debt and then we are going to buy a big chunk of the private economy and this just isn't right, I mean I honestly think that at this—that that concern is less than timely. It reminds me of me beginning a diet, an overdue diet, and worrying—laying awake at night worrying about the effects of emaciation and malnutrition. You know, it is a long way before we get $3.4 trillion worth of debt retired, and Dr. Walker, David Walker, the head of GAO, testified last week in the Senate—

Chairman THOMAS. General Accounting Office.

Mr. POMEROY. Thank you, General Accounting Office—testified that without any tax cut, in light of the fact that our entitlement programs, Social Security and Medicare slip into deficit positions after the next decade, into the teens, that we are going to be in deficit in a unified budget position by 2019 without any tax cut. So I don't see how in the world we get 20 percent of the—that we have a surplus problem when we have got this looming entitlement deficit.

Dr. HASSETT. Can I respond quickly, Mr. Pomeroy?

Mr. POMEROY. Yes.

Dr. HASSETT. I would say quickly that the second part of your question argues in some sense against the first part because the reason why we need to acknowledge the acquisition by the government of private assets, if we don't change policy today, is that one of the arguments against the tax cut that we see is that, no, we should buildup assets in preparation for the deficits that will come, whence Social Security.

Mr. POMEROY. Actually, at this stage, Doctor, we are talking about paying off debt as opposed to building up assets.

Dr. HASSETT. The point is that the debt under the baseline will be paid off relatively quickly and so therefore if you want to hoard assets in order to pay off our Social Security liabilities then you have to simultaneously, unless we address Social Security reform, say that it is okay to have the government own a large share of the private economy.

Chairman THOMAS. The gentleman's time, unfortunately if he thought he was going to be the last person and he could then stretch it a little bit, the gentleman needs to know that the gentlewoman from Washington, who hasn't asked this panel a question, would very much like to inquire.

Mr. POMEROY. Thank you, Mr. Chairman, for that very helpful orientation admonition, and I will cease at this time. Thank you very much.

Ms. DUNN. Thank you very much, Mr. Chairman.

It is a pleasure, gentlemen, to be listening to all of you. You have different points of view but I think your contrast makes things clearer to us.

I think it is important to keep in mind two important points of the Bush tax plan. One is that it takes 6 million people off the tax rolls. That is very important. He has aimed some of his provisions at the lower income folks, and he has a sensitivity there, and I think that is very important to allow people to move out of poverty into what they hope will eventually be the middle income groups.

Also, I want to just point out that a single woman on her own, with two children, will not pay income taxes under this plan until she earns $31,000 a year. That is a very important point because there are a lot of single women out there with little kids and they need to know how they will benefit from this tax plan.

I want to speak specifically and get your opinion on the death tax. In 1997, we tried to write a provision, tried with the best of intentions, that would allow folks with incomes, I think it is $1.3 million, to apply, folks who owned family-held businesses, to apply for an exemption. What we learned very quickly was that it is almost impossible to reflect the complicated, real life relationships in legislative policy. So you had very few people applying for that exemption. Maybe between 1 and 3 percent of family-held businesses could even qualify and of those folks the IRS questioned two-thirds of them. So where we have tried before, we have generally failed in providing for relief from the death tax.

I have got to think—and Dr. Hassett and Dr. Feldstein, thank you very much, I know Dr. Greenstein's opinion but Drs. Feldstein and Hassett, I would like to know your thoughts on the kind of economic infusion the death tax could create in our economy.

I will simply tell you that as we drop a death tax bill this week with over 200 people on board, we provide for that exemption of $1.3 million a person immediately without having to qualify for it. I think that is a stimulating injection, that growth policy. And we also provide for a 5 percent rate reduction over 10 years.

In my conversations and the conversations I have had with my colleague John Tanner, who supports this bill and is my cosponsor, we have spoken to women business groups who say that the cost of compliance alone is killing to them, and other people who have to pay death taxes, they are buying life insurance policies to buy liquidity for themselves at the end of their life, especially if it ends unexpectedly, and they are paying for estate planning.

They believe, under a National Association of Women Business Owners' survey last year, that it cost them about $1,000 a month for small, women-owned businesses to comply with the death tax. Those are dollars that should be going in to cover health insurance, or for whatever those folks want to purchase with their own dollars.

The Black Chamber of Commerce that is on board believes it takes three generations to build a business, provides a legacy for them, the death tax is their enemy. The same thing with the Indian Business Associations, the Hispanic Chamber of Commerce. Conservation groups support death tax repeal because they see farmers having to sell property that has been in that family maybe for generations, families that don't feel like they are wealthy people; they live like normal people do but they are land rich. These are the developments that are created on the outskirts of farm areas, and conservationists don't like that so we have got lots of them on board.

I want to say that I think this death tax affects a lot more people, Dr. Greenstein, than you mentioned with the 2 percent of the top end of the economy because you never do count in those compliance costs that somebody has to pay during their lifetime.

I would like to hear from Drs. Hassett and Feldstein their thoughts on death tax and why it is—the repeal of it and why it is part of the Bush tax plan.

Dr. HASSETT. Thank you, Ms. Dunn.

The death tax is really the third tax that people have to pay on their money. They pay tax when they earn it at work, they pay tax as it grows on their capital income, and then when they die they pay another tax as well. If you add together all the taxes, it is a very high number, depending again where your marginal rate is and so on, and economists generally believe that really high tax rates discourage activity.

In this case, one would say that many people perhaps don't even start businesses because they look at the whole constellation of taxes that they are going to have to pay if they succeed and decide that it is not worth the effort.

But the death tax has been around for a long time and the variation in it isn't such that we can look at it and pinpoint what response we will get if we remove it. Certainly, the hardships that it imposes are significant but the stimulative effects of its repeal are not something that I can quantify.

Dr. FELDSTEIN. I think Kevin Hassett has given a very good answer to the question. Unlike the income tax, where we have a lot of experience of rates coming down and rates going up and we can actually see what impact that has had. We can't do that in the same way with the estate tax. But I think the various things that you said sound right to me.

It is clear this is a tax that collects very little revenue relative to our total revenue system and yet is responsible for an enormous amount of legal activity on the part of potential taxpayers and tax planners trying to figure out how to pay little or no estate tax.

I would say one other thing, and that is about the revenue effect of this. We are back to my old friend static versus dynamic. One of the things that the estate tax does is it encourages people to set up foundations, to make charitable contributions. Some of those are to fine and worthy institutions and some of those are to perhaps less fine and worthy institutions, but the main thing is that once they make that gift, the income that is generated from those assets is outside the tax system.

Once you set up a foundation and you put $100,000 or a million dollars in that foundation, the income that comes every year from that is tax free. So the Treasury loses, the government loses all the taxes on the interest and dividends and capital gains that would otherwise be subject to tax.

When an individual passes that money to another person, then it stays in the tax system. But once it goes into a foundation, although it may do fine work, it costs the Treasury money in perpetuity. I think that is something that you ought to think about when you think about whether this costs anything.

We don't have very good estimates of that but it isn't hard to imagine that the up-front revenue loss, because of the eliminating of the estate tax, is balanced by the present value of all of the future interest and dividend tax payments that would otherwise be there and that under current rules are induced to shift money away; because, people say, it is a 55 percent marginal tax rate at the top, I would rather give that money to some institution or another or create a private foundation and get friends to run it, and heaven knows what good or bad it actually does but at least I am not sending that money to Washington. And not only are they not sending that money to Washington, they are not sending the taxes on the interest and dividends in perpetuity.

Chairman THOMAS. The gentlewoman's time has expired.

Ms. DUNN. Thank you very much, Mr. Chairman.

Chairman THOMAS. The gentleman from Louisiana wishes to inquire?

Mr. MCCRERY. Thank you, Mr. Chairman. Just a couple of comments.

Number one, Dr. Hassett, thank you for your column in the Wall Street Journal recently that very clearly explained why we ought not focus entirely on reducing the publicly-held debt. It is an excellent explanation.

And, Dr. Feldstein, let me thank you for your comments today on the same subject, which I hope will serve—both of your comments will serve to put the focus of this Committee on something other than paying down debt.

Paying down debt is good. We are paying down debt, and if we don't pay down any more debt, just leave it where it is and let the economy grow, it will soon, very soon, be reduced to a level below what we have seen in decades in terms of a percent of our income. So we are doing a good job on paying down the debt, and I am glad you both pointed out that that is not what we ought to focus on entirely as we go through these maneuvers in Congress.

Number two, it has been said by our former chairman that Americans are paying more in taxes now than they have ever paid, and some would roll their eyes. Well, the fact is that last year, and I have the historical table right in front of me from the CBO, last year——

Chairman THOMAS. The Congressional Budget Office.

Mr. MCCRERY. Yes. Last year, Americans paid 20.6 percent of our GDP to the Federal government in the form of taxes, 20.6 percent. This table only goes back to 1962 so I can't really speak with authority before 1962, but there is no year on this table that comes even fairly close to 20.6 of GDP in revenues. So you have to go back before 1962, and I predict that if you did do that you would have to go back to World War II or some wartime when we were collecting more than 20.6 percent of our GDP in taxes.

So indeed we are taxed more than we have ever been in peacetime. We need a tax cut. We don't need to just feed the Federal Government and create more programs to spend all that money. We need to make sure we give that money back to the American people who earned it and let them do what they do best, create jobs and grow our economy.

Thank you, Mr. Chairman.

Chairman THOMAS. And with that, I want to thank all three of you for the endurance test. You passed marvelously. The Committee thanks you, and without any additional comments, the Committee stands adjourned.

[Whereupon, at 3:40 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of the American Bankers Association

The American Bankers Association (ABA) is pleased to have an opportunity to submit this statement for the record on certain of the revenue provisions of the Administration's fiscal year 2002 budget.

The American Bankers Association brings together all categories of banking institutions to best represent the interests of the rapidly changing industry. Its membership—which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks—makes ABA the largest banking trade association in the country.

The ABA supports the Administration's fiscal year 2002 tax cut plan and believes it would provide much needed broad-based economic stimulus. Specifically, we are pleased that the plan would reduce marginal income tax rates, reform the estate tax and provide a permanent extension of the research and experimentation tax credit.

Individual Income Tax Rates

Recent economic reports suggest a pronounced weakening in economic performance. By contrast, the Congressional Budget Office's most recent forecast projected a 10-year surplus of $5.6 trillion, of which $2.5 trillion is the Social Security surplus and $3.1 trillion is the non-Social Security surplus that could be available to fund a tax cut. These figures represent a dramatic increase in the size of the overall surplus.

In this connection, the ABA believes tax cuts are in order to confront the evident pronounced weakening in recent economic performance and agrees with Federal Reserve System Chairman Alan Greenspan that such tax cuts should be enacted sooner rather than later to help smooth the transition to longer term fiscal balance. Indeed, in testimony before the Senate Budget Committee, Chairman Greenspan said that "over the longer run, most economists believe that [tax policy] should be directed at setting rates at the levels required to meet spending commitments, while doing so in a manner that minimizes distortions, increases efficiency, and enhances incentives for saving, investment, and work."

Enactment of a broad-based tax cut would put in place a needed safety measure should the current economic weakness spread beyond current expectations. We urge you to expeditiously enact this legislation.

Estate Tax Reform

The ABA supports reform of the estate tax system; however, the ABA would like to bring to your attention the real-world impact of including a return to the repeal of the estate tax, as some have proposed. As property values have risen, more families have become subject to the estate tax. In many instances, family-owned businesses and farms must liquidate to pay the tax.

The current system provides that the first $675,000 of the net estate and gift value is exempt (this exemption rises to $1,000,000 by 2006). The total estate of a decedent includes the value of all property, real and personal, tangible and intangible, in which the decedent owned an interest on the date of death.

Although ABA supports reform of the estate tax, we caution against the elimination of the step-up in basis at death and a return to carryover basis. The burden that would be put on heirs of determining the basis of assets acquired decades before should not be underestimated.

In 1976, Congress enacted carryover basis, in which the basis of property received from a decedent was "carried over" from the decedent to the heirs. This rule gave heirs a basis in inherited property equal to the decedent's basis on the date of death.

Congress repealed carryover basis in 1980 because it had proven to be an unworkable and expensive burden on heirs. Few individuals maintained accurate records of the purchase price of all items included in an estate. In fact, in many instances executors could not determine so much as an accurate date of acquisition. For example, in one instance an estate involved a decedent who had been an oil "wildcatter" and owned some 25 or 30 parcels of land in two states: the ownership being for surface rights only on certain parcels, and both surface and mineral rights on other parcels. The land was acquired through "swaps" with family members, land patents and like-kind exchanges in consideration for consulting expertise, etc. To date it has taken two attorneys six months just to sort out title. The determination of the decedent's cost basis (or even acquisition dates) has not been possible.

The estate tax has always been complex. Repealing it would go a long way toward simplifying the tax code. However, we are concerned that a return to carryover basis would be an administrative nightmare, leading the nation further away from a simplification of the tax code. These costs—both in legal and executor fees and in the many personal hours looking for records—will be borne by the many Americans who would otherwise receive the stepped-up basis.

Research and Experimentation Tax Credit

ABA supports the permanent extension of the tax credit for research and experimentation. The banking industry is actively involved in the research and development of new intellectual products and services in order to compete in an increasingly sophisticated and global marketplace. The proposal would extend sorely needed tax relief in this area and facilitate tax and business planning with respect to its use.

Other Issues

The ABA urges Congress to pass the Administration's tax package. We understand that Congress may address other tax matters, either as a part of this package or later in this Session. Should such opportunity arise, we would request that you consider legislation that would:

- Expand IRAs, pensions and tax incentives for savings
- Create Farm, Fish, and Ranch Risk Management Accounts ("FFARRM" accounts)
- Exempt state issued agricultural "aggie" bonds from the private activity bond volume cap
- Improve tax laws and remove competitive barriers for Subchapter S banking
- Enact a permanent "active finance" exception to Subpart F
- Reform the Alternative Minimum Tax.

Conclusion

The ABA appreciates having this opportunity to present our views on the revenue provisions contained in the President's fiscal year 2002 budget proposal. We look forward to working with you in the future on these most important matters.

Statement of John Pratt, Chairman, American Business Council of the Gulf Countries

GENERATING U.S. EXPORTS AND U.S. JOBS THROUGH INCOME TAX RELIEF

Expanding the Foreign Earned Income Exclusion

Thank you, Chairman Thomas, for the opportunity to present testimony in support of your hearing on the President's tax relief proposals. My name is John Pratt, and I serve as Chairman of the American Business Council of the Gulf Countries, a Gulf-based affiliate of the U.S. Chamber of Commerce representing the more than

700 U.S. companies with operations in the region. Widely regarded as the voice of American business in the Arabian Gulf, the ABCGC is a non-profit, non-partisan organization consisting of the nine American Chambers of Commerce in the region. For more than a decade, the ABCGC has worked closely with the U.S. Government to enhance America's business competitiveness overseas.

Mr. Chairman, in the ongoing battle for international market share, the Section 911 foreign earned income exclusion has proved to be one of the most important weapons in America's trade arsenal. By helping to maintain the presence of U.S. citizens "on the ground" around the world, Section 911 has had a direct impact on the competitiveness of American workers and U.S. companies operating in foreign markets. In the ABCGC's experience, Americans abroad are the best salesmen and saleswomen for U.S. goods and services overseas. Put another way:

Americans Abroad = U.S. Exports = U.S. Jobs

As part of the Taxpayer Relief Act of 1997, and thanks largely to the efforts of your predecessor, Chairman Bill Archer, Congress increased Section 911 by $2,000 per year, leveling off at $80,000 next year. Moreover, beginning in calendar year 2008, the $80,000 exclusion will also be adjusted for inflation for 2008 and subsequent years.

American workers and U.S. companies around the world appreciated this step by Congress, which helped to shore up temporarily the backsliding that the foreign earned income exclusion had experienced for more than a decade. But beginning next year, when the exclusion tops out at $80,000, the backsliding will return with a vengeance.

According to a study conducted by PricewaterhouseCoopers LLP in 1999, the exclusion amount in real dollars is 45 percent below its level in 1983 ($80,000 in nominal dollars and $134,197 in 1999 dollars), following passage of the Economic Recovery Tax Act of 1981. The real value of the exclusion will continue falling until 2007, when it will stabilize at approximately $65,150 in 1999 dollars. Looked at from a "purchasing power" perspective, the value of the exclusion will have plummeted in real dollars from $134,197 (1983) to $65,150 (2007), a substantial loss of nearly $70,000 in 1999 dollars. (A copy of the 1999 report by PricewaterhouseCoopers LLP—*The Effect of Inflation on the Foreign Earned Income Exclusion Amount—is attached to this testimony as Appendix A.)*

The ABCGC believes that if the U.S. Government wants to put American workers and U.S. companies on an equal footing with their competitors in the global marketplace, Congress should remove limitations on the Section 911 exclusion. The United States is the only major industrial country in the world that taxes on the basis of citizenship rather than residence, which puts our companies and our workers at a competitive disadvantage in foreign markets.

But because the Bush Administration and Congress have many tax relief priorities and are committed to limiting the President's package to $1.6 trillion, the ABCGC proposes an interim measure intended to restore value to the exclusion that has been eroded over the years as a result of inflation.

This interim measure consists of two parts. First, the Section 911 exclusion would be raised to $100,000. This is substantially less than what the exclusion would be worth today ($135,000+ in real dollars) if it had been indexed, as it was intended to be, since the early 1980s. Second, the exclusion would be indexed to compensate for the effects of inflation. Such indexation would be entirely consistent with the inflation adjustments made in many other dollar amounts in the individual income tax system—the standard deduction, personal exemption, tax bracket amounts, earned income credit, phase-out of itemized deductions and personal exemptions, and so on.

Enactment of this two-part measure represents a relatively small investment that will position the United States to compete globally in the twenty-first century and yield billions of dollars worth of dividends to the U.S. economy in the years ahead.

* * * * * * *

When it comes to taxing its citizens on foreign earned income, the United States is out of step with the rest of the world. As a result, American workers are significantly more expensive to hire than comparably qualified foreign nationals. The $78,000 foreign earned income exclusion helps to offset some of the imbalance created by this policy, but U.S. companies and Americans abroad remain vulnerable. U.S. citizens overseas must include as taxable "income" many non-salary, quality-of-life items for which their employers provide reimbursement: schooling for children, cost-of-living allowances, home leave, emergency travel, and other necessary and often expensive aspects of living overseas.

Taxable reimbursements like these often double an overseas American's taxable income. He or she therefore has a much higher tax liability than does a worker with the same salary employed in the United States. If his or her employer agrees to offset these increased taxes, the cost to the company of hiring this American worker goes still higher. As a result, the trend worldwide is to replace American workers with less expensive (inclusive of taxes) third country nationals, especially Canadians and Europeans.

Current U.S. tax policy makes it very difficult for U.S. companies to bid competitively on international contracts if they plan to utilize American employees to staff overseas projects. The Section 911 exclusion offers an important step toward placing U.S. companies on a level playing field with non-U.S. companies competing for these global contracts. Section 911:

- Makes U.S. citizens working overseas more competitive with foreign nationals who pay no tax on their overseas earned income;
- Makes American companies more competitive in their bids on overseas projects;
- Helps to put Americans "into the field" overseas, where they promote U.S. goods and services, repatriate much of their earnings to the USA, pave the way for future growth of U.S. export opportunities, and create hundreds of thousands of jobs in the United States.

Two independent studies commissioned by the non-profit Section 911 Coalition in 1995 reinforced the long-held view that the foreign earned income exclusion is especially important to the "little guy" trying to do business or provide educational services overseas.

The first study, a survey conducted by international economists at the Johns Hopkins University, suggests that the overseas American workforce of small and medium-sized companies depends heavily on the Section 911 exclusion. (A summary of this study is attached as Appendix B.)

The second study, conducted by Price Waterhouse LLP, found that without Section 911, U.S. exports would decline by nearly two percent. That translated into a loss of some 143,000 U.S.-based jobs. These figures do not include service-related jobs or indirect employment, which would likely double the number of jobs lost. (A summary of this study is attached as Appendix C.)

The Price Waterhouse study also found that: (1) The benefits of Section 911 are more important for lower-paid Americans abroad than for those who receive higher pay; (2) By 1995, the benefit of the exclusion had dropped by 43 percent in little more than a decade and that the downward spiral is expected to continue; (3) An unlimited exclusion would be "consistent with the international tax policy standards of competitiveness, preservation of the U.S. tax base, and harmonization."

Moreover, the ABCGC's "real world" experience has shown that:

- Small and medium-sized companies, when trying to gain a foothold overseas, are more likely than large companies (many with an established overseas presence already) to draw on U.S.-based personnel to penetrate foreign markets.
- Small and medium-sized companies, because they lack the world-class name recognition that might provide them with open access to foreign customers, traditionally rely very heavily on Americans overseas to specify and purchase their products.
- Small and medium-sized companies are, by necessity, much more sensitive to individual cost elements and the financial bottom line. Without the $78,000 Section 911 exclusion to help make overseas Americans more competitive with foreign nationals, relatively few of these small and medium-sized companies would be able to hire Americans to fill overseas slots.

In our experience, Mr. Chairman, having Americans overseas is not just helpful, it is essential. In effect, taxation of foreign earned income amounts to a short-sighted, indirect tax on U.S. exports and American culture. This is a debilitating and entirely self-inflicted wound—a policy which discriminates against America's companies, U.S. workers, and American educational institutions abroad.

For U.S. companies to continue expanding their market share worldwide, they must think and act globally. To stay competitive internationally, American managers need the kind of "hands on" experience that can only be gained by living and working abroad. In recent years, for example, two of the traditional Big Three automobile companies promoted their CEOs directly from European positions to corporate headquarters. This clearly demonstrates recognition by these companies of the role that international experience plays in their economic futures.

Nevertheless, it is often very difficult to persuade key employees to adjust their career paths and family situations by leaving corporate headquarters and the United States. And from the companies' perspective, despite the many advantages of hiring American peak performers to head overseas offices, current tax policies tend to make this option prohibitively expensive.

The loss of U.S. market share and the cutback in American jobs overseas represent a setback for American competitiveness. However, this tells only part of the story. The other part, of more immediate concern here at home, is the impact felt in communities all across the United States as jobs created or sustained by exports would disappear.

All Americans abroad, whatever their background, are helping to fuel the economy in the United States. By securing employment overseas, they free up jobs for other Americans back home, thereby reducing unemployment. They also support the American economy by repatriating much of their overseas earnings back to the United States. Most important of all, perhaps, Americans working overseas serve as the front-line marketing and sales force for U.S. exports.

Unless all Americans support competitiveness through exports, our nation's trade deficit will surely continue. Exports are widely considered the engine of growth for the U.S. economy. But when the engine of growth is stalled out by constrictive U.S. tax laws that are no longer appropriate, Americans everywhere pay the price.

* * * * * * *

Mr. Chairman, jobs that were traditionally held by Americans are going to our country's trade competitors. The situation will only get worse unless Congress and the new Bush Administration take steps soon to make American workers and U.S. companies more competitive in overseas markets, The Section 911 foreign earned income exclusion is one of the most effective trade weapons that the United States has at its disposal, and President Bush's tax relief package is offering a unique opportunity to staunch the flow of U.S. jobs to America's competitors. In the weeks ahead, we urge you to move aggressively to expand Section 911 to $100,000 and to index it for inflation . . . before it's too late.

Thank you for the opportunity to provide testimony. I look forward to answering any questions that the Committee may have.

APPENDIX A

PRICEWATERHOUSECOOPERS L.L.P.

The Effect of Inflation on the Foreign Earned Income Exclusion Amount

Introduction

This report updates information on the effect of inflation on the real value of the foreign earned income exclusion amount, which was originally included in an October 1995 report (*entitled Economic Analysis of the Foreign Earned Income Exclusion*) prepared by Price Waterhouse LLP for The Section 911 Coalition.

Under the provisions of Section 911 of the Internal Revenue Code, a U.S. citizen or resident alien whose tax home is outside the United States, and who meets a foreign residence or foreign presence test, may exclude from gross income in 1999 up to $74,000 per year of foreign earned income plus a housing cost amount. Historically, the principal rationale for the exclusion has been to make the tax treatment of Americans working abroad more competitive with that of foreign nationals and, thereby, to promote exports of U.S. goods and services.

History of the Foreign Earned Income Exclusion

The foreign earned income exclusion originally was enacted in 1926 to help promote U.S. exports. From 1926 to 1952, the exclusion was unlimited, corresponding to the present day practice of other major industrial countries. From 1953 to 1977, the exclusion was limited to $20,000 per year; however, for Americans working abroad for more than three years, the exclusion was increased to $35,000 from 1962 to 1964 and subsequently reduced to $25,000 from 1965 to 1977.

In 1978, the Foreign Earned Income Act replaced the Section 911 exclusion with Section 913, a series of deductions for certain excess costs of living abroad.

The Economic Recovery Tax Act of 1981 restored Section 911 and increased the exclusion to $75,000 in 1982 with scheduled increases to $95,000 in 1986. The legislative history indicates that Congress was concerned that the rules enacted in 1978 made it more expensive to hire Americans abroad compared to foreign nationals, reduced U.S. exports, rendered the United States less competitive abroad, and due to the complexity, the new rules required many Americans employed abroad to use professional tax preparers.

Among a number of other deficit reduction measures, the Deficit Reduction Act of 1984 delayed the scheduled increases in the foreign earned income exclusion, freezing the benefit at $80,000 through 1987. The Tax Reform Act of 1986 reduced the exclusion to $70,000 beginning in 1987. The exclusion remained at this level through 1997.

Present Law

The Taxpayer Relief Act of 1997 increased the $70,000 exclusion to $80,000 in increments of $2,000 beginning in 1998. The following table shows the exclusion amounts specified by the Act.

Table 1.—Present Law Section 911 Exclusion Amounts

Calendar year	Exclusion amount
1998	$72,000
1999	$74,000
2000	$76,000
2001	$78,000
2002–2007	$80,000
2008 and thereafter	$80,000 adjusted for inflation

As noted in the table, beginning in 2008 the $80,000 exclusion for foreign earned income will be adjusted for inflation. Thus, for any calendar year after 2007, the exclusion amount will be equal to $80,000 times the cost-of-living adjustment for that calendar year. The cost-of-living adjustment will be calculated using the methodology that adjusts the income brackets in the tax rate schedules (Section 1(f)(3) of the Internal Revenue Code). The Consumer Price Index for all urban consumers (CPI–U) that is published by the Department of Labor will be used to determine the adjustment. Specifically, the cost-of-living adjustment for a calendar year will equal the CPI–U for the preceding calendar year divided by the CPI–U for calendar year 2006 (the base year). The Internal Revenue Code further specifies that, in making this calculation, the CPI–U for a calendar year is to be calculated as the average of the CPI–U as of the close of the 12-month period ending on August 31 of such calendar year. Finally, the Taxpayer Relief Act of 1997 stipulates that if the adjusted exclusion amount is not a multiple of $100, then it is to be rounded to the next lowest multiple of $100.

For this report, we have estimated the inflation-adjusted exclusion amounts for 2008 and 2009 to be $82,000 and $84,200, respectively. These estimates assume that the CPI–U will increase by 2.6 percent annually beginning in calendar year 2000. This assumption is based on the Congressional Budget Office's (CBO) most recent published economic projections (*The Economic and Budget Outlook: Fiscal Years 2000–2009*, January 1999, Table 1.4).

Effect of Inflation

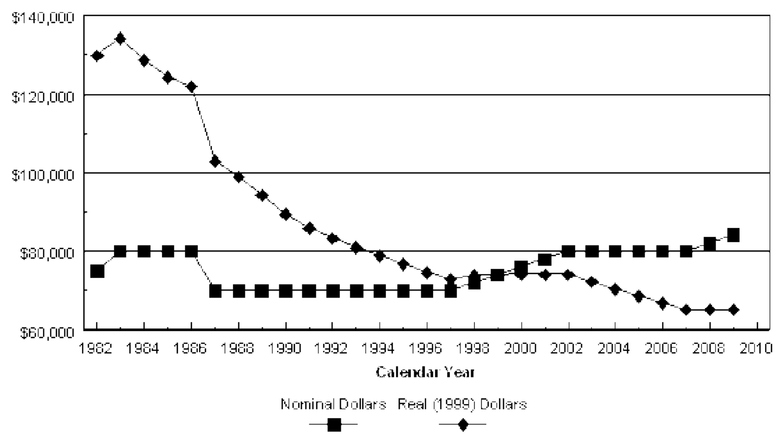
Figure 1 shows the exclusion amount in both nominal and real (1999) dollars. The nominal dollar line shows the exclusion amounts specified by legislation. The effect of the Taxpayer Relief Act of 1997 is shown starting in 1998 when the exclusion amount begins to increase in $2,000 increments from the $70,000 amount established by the Tax Reform Act of 1986. In 2002, the exclusion amount reaches $80,000 and remains at that level until 2008 when the exclusion amount begins to be adjusted for inflation.

As illustrated in Figure 1, the real value of the exclusion has dropped substantially. In real 1999 dollars, the 1999 exclusion amount of $74,000 is 45 percent below its level in 1983 ($134,197 in 1999 dollars) when the nominal dollar amount of the exclusion ($80,000) reached its highest level after the 1981 Act.

Figure 1 also shows that the real value of the exemption is projected to continue to fall after 1999, even though the Taxpayer Relief Act of 1997 eventually will raise the exclusion amount to $80,000.

The provision to adjust the exclusion amount for inflation will stabilize the real value of the exclusion amount beginning in 2008. Based on the CBO's projection that consumer prices will be 2.5 percent higher in 1999 than they were in 1998 and that annual price increases will amount to 2.6 percent thereafter, the value of the exclusion amount will stabilize at approximately $65,150 in 1999 dollars—an amount that is 12 percent below the current exclusion amount in real terms and 51 percent below the 1983 peak as measured in 1999 dollars.

Figure 1
Section 911 Exclusion Amount, 1982-2009
in Nominal and Real (1999) Dollars



Conclusion

Since the Section 911 exclusion amount has not been automatically indexed for inflation in the way that the Internal Revenue Code adjusts the income tax tables and other dollar amounts, the real value of the exclusion has dropped substantially. If the $80,000 exclusion that was in effect in 1983 had been continually adjusted for inflation, the exclusion would be approximately $134,000 in 1999. Based on current CBO projections of inflation, the exclusion amount in the year 2000 would be nearly $138,000.

APPENDIX B

SECTION 911 SURVEY RESULTS ARE IN

Survey Finds Exclusion is Especially Important to Small & Medium-Sized Companies

The Section 911 Coalition has announced the findings of its "American Competitiveness Survey." With nearly 150 companies and associations responding to the survey, it represents the largest and most broad-based Section 911 survey ever conducted.

The six-page survey examined the importance of the foreign earned income exclusion (under Section 911 of the U.S. Tax Code) and its impact on America's global competitiveness. A report prepared by economists at the Johns Hopkins University School of Advanced International Studies, Drs. Charles Pearson and James Riedel, found that:

• The Section 911 exclusion is especially important to small and medium-sized firms (including International and American schools abroad), which are at least ten times more dependent on Section 911 than are the large firms that were surveyed. Eighty-two percent of small and medium-sized firms said that a loss of the exclusion would result in a moderate (6 to 25 percent) or major (above 25 percent) change in their ability to compete abroad.

• Nearly two-thirds (65 percent) of respondents felt that their ability to secure projects and compete abroad would be improved if the exclusion ($70,000 in 1995) were raised to $100,000—a long-standing position of Americans resident overseas.

• Americans abroad showed a strong tendency to source goods and services produced in the United States. Seventy-seven percent of respondents said that nationality has an effect on sourcing decisions. Among small and medium-sized firms, the number is even higher: 89 percent said their American expatriate employees prefer to Buy American.

• Compensation costs are significant in determining whether or not to hire U.S. nationals overseas, and the Section 911 exclusion is important in holding down compensation costs. Eighty percent of respondents said elimination of Section 911 would have a moderate or major negative effect on compensation costs, with 66 percent saying elimination of the exclusion would have an important negative impact on future hiring practices.

The survey results strongly suggest that the Section 911 exclusion plays a key role in America's competitiveness and the creation of U.S. jobs through exports. For further information, please contact the Section 911 Coalition.

APPENDIX C

HIGHLIGHTS OF THE PRICE WATERHOUSE STUDY

"Economic Analysis of the Foreign Earned Income Exclusion"

Price Waterhouse LLP, in a study prepared in 1995 for the Section 911 Coalition, found that:

• The U.S. is the only major industrial country that does not completely exempt from taxation the foreign earned income of its citizens working abroad.

• Because the Section 911 exclusion is not adjusted for inflation, its real value has dropped by 43 percent since 1982. If the exclusion had been adjusted for inflation since it was set at $70,000 in 1987, the exclusion would rise to over $111,000 in the year 2000. If the exclusion is not indexed for inflation soon, its value will continue to decline.

• Without the Section 911 exclusion, compensation levels for Americans abroad would need to increase by an average of 7.19 percent to preserve after-tax income. Section 911 was shown to provide benefits in both low tax and high tax nations. Moreover, the exclusion represents a larger share of the compensation of low income than of high income Americans working abroad.

• A 7.19 percent increase in required compensation would result in a 2.83 percent decrease in Americans working abroad. Without Section 911, U.S. exports would decline by 1.89 percent or $8.7 billion. This translates into a loss of approximately 143,000 U.S.-based jobs. [N.B.—These figures do not include service-related jobs or indirect employment, which would likely double the number of jobs lost.]

• From a tax policy standpoint, the 911 exclusion meets the traditional standards for evaluating income tax provisions: *Fairness*—Absent Section 911, Americans working abroad would pay much higher taxes than U.S.-based workers with the same base pay. *Economic efficiency*—Absent 911, U.S. tax law would discourage U.S. companies from hiring Americans in overseas positions, causing foreign nationals to be hired even where Americans would, but for taxes, be preferred. *Simplicity*—The current structure of Section 911 was specifically enacted by Congress in 1981 in reaction to the unmanageable complexity of the rules enacted in 1978.

• Section 911 also adheres to three additional tax policy standards often used to evaluate provisions that affect international income: *Competitiveness*—The competitiveness standard, that U.S. capital and labor employed in foreign markets bear the same tax burden as foreign capital and labor in those markets, would be achieved if the U.S. excluded all foreign earned income (without the current cap). *Protecting the U.S. tax base*—Section 911 applies only to income that is earned abroad for activities that are performed abroad by individuals who are not residents of the USA. *Harmonization*—True harmonization with other nations would require an unlimited exclusion, as was in effect in the USA from 1926 to 1952.

Statement of W. Henson Moore, President and Chief Executive Officer, American Forest & Paper Association

Mr. Chairman and Members of the Ways and Means Committee, I am very pleased to have the opportunity to address this Committee concerning the issue of the President's Tax Relief Proposals.

The American Forest and Paper Association (AF&PA) is the national trade association representing producers of paper, pulp, paperboard and wood products, as well as growers and harvesters of this nation's forest resources. AF&PA fully supports the tax relief plan outlined by President Bush.

The members of AF&PA encompass the full spectrum of U.S. businesses. AF&PA members range from large integrated corporate operations to small private tree farms long held within a family. All our members are dedicated to business practices that foster responsible environmental stewardship at home and abroad. Our members, both large and small, welcome the stimulant effect of the income tax rate reductions in the President's plan as well as repeal of the estate tax that often forces families and small businesses to consider sale of all or a portion of the business to pay this unfair tax. For our landowners, the economics of the death tax can weigh heavily in a family's decision about whether to sell off lands to developers (to pay off the estate tax) or to continue the business and find the funds to pay the estate tax from another source. Repeal of the death tax is the top priority of our family landowners.

As CEO of AF&PA, I am troubled by the fiscal difficulties facing the U.S. manufacturing sector, however, particularly companies in the integrated forest and paper manufacturing business that are members of AF&PA. I see evidence on a daily basis of how the U.S. tax code negatively impacts the forest products and paper manufacturing industry as we compete in a global economy. The need for expeditious business tax relief could not be clearer. Blistering competition from outside the U.S. has forced our companies to carefully evaluate investments. Our competition pay less in taxes than we do and thus, they have an advantage.

We know from studies completed by PricewaterhouseCoopers (PwC) that the provisions of the current tax code are a major obstacle to a level playing field between the U.S. forest products and paper manufacturing industry and our competitors around the world. Our taxes are higher than those of competing nations. Moreover, competing nations are reforming their tax laws to enable them to lure U.S. businesses to relocate to their shores. When added to trade barriers to exports of our products, the U.S. worldwide system of taxation functions as a major obstacle in global competition. We need a corporate income tax rate reduction added to the President's bill just as he has proposed for individual taxpayers.

The daily drumbeat of negative economic news coming from the business sector raises concerns in the business community about the lack of tax relief for the business sector. There can be little doubt that the daily list of layoffs and downtime announced by major U.S. companies has a devastating impact on consumer confidence. In the U.S. paper and paperboard mills, there has been a significant decline in employment: over the past three years, 28,000 jobs have been lost representing 13% of the workforce. In the period from 1998 to 2000, 39 mills were closed: four additional mill closings have already been announced this year. An across-the-board tax rate cut, including a cut of corporate income tax rates is a simple, straightforward way to boost nationwide confidence and growth and improve our competitiveness.

We regard ourselves as stewards of the vast forest resources that have actually been growing over time. Our nation's 500 million acres of timberland contain over 36% more wood fiber today than they did fifty years ago despite continuously growing demand. Unfortunately, in recent years, a greater proportion of our national wood and paper needs have been supplied not from our own industry, but from imports. This is the reason we have worked to support tax changes that remove disincentives to the ownership and sound management of U.S. forests. To compete with companies in competing nations studied in the PwC Study, we need tax changes such as those in HR 1083 and S 1303, both of which were introduced during the 106th Congress.

The U.S. tax system raises greater disincentives to corporate investment in manufacturing and corporate forestry activities than that of any major competitor country. The PricewaterhouseCoopers Study shows that the effective corporate tax rate for the forest and paper manufacturing industry is the second highest among these competing countries. Corporate capital gains are taxed at higher effective rates in the U.S. than in most competitor countries. And even within the U.S., the identical asset—timber—is taxed at widely disparate rates, creating disincentives for holding timber in corporate form.

The forest products industry supplies more than $230 billion to the nation's gross domestic product; we rank sixth among domestic manufacturing sectors. We employ 1.5 million people and rank among the top ten manufacturing employers in 46 states. The forest products industry represents more than seven percent of U.S. manufacturing output, and provides a basic renewable resource that supports a unique and vital forest-based economy.

Our industry has an enviable environmental record. Members of AF&PA subscribe to the *Sustainable Forestry Initiative,* a program that assures the practice of sustainable forestry through the perpetual growing and harvesting of trees while protecting wildlife, plants, soil and water quality. However, unless we can improve the investment climate for forestry in our own country, our forests will be deforested and developed and production will shift to other countries, many of which have less environmentally sensible practices than we do in the U.S. Improvements in our tax system will be beneficial not only to U.S. workers, companies and our economy—they will support U.S. environmental goals as well.

The general economic downturn is causing sector hardship, constriction and loss of jobs. That status is reason enough to state that the benefits of tax relief should be extended to the corporate manufacturing sector. There is an additional, perhaps more compelling, reason to extend the across-the-board tax relief plan to reduce the corporate tax rate. If the rationale for the tax relief plan is to return money to taxpayers, then fairness argues that the portion of the surplus allocable to corporate tax payments should be returned to that sector too. And since time is of the essence for a short-term stimulant impact on the economy, an across-the-board rate cut to all taxpayers, both individual and corporate, is a simple and direct way to infuse money into the economy, to increase jobs and to promote growth.

We applaud the President's efforts to rationalize our tax system, to make it fairer for all taxpayers and to provide much needed tax relief. We look forward to working with the Congress and the Administration to promote the tax plan and to build a stronger America.

Statement of Mortimer M. Caplin, Caplin & Drysdale

My name is Mortimer Caplin, a member of the Washington law firm of Caplin & Drysdale. I served as U.S. Commissioner of Internal Revenue from 1961 through 1964, during the Kennedy and Johnson years, and have specialized in the study and practice of tax law for some 50 years—as a professor at the University of Virginia School of Law, and as a lawyer representing a wide variety of business and individual taxpayers.

With a $5.6 trillion budget surplus projected for the coming decade, and with the President and both parties poised to enact sizable tax cuts, we are at a rare political moment—one that enables us to undertake a major overhaul of our tax structure, as well as to greatly simplify tax returns, reduce rates, and make tax laws fairer.

"Simplification" and "fairness" need to be at the heart of any new proposal for broad tax legislation. By combining such a focused perspective in conjunction with a broad-based/low graduated rate tax system, Congress will give American taxpayers unprecedented relief and, at the same time, will help revitalize public faith in how we run our government.

Our tax laws today are riddled with an array of targeted tax preferences and so-called incentives—grievously complicating tax compliance, eroding our tax base and thus necessitating increased tax rates to meet revenue demands. The federal tax code is replete with special deductions and credits, exemptions and exclusions, deferrals and other preferred treatment for particular industries, groups or interests. Such provisions constitute a strong brew often leading to distortion of normal decision-making and encouragement of tax-motivated, non-economic behavior. Tax avoidance and abuse are inevitable byproducts.

That these common techniques—typically justified on a variety of high-sounding grounds—are simply tax reductions for one anointed body or other, was candidly revealed by Treasury Secretary Paul H. O'Neill at his recent Senate Finance Committee confirmation hearings. In response to suggestions that business tax incentives might be good for our economy, Secretary O'Neill answered:

"As a businessman I never made an investment decision based on the tax code. If you give money away I will take it, but good business people don't do things because of inducements."

Indeed, both as a former IRS Commissioner and as a practicing lawyer, I have found most businessmen's attitude on tax incentives entirely in line with that of Mr. O'Neill. How true is the observation that our tax laws reflect "a continuing struggle among contending interests for the privilege of paying the least."

Beyond this, we continue to see excessive manipulation of the tax laws to promote discrete social or economic objectives. The result: further fueling of taxpayer frustration from added complexities, tax base erosion, and resulting tax increases. All too often, Congress finds this "backdoor financing" route significantly more convenient, albeit more revenue costly, than the better-monitored process of direct appropriations.

Many taxpayers feel left out, discriminated against and abused. Their respect for the tax system is repeatedly undermined; they are less willing to comply. And when weakening occurs in voluntary compliance—which is at the very heart of our tax collection process—our nation pays a high price.

With major tax reductions before us, a unique opportunity presents itself to sweepingly simplify tax reporting, ease tax administration and restore taxpayer confidence in the entire system. Enacting the following changes would put these goals well within our reach:

1. Focus on tax return simplification, eliminating as many complexities as possible within reasonable revenue costs.
2. Restore a straightforward rate structure, minimizing the hidden rate increases imposed by "floors," "bubbles," "phase outs," "clawbacks," and the like.
3. Eliminate the bulk of special preferences, broadening the tax base significantly.
4. Tax capital gains in the same manner as ordinary income.
5. Repeal the alternative minimum tax ("AMT") for individuals as well as corporation, offsetting the enlargement of the tax base.
6. Lower all graduated rates across the board.

We as a people would be better served by a broad-based/low graduated rate tax system, with only the most limited of tax favors. Such a regime—-aimed at treating all forms of income alike, and providing equal tax treatment for persons with equivalent dollar incomes—would clearly be simpler, fairer and more equitable for our citizenry at large.

With the new administration primed for major tax changes, Congress should boldly move forward on the path first carved out by President Reagan's Tax Reform Act of 1986. In addition, steps must be taken to correct some of the undue restraints imposed on the IRS by the IRS Restructuring and Reform Act of 1998.

Widespread publicity is currently being given to (1) blatant examples of outright flouting of the tax laws, and (2) the disturbing and critical drop in the number of tax returns IRS examined in fiscal 2000—less than one-half of one percent of returns filed, and about 50 percent less than the percentage examined in 1999. Compliance and confidence in the tax system obviously suffers seriously by this weakening of enforcement.

Taxpayers want assurance that their neighbors down the street are paying their proper share of taxes; and it is, indeed, shortsighted to pass new tax laws without providing the IRS the manpower and resources to carry them out in a fair and reasonable fashion. Congress will certainly make sure that this proper balance is maintained in any new legislation enacted.*

*This testimony is based in part on my article, "*Now is the Time to Reform the Tax Code,*" which appeared in The Wall Street Journal, February 7, 2001.

JOSHUA TREE, CALIFORNIA 92252
February 19, 2001

Allison Giles, Staff Director
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Re: Response to Request for Written Statement Concerning President Bush's Tax Relief Proposal Dated February 6, 2001

Dear Ms. Giles: The following information is offered in response to the Committee's request and we would like to have this information included in the record. We do not profess to represent anyone but ourselves, although we probably speak for a great number in voicing our concerns.

We do not protest the taxation of income, in fact we agree with its original purpose. We do however, question the intent of Congress in their application of the Income Tax to "personal living and family expenses". The reason we question their intent is evident by the statement of Judge Hull in his synopsis of the first income tax levied under the 16th Amendment. The synopsis is found in Volume 50, Part 6, of the Congressional Record dated October 16, 1913 and begins on page 5679. There are two major concerns addressed by this synopsis to which the Committee should be enlightened.

First: "**The statutory exemption of $3,000 is allowed for personal living and family expenses; however, this and other gross income for which special deductions are allowed by the law must be embraced in the return of gross income * * *"**

It seems to us that this would be the proper place to begin any tax reduction; for the simple reason that it treats every taxpayer the same, regardless of the amount of "income" involved. The Court recognized this principle in 1895 through Justice Harlan's and Justice Brown's dissenting opinions in the Pollock Cases 158 U.S. 601 @ 676 and 694:

"The basis upon which such exemptions rest is that the general welfare requires that in taxing incomes, such exemptions should be made as will fairly cover the annual expenses of the average family, and thus prevent the members of the such families becoming a charge upon the public. The statute allows corporations, when making returns of their net profits or income, to deduct actual operating and business expenses. Upon like grounds, as I suppose, Congress exempted incomes under $4,000."

"The exemption of $4,000 is designed, undoubtedly, to cover the actual living expenses of a large majority of families, and the fact that it is not applied to corporations is explained by the fact that corporations have no corresponding expenses. The expenses of earning their profits are, of course, deducted in the same manner, as the corresponding expenses of a private individual are deductible from the earnings of his business. * * *"

Attorney General Olney, in the 1895 Pollock Cases, also recognized this principle in his statements before the Court, 157 U.S. 427 (pg. 778):

"**In the present case there is no lack of uniformity as between corporations and individuals. The exemption of $4,000 a year in the case of individuals or families, as will be shown, is intended as a compensation for the necessarily excessive burden of consumption taxes upon small and moderate incomes.**

There is no such situation in the case of a business corporation. Every cent which it expends is allowed it. It is taxed only on its net profits, deducting the wages account; which corresponds to the living expenses of the individual."

Second: **"The Treasury regulations soon to be prepared will make it clear to every taxpayer the requirements of the law and its application to income derived from the various kinds of business. To any person who keeps familiar with his business affairs during the year to the extent that at its end he known with reasonable accuracy the amount of his aggregate annual profits, the matter of executing his tax return would be both simple and convenient."**

What type of a "business" is the labor for hire employee in, and what "profit" do they acquire from their annual wages? It is evident from the above quotes, and the historical information contained in the Statistical Abstract of the United States, that the average labor for hire employee was not subject to the Federal "Income Tax" until after 1940 (actually the "Individual Income Tax Bill of 1944" [H.R. 4646]). This is especially interesting when you realize that labor for hire employees were earning more than the "single personal exemption of $1,000" allowed as early as 1917. What changed the levy of the "income tax" on net income (business) to include the gross receipts (employee wages) of labor?

Perhaps it is time to look into the "Public Salary Tax Act of 1939" and the "party politics" which endorsed it. The reason we suggest this, to us, is simple. The Congress that passed this legislation intended for it to be challenged. Many of the comments made by the minority Republican Members indicate the possibility that certain provisions of the Act were indeed unconstitutional. Congressman Plumley of Vermont made this statement in reference to the Act:

"So radical a change in our constitutional system as is contemplated and proposed by this act can and should only be made after and by the submission and adoption of a constitutional amendment, which will so extend the power of the Federal Government as to impose such a tax." (Congressional Record of February 9, 1939 page 1308)

His statement follows that of Congressman Buck recorded on page 1305. In addressing the issue of constitutionality Mr. Buck says:

"The value of an affirmative decision by Congress on the question of Federal taxation of officers of States and their subdivisions lies in the fact that the tax would be supported by the presumption of constitutionality attaching to a law passed by Congress and passed by its deliberate judgement after debate."

In this same light Senator Brown, on page 3765, in quotes as saying:

"The Senator from Vermont for himself may certainly make that reservation; but there is no question, under the accepted practice here and in the courts, that the fact that we pass the bill will lend to it the presumption of constitutionality."

Just an observation: The Democratic majority was 2:1, with Roosevelt as President.

The reason for our concern is a statement made by Congressman Disney on page 1313 where he says:

"The bill provided for a direct tax upon the State employee * * *"

Direct taxes levied upon employees are commonly referred to as "poll taxes", or "capitation" taxes requiring apportionment. At least they were in the opinion of the Judges in office prior to 1937. ("Taxing the Exercise of Natural Rights" by John MacArthur Maguire, Harvard Legal Essays 1934 pp. 273–322 [cited by Justice Cardozo in Steward Mach. Co. v. Davis 301 U.S. 548 @ 581]).

Final point: The Sixteenth Amendment provides for the taxation of *incomes,* from whatever *source* derived, without apportionment. It is clear from that Amendment that taxation of the *source* was not included or permitted without apportionment. So what is the meaning of the word *source?*

That may sound like a silly question, but think about it. Immediately after the ratification of the Amendment the Court took up the question of what the term "income" meant. No one considered that a silly question, although the answer was universally known. They, however, defined it in light of the 16 Amendment as; "the *gain* derived from capital, from labor or from both combined". How many "sources" did they list, only two. Why? Because, "income" belongs to the person owning the capital or providing the labor and has nothing to do with "who" paid for it. This all changed in 1939 with the "Public Salary Tax Act" and the Court's decision in the Graves v. New York Case [306 U.S. 466].

The above case deals with the question of sovereign immunity in the taxation of governmental entities. The question presented to the court was:

"We are asked to decide whether the imposition by the State of New York of an income tax on the salary of an employee of the Home Owners' Loan Corporation places an unconstitutional burden upon the federal government."

The answer the court gave is found on page 480, it reads:

"The present tax is a nondiscriminatory tax on income applied to salaries at a specific rate. It is not in form or substance a tax upon the Home Owners' Loan Corporation or its property or income, nor is it paid by the corporation or the government from their funds. It is measured by income which becomes the property of the taxpayer when received as compensation for his services; and the tax laid upon the privilege of receiving it is paid from his private funds and not from the funds of the government, either directly or indirectly. The theory, which once won a qualified approval, that a tax on income is legally or economically a tax on its source, is no longer tenable."

What about the employee's labor, isn't that the real "**source**" of the employee's income (salary or wage), and if that happens to be his only income, is that not a tax upon the "**source**" unless compensated for by the allowance of the personal exemption?

What is meant by "nondiscriminatory"? The tax levied upon corporations is levied only upon their "net-profits". The tax levied upon business, professions and the dealings in real and personal property is levied only upon net income, the **gain** derived from such things. The employee, however, is required to pay the "income" tax on the basis of their annual gross receipts. Yet, all three are classified as "persons", subject to the tax law?

In a recent case the Supreme Court took up the question of an "occupation" tax levied by Jefferson County, Alabama. The court recognized the fact that the County did not have the authority to levy an "income tax", but did have the authority to levy a "license or privilege" tax. They then upheld the tax based upon the "Public Salary Tax Act". (No. 98–10. Argued March 29, 1999—Decided June 21, 1999, Jefferson County, Alabama v. Acker, Senior Judge)

In 1903 the Federal District Court of Arkansas ruled upon a 13th and 14th Amendment issue [125 F 322]. In making that decision the court refers to the "unalienable" rights of "Life, Liberty and the Pursuit of Happiness". In doing so, Judge Trieber seems to reduce those rights to their most basic form. He starts out with a question:

"Can there be any doubt that the right to purchase, lease, and cultivate lands, or to perform honest labor for wages with which to support himself and family, is among these rights thus declared to be "inherent and inalienable"?

And ends with the statement:

"That the rights to lease lands and to accept employment as a laborer for hire are fundamental rights, inherent in every free citizen, is indisputable;"

Is it possible to have the inalienable right to labor for others and yet the receipt of wages earned by that labor be taxable as a "privilege"?

We do not object to a reasonable income tax, so long as the basis of that tax allows for a reasonable standard of living. It is well known that the higher one's income is, the less impact the "income tax" has upon living expenses. The question then is what "standard" of living is reasonable? Isn't the attainment of a basic standard of living the driving force behind labor, and are not the wages earned by hired labor in direct relation to the cost of providing that basic standard of living? Raising the "Personal Exemption" is fair to all, it treats everyone the same whether rich or poor. Why should you take the basic necessities away from the poor and not take the luxuries away from the wealthy, yet that is what our current system does. The current "personal" exemption is less than $3,000 a year, hardly enough to buy groceries let alone pay rent and utilities.

Raising the "Personal Exemption" is also the fastest way of putting money back into the economy, it simply lowers the amount withheld from wages and reduces the quarterly tax payments. Other than that, there are no other changes required in the Tax Law. The money thus injected into the lower brackets ultimately will end up in the higher brackets through increased consumer spending. A side benefit will be the decrease in the number of tax returns filed, thereby reducing the cost of processing those returns.

Respectfully submitted,

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Statement of Peter Goldberg and Sara E. Meléndez, Independent Sector

Independent Sector is a coalition of more than 700 national organizations and corporations representing the vast diversity of the nonprofit sector and the field of philanthropy. Its members include many of the nation's most prominent nonprofit organizations, leading foundations, and Fortune 500 corporations with strong commitments to community involvement. The network represents millions of volunteers, donors, and people served in communities around the world. Independent Sector members work globally and locally in human services, education, religion, the arts, research, youth development, health care, advocacy, democracy, and many other areas. No other organization represents such a broad range of charitable organizations and activities.

Independent Sector strongly commends President Bush for proposing enactment of a charitable contribution deduction for the more than 80 million Americans who use the standard deduction in computing their income tax liability. Under the President's proposal, non-itemizers would be able to deduct their charitable contributions up to a ceiling equal to the amount of the standard deduction.[1] In non-technical terms, the President's proposal would make charitable contributions tax deductible for all Americans—not just for the 30% of taxpayers (generally higher income) who itemize their deductions. Congressman Phil Crane will shortly introduce legislation to enact the President's proposed non-itemizer deduction.

Independent Sector strongly urges Congress to enact the President's proposal, as embodied in Congressman Crane's legislation, as part of this year's first piece of tax legislation. We attach a list of more than 500 charitable organizations—including many of the largest national charities—which have individually joined in support of this position (Attachment A).

America depends on a strong charitable sector, and America's charities depend on a strong base of charitable giving. Independent Sector believes that the following principles state a powerful case for the importance of a strong charitable sector and a strong tradition of charitable giving as cornerstones of our free society.

- **A strong and healthy independent sector is vital to our democracy, our quality of life and our free society.** The independent (voluntary, charitable, nonprofit) sector nurtures and sustains two fundamental prerequisites for a free society: an engaged and public-spirited citizenry and a rich network of autonomous communities working to advance the public good. Through our participation in and support of the organizations of the independent sector, we give life to some of our most cherished values: freedom of speech, association, and religion; pluralism; the responsibilities of citizenship; the dignity and worth of each and every individual; justice; and, building community.
- **Within our three-sector society, a strong independent sector, a healthy business sector and an effective governmental sector all play critical roles.** The independent sector sustains a broad range of vital public-benefit activities. Many of these activities are undertaken in partnership with government and business, and the independent sector also plays a role in holding business and government accountable. Through the independent sector, Americans both help to shape government policy and support private initiatives for the public good that complement the essential work of government. Our three-sector society works best when each sector understands, respects, and supports the vital functions of the other sectors.
- **The independent sector depends on a strong base of charitable giving.** Donated resources allow the organizations of the independent sector to sustain public-benefit activities. Without a strong base of charitable support, the independent sector could not perform these vital roles. While earned income and government support are also important revenue sources to nonprofit organizations, donated resources often form the core support of the organizations and allow them the independence so vital to performing their role in society. Thus, society has a fundamental interest in encouraging charitable support.
- **Tax policy should strongly encourage giving by all Americans.** The tax code is the most powerful tool available to the federal government for sending the message that we as Americans highly value and strongly support charitable giving. But today that message goes out only to the 30% of taxpayers who itemize their deductions. The tens of millions of hard-working low- and middle-income Americans who claim the standard deduction do not receive any recognition or encouragement through the tax code for their charitable giving. Intended or not, the message they receive from current law is that their charitable giving is not worth encouraging.

At a time when the need for stronger civic engagement could not be clearer, this is a message we simply cannot afford to keep sending. On the contrary, we need to democratize the charitable contribution deduction by making it available to all Americans. We need to send a clear and unequivocal message that charitable giving is an important responsibility of citizenship—for all Americans. Enacting the charitable deduction for non-itemizers is the only real way for the federal government to send this message.

- **The non-itemizer deduction would strongly encourage more gifts and new givers.** Beyond its powerful symbolic importance, the non-itemizer deduction would provide a strong stimulus for increased giving and new givers. In this regard, we attach a report prepared by the National Economic Consulting Division of PricewaterhouseCoopers summarizing the results of an econometric analysis of the effect of the non-itemizer deduction on charitable giving (see Attachment B).

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[1] The standard deduction is currently $4,500 for single returns and $7,600 for joint returns.

PricewaterhouseCoopers concludes that had the non-itemizer deduction, as proposed by President Bush, been in effect in 2000, total charitable giving would have increased by $14.6 billion—an increase of 11.2%.

Perhaps even more important, PricewaterhouseCoopers concludes that the non-itemizer deduction would have stimulated charitable gifts by 11 million Americans who would have otherwise given nothing. The long-term importance of encouraging these millions of Americans to begin to develop the habit of giving surely dwarfs the immediate increase in charitable giving, as important as that increase would be.

Two other perspectives strongly confirm the importance of the non-itemizer deduction in encouraging increased giving. First, in 1981, Congress enacted the non-itemizer deduction on a 5-year trial basis from 1982 through 1986. The deduction was phased in gradually, and was fully in effect only in 1986. Significantly, between 1985, when non-itemizers were allowed to deduct only 50% of their contributions, and 1986 when non-itemizer gifts were fully deductible, total giving by non-itemizers increased by 40% according to IRS data. Second, Independent Sector research, summarized in Attachment C, indicate that in every income category, individuals who itemize their deductions contribute significantly more to charity than do non-itemizers with the same income.

• **The non-itemizer deduction would provide important tax relief to low- and middle-income Americans.** In recent months, broad consensus has emerged on the importance of enacting a significant, broad-based tax cut. Major tax relief for America's hard working low- and middle-income families must surely be a part of any such legislation. The non-itemizer deduction is an extremely attractive means of providing part of this needed tax relief since the deduction would achieve three important social goals rather than only one—it would reduce taxes, target those tax cuts to low- and middle-income taxpayers, *and* encourage increased charitable giving.

• **The non-itemizer deduction would provide much-needed funding to thousands of community-based and religious organizations that are addressing America's most urgent social concerns.** Significantly over half of all contributions by non-itemizers go to religious and human service organizations. Enacting the non-itemizer deduction would, as noted above, substantially increase these contributions. Thus, the non-itemizer deduction would directly advance a policy objective championed by President Bush and embraced by leaders across the political spectrum—increasing the resources available to the thousands of community-based organizations, religious and secular, which are on the front lines of efforts to help our neediest citizens. To be more concrete, if the non-itemizer deduction is enacted, community-based organizations will be able to provide dramatically more child care, mentoring, job training, drug rehabilitation, elder care, and a host of other vital social services. No other measure could do more to strengthen America's vital infrastructure of community-based service organizations.

The non-itemizer deduction would be simple for taxpayers and easy for the IRS to administer. It is hard to imagine a tax provision easier to explain. The message to non-itemizers would be simple and clear: before you could not deduct your contributions—now you can. The deduction would require only a single additional line on the Form 1040. The IRS has already developed—in the course of administering the existing charitable deduction for itemizers—clear, user-friendly instructions explaining what types of contributions are and are not deductible.

Moreover, rules are already in place that require charities to provide written receipts for contributions of $250 or more and to advise donors when they must reduce their charitable deduction because they have received a return benefit from the charity. These and other existing safeguards have effectively ensured the integrity of the existing charitable contribution deduction for itemizers, who, because of their larger average level of giving, account for 80% of all charitable contributions. These existing safeguards will likewise ensure the integrity of the non-itemizer deduction.

In closing, we reiterate the key principles that undergird Independent Sector's support for the non-itemizer deduction: America's health as a free, democratic society depends on a strong charitable sector, and America's charities depend on a strong base of charitable giving. The non-itemizer deduction would powerfully encourage that charitable giving by all Americans. We applaud President Bush and Congressman Crane for their leadership on this issue, commend the many other members of Congress who have supported this proposal, and call on Congress to enact it now.

Attachment A

JANUARY 31, 2001

DEAR PRESIDENT GEORGE W. BUSH: We, the undersigned organizations, representing a cross-section of the entire charitable sector, write in support of your Administration's proposal to allow all taxpayers, including non-itemizers, to deduct their charitable contributions, whether they itemize their deductions or not. This proposal would allow non-itemizers to deduct all their charitable contributions up to a ceiling equivalent to the standard deduction.

The non-itemizer charitable deduction reflects the generosity and sacrifice made every day by tens of millions of Americans. The proposal would allow the 85 million Americans who do not itemize their tax returns (more than two out of every three taxpayers) to deduct their charitable contributions.

A forthcoming PricewaterhouseCoopers study for Independent Sector reveals that this proposal could increase charitable giving by as much as $14 billion per year. In addition, the proposal would encourage over 11 million taxpayers to become new givers.

The non-itemizer charitable deduction does triple duty: It provides tax relief for non-itemizers, who are largely low-and middle-income taxpayers; it improves tax fairness by recognizing the generosity of all taxpayers; and, by creating an incentive for additional giving, it encourages individuals and families to give more to support the work of their favorite charities.

A similar proposal received broad bipartisan support in the 106th Congress.

President Bush, several times you voiced your support of the nonprofit community as partners to government throughout your campaign and most recently in your inaugural address. The place to start is with the charitable non-itemizer deduction.

We strongly support your Administration's proposal and urge its speedy passage.

Sincerely,

SARA E. MELÉNDEZ
President & CEO

Attachment A

Over 500 National and Local Organizations, Collectively Representing Thousands of Organizations Nationwide, Have Joined Independent Sector in Support of this Letter

February 28, 2001

Alaska

Alaskan AIDS Assistance Association, Anchorage
Victory Ministries, Inc., Palmer

Alabama

Family Guidance Center of Alabama, Montgomery
Gateway, Birmingham
Nonprofit Resource Center of Alabama, Birmingham
Presbyterian Home for Children, Talladega

Arkansas

Arkansas Community Foundation, Little Rock
Family Service Agency, North Little Rock
United Way of Pulaski County, Little Rock

Arizona

Family Service Agency of Phoenix, Phoenix
Jewish Family and Children's Service, Phoenix
Make a Wish Foundation of America, Phoenix

California

Adult and Child Guidance Center/Family Service Mid-Peninsula, San Jose
ANGELCARE, San Diego
Bolthouse Foundation, Bakersfield
Canine Companions for Independence, Santa Rosa
Children Affected by AIDS Foundation, Los Angeles
Chrysalis, Los Angeles
Dominican University of California, San Rafael
East Bay Habitat for Humanity, Oakland
Family Service Agency of Santa Barbara, Santa Barbara
Freedom from Hunger, Davis
Harry Singer Foundation, Carmel

James Irvine Foundation, San Francisco
Joshua Venture, San Francisco
Los Angeles Women's Foundation, Los Angeles
McKesson HBOC Foundation, San Francisco
Monterey Bay Aquarium, Monterey
Mountain Community Resources, Ben Lomond
National Association of Latino Elected Officials Educational Fund, Los Angeles
Nonprofits Insurance Alliance of California, Santa Cruz
Olive Crest, Santa Ana
Pacific Lodge Youth Services, Woodland Hills
Public Interest Clearinghouse, San Francisco
Sacramento Opera Association, Sacramento
Sacramento Tree Foundation, Sacramento
Sacramento Zoo, Sacramento
San Francisco Food Bank, San Francisco
San Gorgonio Memorial Hospital Foundation, Banning
Senior Community Centers, San Diego
Streetlights Production Assistant Program, Hollywood
Verdugo Mental Health Center, Glendale
William and Flora Hewlett Foundation, Menlo Park
World Emergency Relief, Carlsbad

Colorado

Boys and Girls Club of the Pikes Peak Region, Colorado Springs
Christian Camping International/USA, Colorado Springs
Colorado Association of Non-Profits, Denver
El Pomar Foundation, Colorado Springs
El Pueblo Boys and Girls Ranch, Pueblo
Fort Collins Area United Way, Fort Collins
General Service Foundation, Aspen
Independent Higher Education of Colorado, Denver
Namaqua Center, Loveland
National Associations in Colorado Springs, Colorado Springs
Native American Rights Fund, Boulder
Third Way Center, Denver
Turning Point Center for Youth and Family Development, Fort Collins

Connecticut

Children's Home of Cromwell, Cromwell
Connecticut Association of Nonprofits, Hartford
Connecticut Council of Family Service Agencies, Nethersfield
Connecticut Council of Philanthropy, Hartford
EFT Corporation, Hamden
Empowering Resources, Bridgeport
Family Centers, Greenwich
Family Counseling of Greater New Haven, Inc., New Haven
Family Services of Central Connecticut, Inc., New Britain
Family Services Woodfield, Bridgeport
Village for Families and Children, Inc., Hartford

District of Columbia

ACCESS: Networking in the Public Interest
Agudath Israel of America
Alliance for Nonprofit Management
Alliance to End Childhood Lead Poisoning
American Association of Museums
American Arts Alliance
American Council for International Education
American Council on Education
American Diabetes Association
American Humane Association
American Red Cross
American Society of Association Executives
America's Public Television Stations
Association of American Art Museum Directors
Association of American Universities
Association of Governing Boards of Universities and Colleges
Association of Performing Arts Presenters
Black Patriots Foundations

CARE
Center for Policy Alternatives
Center for Resource Economics/Island Press
Child Welfare League of America
Community Family Life Services
Council for Advancement and Support of Education (CASE)
Council on Foundations
Ethics Resource Center
Forum of Regional Associations of Grantmakers
Foundation for Independent Higher Education
Girl Scouts of the USA
Global Fund for Children
Habitat for Humanity International
HalfthePlanet Foundation
Islamic InstituteKaBOOM!
Lutheran Services in America
March of Dimes Birth Defects Foundation
National Asian Pacific American Legal Consortium
National Association of Independent Schools
National Center for Institutionally Related Foundations
National Conference for Community and Justice
National Council of Jewish Women
National Council of Nonprofit Associations
National Crime Prevention Council
National Grange
National Multiple Sclerosis Society
National Peace Corps Association
OMB Watch
PACT
Pan American Development Foundation
Partners of the Americas
Points of Light Foundation
Population Services International
Presbyterian Church USA
Reading is Fundamental, Inc.
SOS Children's Villages USA
United Cerebral Palsy Associations, Inc.
United States Catholic Conference
Washington Center for Internships
Washington Council of Agencies
The World Institute for Development and Peace
Youth Service America

Delaware

Delaware Association of Nonprofit Agencies, Wilmington

Florida

Anne Norton Sculpture Gardens, Inc., West Palm Beach
Avatar, Casselberry
Charity Works, Inc., Clearwater
Florida Association of Nonprofit Organizations, Miami Lakes
Hillsborough CARES, Tampa
Junior League of Greater Orlando, Orlando
Learn to Read, Inc., Jacksonville
Nassau County Volunteer, Yule
Nicaraguan Development Center, Miami
Nonprofit Management Solutions, Inc., Hollywood
United Way of Florida, Tallahassee
Webb Center, Inc., Jacksonville

Georgia

American Cancer Society, Atlanta
Action Ministries, Inc., Atlanta
AEC Trust, Atlanta
AIDS Survival Project, Atlanta
Atlanta Neighborhood Development Partnership, Atlanta
Boys and Girls Clubs of America, Atlanta
CDC Foundation, Atlanta
Community Foundation for Greater Atlanta, Inc., Atlanta

Emory University, Atlanta
Furniture Bank of Metro Atlanta, Atlanta
Jewish Family and Career Services, Atlanta
Light of Hope Ministries Global International, Albany
Rockdale County Emergency Relief Fund, Inc., Conyers
Union Mission, Inc., Savannah
West Broad Street YMCA, Inc., Savannah

Hawaii

TILT Dance Company, Makawao

Iowa

Community Corrections Improvement Association, Cedar Rapids

Idaho

Children's Village, Inc., Coeur d'Alene
Idaho Youth Ranch, Boise

Illinois

American Library Association, Chicago
America's Second Harvest, Chicago
Ashlumn Community Project, Chicago
Bethany for Children and Families, Moline
CenterPoint Institute, New Lenox
Chaddock, Quincy
Child Care Association of Illinois, Springfield
Children's Home Association, Peoria
Counseling and Family Services, Peoria
Easter Seals, Chicago
Educational Assistance, Ltd., Wheaton
Executive Service Corps of Chicago, Chicago
Field Foundation of Illinois, Chicago
Handkind Company, Chicago
Illinois Association of Rehabilitation Facilities, Springfield
Illinois Fatherhood Initiative, Chicago
Institute for Voluntary Organizations, Downers Grove
Jewish United Fund/Jewish Federation of Metro Chicago, Chicago
Kemmerer Village, Assumption
Lutheran Advocacy Network of Illinois, Des Plaines
Lutheran Social Services of Illinois, Des Plaines
North Park University, Chicago
Northwestern University, Evanston
Oak Park River Forest Community Foundation, Oak Park
OMNI Youth Services, Buffalo Grove
Prevent Blindness America, Schaumburg
Salem Children's Home, Flanagan
Silver Cross Hospital and Medical Centers, Joliet
Sunny Ridge Family Center, Inc., Wheaton
United Way of Illinois, Chicago
World Education Services, Chicago
YMCA of the USA, Chicago

Indiana

Ball Brothers Foundation, Muncie
Christian Church Foundation, Inc., Indianapolis
Covenant Community Church, Indianapolis
Ecumenical Stewardship Center, Indianapolis
Family and Children's Center, Inc., Mishawaka
Family and Children's Center, South Bend
Family Service Association of Howard County, Inc., Kokomo
Family Services Association of Wabash Valley, Inc.
Family Services of Delaware County, Indiana, Inc., Muncie
Family Services of Elkhart County, Inc., Elkhart
Indiana University Center for Philanthropy, Indianapolis
Indiana University School of Nursing, Indianapolis
Meningitis Foundation of America, Indianapolis
National Committee on Planned Giving, Indianapolis
Wesleyan Church Cooperation, Indianapolis
YMCA of Greater Indianapolis, Indianapolis

Kansas

Associated Youth Services, Kansas City
Catholic Charities, Kansas City
St. Lukes Shawnee Health Mission, Shawnee Mission
Youth Volunteer Corps of America, Shawnee Mission

Kentucky

Children's Alliance, Frankfort
Family and Children's Counseling Centers, Louisville
Family Counseling Service, Lexington,
United Way of Kentucky, Louisville

Louisiana

Family and Youth Counseling Agency, Lake Charles
Family Service of Greater New Orleans, New Orleans
University of Louisiana Department of Communication, Lafayette

Massachusetts

Donovan Sloan, Inc., Salem
Family Service, Inc., Lawrence
Family Services of Greater Boston, Jamaica Plain
Girls Incorporated of the Berkshires, Pittsfield
Grants Management Associates, Boston
Massachusetts Audubon Society, Lincoln
Tabor Services, Inc., Arlington
United Way of Merrimack County, Ward Hill
Women's Action for New Directions, Arlington
Youth on Board, Somerville

Maryland

American Institute of Philanthropy, Bethesda
American Zoo and Aquarium Association, Silver Spring
Board of Child Care, Baltimore
Epilepsy Foundation, Landover
Goodwill Industries International, Inc., Bethesda
Maple Shade Youth and Family Services, Inc., Mardola
Maryland Association of Nonprofit Organizations, Baltimore
International Youth Foundation, Baltimore
Izaak Walton League of America, Gaithersburg
TG77 Enterprises, Silver Spring

Maine

Cedars Nursing Care Center, Portland
Institute for Global Ethics, Camden
Maine Association of Nonprofits, Portland

Michigan

American Auto Immune and Related Diseases Association, East Detroit
Action Institute for the Study of Religion and Liberty, Grand Rapids
Boys and Girls Republic, Farmington Hills
Catholic Social Services of Wayne County, Detroit
Christian Reformed Church, Grand Rapids
Dispute Resolution Center of Western Michigan, Grand Rapids
Family Service Area of Genesee County, Flint
Greenville Area Community Foundation, Greenville
High/Scope Educational Research Foundation, Ypsilanti
Hudson-Webber Foundation, Detroit
Lakeside Treatment and Learning Center, Kalamazoo
Lutheran Child and Family Services of Michigan, Bay City
Lutheran Social Services of Michigan, Lansing
Michigan Federation of Private Children's and Family Agencies, Lansing
Michigan Nonprofit Association, East Lansing
The Nokomis Foundation, Grand Rapids
Nonprofit Enterprise at Work, Ann Arbor
Starr Commonwealth, Albion
Teen Ranch, Inc., Marlette
Whaley Children's Center, Flint

Minnesota

Dakota Area Transportation and Resources for Seniors, St. Paul
Family and Children's Services of Minneapolis, Minneapolis
Family Means, Stillwater
Jewish Family and Children's Service, Minnetonka
Maya Foundation, Rochester
Minnesota Council of Nonprofits, St. Paul
Otto Bremer Foundation, St. Paul
Second Harvest St. Paul Food Bank, St. Paul
Sheriff's Youth Programs of Minnesota, Inver Grove Heights
West Central Initiative, Fergus Falls

Missouri

Beyond Housing, St Louis
Butterfield Youth Services, Marshall
Cardinal Ritter Institute, St Louis
Child Advocacy Center, Inc., Springfield
Ewing Marion Kaufmann Foundation, Kansas City
Harvesters, Kansas City
KRCU Southeast Public Radio, Gape Girardeau
Mid-America Arts Alliance, Kansas City
Shepard's Centers of America, Kansas City
YWCA of St. Joseph, St. Joseph

Mississippi

Mississippi Center for Nonprofits, Jackson
Natchez Childrens Home, Natchez

Montana

Four Times Foundation, Red Lodge
Montana Parks Association, Billings
Yellowstone Boys and Girls Ranch, Billings

Nebraska

Catholic Charities of the Archdiocese of Omaha, Omaha
Christian Urban Education Service, Omaha
Family Services of Lincoln, Lincoln
Girls and Boys Town, Boys Town
Woods Charitable Fund, Inc., Lincoln

North Carolina

Baptist Children's Homes of North Carolina, Thomasville
Barium Springs Home for Children, Barium Springs
Charlotte Museum of History, Charlotte
Community Housing Development Corporation, Mooresville
Family Guidance Center, Hickory
Family Services of the Piedmont, Inc., High Point
Nazareth Children's Home, Rockwell
North Carolina Center for Nonprofits, Raleigh
North Carolina Victims Assistance Network, Raleigh
Presbyterian Hospital Foundation, Charlotte
Samaritan's Purse, Boone
Sipes Orchard Home, Conover
YMCA Blueridge Assembly Inc., Black Mountain

North Dakota

The Village Family Service Center, Fargo

New Hampshire

Camp Berea, Bristol
New Hampshire Charitable Foundation, Concord

New Jersey

Association of Jewish Family and Children's Agencies, East Brunswick
Center for Arts and Cultural Policy Studies, Princeton
Center for Family Services, Inc., Camden
Center for Non-Profit Corporations New Jersey, North Brunswick
Children's Aid and Family Services Inc., Paramus
Family Service Association of South Jersey, Absecon
First Occupational Center of New Jersey, Orange

Lucent Technologies Foundation, Murray Hill
Medical Education for South African Blacks, New Brunswick
Partnership in Philanthropy, Chatham
Prudential Foundation, Newark
Recording for the Blind and Dyslexic, Princeton

New Mexico

Americans for Indian Opportunity, Bernalillo
Assurance Home, Inc., Roswell
Rocky Mountain Youth Corps, Taos
United Way of Central New Mexico, Albuquerque

Nevada

Family Counseling Service of Northern Nevada, Reno
Girl Scouts of Frontier Council, Las Vegas

New York

Albert Kunstadter Family Foundation, New York
Alliance for Children and Families, Buffalo
American Foundation for AIDS Research, New York
American Foundation for the Blind, New York
American Lung Association of New York State, Inc., Albany
American Symphony Orchestra League, New York
Angel Guardian Children and Family Services, Brooklyn
Association of Advanced Rabbinical and Talmudic Studies, New York
Association of Junior Leagues International, New York
Compeer, Inc., Rochester
Council of Family and Child Caring Agencies, New York
CUNY Center for the Study of Philanthropy, New York
DOROT, Inc., New York
Environmental Defense, New York
Family and Children's Association, Minneola
Family and Children's Services of Niagara, Inc., Niagara Falls
Family Services of Rochester, Rochester
Girls Incorporated, New York
Heveron and Heveron, Rochester
International Center for the Disabled, New York
Jewish Board of Family and Children's Services, New York
Jewish Community Centers Association, New York
Jewish Community Relations Council of New York, New York
Julia Dyckman Andrus Memorial, Yonkers
Kosciuszko Foundation, New York
LaSalle School Albany, Albany
Libraries for the Future, New York
Literacy Volunteers of America, Inc., Syracuse
National Catholic Development Conference, Hempstead
National Center for Learning Disabilities, New York
National Council of Churches, New York
National Council of Women of the U.S., New York
National Hospital Foundation, New York
National Medical Fellowships, New York
Natural Resources Defense Council, New York
New York Regional Association of Grantmakers, New York
Nonprofit Coordination Contactors of New York, New York
Northeast Parent and Child Society, Inc., Schenectady
NYSARC, Inc., Schoharie
ORBIS International, New York
Park Foundation, Ithaca
Peter F. Drucker Foundation for Nonprofit Management, New York
Planned Parenthood Federation of America, New York
Rural and Migrant Ministry of Oswego County, Inc., Richland
Rural Opportunities, Inc., Rochester
Russell Sage Foundation, New York
Samuel H. Kress Foundation, New York
St. Mary's Foundation for Children, Bayside
Synergos Institute, New York
Theater Communications Group, New York
United Health Services, Binghamton
United Jewish Appeal Federation of Jewish Philanthropies, New York

United Jewish Communities, New York
United Way of Broome County, Inc., Binghamton
YWCA of the USA, New York

Ohio

Cancer Family Care, Cincinnati
Catholic Charities and Human Services Cleveland, Cleveland
Center for Families and Children Cleveland, Cleveland
Cincinnati Institute of Fine Arts, Cincinnati
Community Solutions Association, Warren
Crittenton Family Services, Columbus
Easter Seals Southwest Ohio, Cincinnati
Family Service Agency Youngstown, Youngstown
Family Service of Northwest Ohio, Toledo
Family Services Association of Dayton, Dayton
Family Services of Summit County, Akron
George Gund Foundation, Cleveland
Holy Family Institute, Canfield
Kent State University Foundation, Kent
Mandel Center for Nonprofit Organizations, Cleveland
Mohawk Area Development Corporation, Cincinnati
Ohio Academy of Family Physicians, Columbus
Ohio Association of Nonprofit Organizations, Columbus
Ohio United Way, Columbus
Recovery Resources, Cleveland
Youngstown State University Foundation, Youngstown

Oklahoma

Family and Children's Services, Inc., Tulsa
Oklahoma Public Employees Association, Oklahoma City
Sunbeam Family Services, Inc., Oklahoma City
World Neighbors, Oklahoma City

Oregon

Forest Service Employees for Environmental Ethics, Eugene
Interfaith Volunteer Caregivers of Central Oregon, Bend
Metropolitan Family Service, Portland
Oregon Advocacy Center, Portland
Oregon Independent Colleges Association, Portland
PhilanthropyNow, Portland
St. Mary's Home, Beaverton

Pennsylvania

American Friends Service Committee, Philadelphia
Biblical Theological Seminary, Hartsfield
Big Brothers/Big Sisters of America, Philadelphia
Brighter Horizons Behavioral Health, Edinboro
Children's Aid Society of Mercer County, Mercer
Children's Home of Reading, Reading
Community Foundations for Pennsylvania, Harrisburg
Delaware Valley Grantmakers, Philadelphia
Esperanza Health Clinic, Philadelphia
Evangelical Council for Financial Accountability, Winchester
Family and Community Service of Delaware County, Media
Family Service of Chester County, West Chester
Family Services Association of Bucks County, Langhorne
Family Services Lancaster, Lancaster
Family Services of Lackawanna County, Scranton
Family Services of Northwestern Pennsylvania, Erie
Family Services of Western Pennsylvania, Pittsburgh
Foundation of the Pennsylvania Medical Society, Harrisburg
Grace Brethren Retreat Center Camp Conquest, Denver
Institute for the Study of Civic Values, Philadelphia
Pennsylvania Association of Nonprofit Organizations, Harrisburg
Pennsylvania Council of Youth and Family Services, Harrisburg
Pennsylvania Federation of Museums, Harrisburg
Sarah Reed Children's Center, Erie
Wayne Memorial Health Foundation, Honesdale
Woman's Way, Philadelphia

YWCA of Lancaster, Lancaster

Rhode Island

Jewish Family Service, Providence
University of Rhode Island, Providence

South Carolina

Carolina Counseling, Spartanburg
Compass of Carolina, Greenville
International Primate Protection League, Summerville
South Carolina Association of Nonprofit Organizations, Columbia
Tara Hall Home for Boys, Georgetown

Tennessee

Alliance for Children and Families, Knoxville
Baptist Memorial Health Care Foundation, Memphis
Child and Family Tennessee, Knoxville
Exchange Club Family Center, Memphis
Family and Children's Service, Nashville
Family and Children's Services of Chattanooga, Inc., Chattanooga
Holston United Methodist Home for Children, Greeneville
Lloyd C. Elam Mental Health Center, Nashville
Lyndhurst Foundation, Chattanooga
Park Center, Nashville
Prevent Child Abuse Tennessee, Madison
United Methodist Higher Education Foundation, Nashville

Texas

Alliance of Nonprofits, Irving
American Heart Association, Dallas
Boys and Girls Harbor, Inc., Houston
Boys and Girls Country of Houston, Inc., Hockley
Catholic Diocese of Fort Worth, Fort Worth
Center for AIDS: Hope and Remembrance Project, Houston
Dini Partners, Houston
Family Counseling Service Corpus Christi, Corpus Christi
Family Service Association of San Antonio, San Antonio
Family Services of Southeast Texas, Beaumont
Family Support Services, Amarillo
Florence Crittenden Agency, Inc., Knoxville
Fort Bend County Women's Center, Rosenberg
Galveston College Foundation, Galveston
Girl Scouts of Lone Star Council, Austin
Girl Scouts of the Permian Basin, Odessa
Hogg Foundation for Mental Health, Austin
Lutheran Social Services of the South, Inc., Austin
Providence Foundation, Inc., Waco
Sid W. Richardson Foundation, Fort Worth
Texas Alliance for Human Needs, Austin
Texas Association of Museums, Austin
Texas Development Institute, Austin
Texas Methodist Foundation, Austin
Texas Network of Youth Services, Austin
United Way of the Texas Gulf Coast, Houston
Victim Assistance Center, Inc., Houston

Utah

Granite Education Foundation, Salt Lake City
Simmons Family Foundation, Salt Lake City
Utah Valley State College, Orem

Vermont

Vermont Natural Resources Council, Montpelier

Virginia

America's Promise, Alexandria
Association for Volunteer Administration, Richmond
Association of Farmworker Opportunity Programs, Arlington
Association of Fundraising Professionals, Alexandria
Catholic Charities USA, Alexandria

Christian Service Charities, Springfield
Close Up Foundation, Alexandria
Conservation Fund, Arlington
Gifts In Kind International, Alexandria
Human Service Charities of America, Springfield
International Service Agency, Alexandria
Leukemia and Lymphoma Society, Alexandria
Medical Research Agencies of America, Springfield
National Association of Children's Hospitals, Alexandria
National Association of Schools of Art and Design, Reston
National Association of Schools of Dance, Reston
National Association of Schools of Music, Reston
National Association of Schools of Theater, Reston
National Military Family Association, Inc., Alexandria
Northern Virginia Family Service, Falls Church
Operation Smile, Norfolk
Research America, Alexandria
Salvation Army of America, Alexandria
Share America, Springfield
United Way of America, Alexandria
Volunteers of America, Alexandria

Washington

Children's Services of Sno-Valley, Snoqualmie
Deaconess Children's Services, Everett
Evergreen State Society, Seattle
Family Resource Center Redmond, Redmond
Friends of Youth, Redmond
Gateways for Youth and Family, Tacoma
Giraffe Project, Langley
Morning Star Boys Ranch, Spokane
Mothers Against Violence in America, Seattle
Northwest Regional Facilitators, Spokane
Pacific Northwest Ballet, Seattle
Seattle Children's Home, Seattle
Seattle Lighthouse for the Blind, Seattle
Waitt Family Foundation Technology Resource Center, Seattle

West Virginia

Family Service of Upper Ohio Valley, Wheeling

Wisconsin

Donors Forum of Wisconsin, Milwaukee
Family Service Association of Beloit, Beloit
Family Services of Madison, Madison
Family Services of Racine, Racine
IMPACT Alcohol and Other Drug Abuse Services, Inc., Milwaukee
Madison Avenue Center, Madison
Milwaukee Public Museum, Milwaukee
Nonprofit Center of Milwaukee, Milwaukee
Norris Adolescent Center, Mukwonago
Rehabilitation for Wisconsin, Inc., Madison
Ripon College, Ripon
School Sisters of St. Francis, Inc., Milwaukee

Attachment B

PRICEWATERHOUSECOOPERS L.L.P

INCENTIVES FOR NONITEMIZERS TO GIVE MORE: AN ANALYSIS

A. Background

Purpose

This report is prepared for the Independent Sector by the National Economic Consulting practice of PricewaterhouseCoopers LLP.

The report concerns a proposal for allowing individuals who do not itemize deductions ("nonitemizers") in computing federal income tax to deduct 100 percent of their charitable contributions, up to the amount of the standard deduction applicable to the taxpayer's filing status. The proposal is referred to as the "Bush proposal" because it was included by then-Governor G.W. Bush in A Tax Cut with a Purpose, published in December 1999.

The objectives of the report are to—

- Estimate the amount of additional charitable giving that the Bush proposal would stimulate, nationwide and in each State, and
- Estimate the amount of additional giving nationwide according to the income of the donor.

Economic rationale and methodology

Rationale.—The proposal would encourage philanthropy by reducing the after-tax price of giving to a donor. Under present law, the after-tax price for a non-itemizer is $100 per $100 contributed because he or she is not allowed to deduct charitable contributions in computing taxable income. In contrast, the after-tax price for an individual in the 28-percent tax bracket who itemizes deductions is $72 per $100 donated because the donation generates a $28 tax reduction. The economic rationale for the Bush proposal is to confer the same tax reduction on nonitemizers as itemizers now enjoy.

Research that has been conducted in universities, think tanks, and the federal government preponderantly supports the economic proposition that people tend to give more when the price of giving is lower for them. There is, however, a variance of results in this research about how strongly price affects the amounts given.

Methodology.—We use PricewaterhouseCoopers' computerized model of charitable giving by individuals for the analysis in this report. The model was developed for a prior project for the Council on Foundations and INDEPENDENT SECTOR and is described in detail in the associated report, *Impact of Tax Restructuring on Tax-Exempt Organizations*.

The model is based on data from the 1994 Public Use Tax File that is issued by the Internal Revenue Service. This file contains information on over 96,000 actual tax returns. We impute information on giving by nonitemizers. This information did not appear on 1994 tax returns because it was not necessary for income tax purposes then. Rather, the imputation is based on characteristics of nonitemizers as disclosed on tax returns in 1986, the last year that they could fully deduct charitable contributions under prior law.

The model uses a two-step regression procedure to determine charitable giving. The first step determines an individual's probability of making any charitable contribution at all. The second step estimates an individual's level of giving, after he or she has been determined to be a giver. The two-step statistical procedure makes the model unique in the sophistication of its approach to the analysis of charitable contributions.

We apportion additional amounts given among the 50 States by equally weighting two factors—the percentage of nonitemizers nationwide who reside in a jurisdiction and the percentage of charitable contributions deducted nationwide that is currently originating in the jurisdiction. This information is available from IRS tabulations. We then apply the apportionment factors to an estimate of increased nationwide giving over 2000–04. We derive this 5-year total by growing our nationwide estimate for 2000 over 2001–2004 at the same growth rates as the Congressional Budget Office projected for the Gross Domestic Product in its July 2000 economic forecast.

The computations were done in 2000, as if the Bush proposal were fully effective then. Obviously the computations are one year "off" in their *fineness* if the question is about implementing the proposal today. However, the *essential character* of the results in this report is certainly applicable to the current discussion of incentives for nonitemizers to give more.

B. Results

Overview

The results are organized in the following four tables.

Table 1 shows estimates of the amounts given, number of givers, and number of itemizers under current law and the Bush proposal.

Table 2 shows estimates of the amounts given under current law and the proposal, according to the income level of the donor. It also has estimates of the number of givers under current law and the Bush proposal at various levels of income.

Table 3 shows estimates of percentage increases in amounts given under the proposal for individuals at various income levels. It also has estimates of the percentage increase in the number of givers at various income levels under the Bush proposal.

Table 4 shows estimates of additional giving in each State under the Bush proposal, for the 5-year period 2000–04.

Bush proposal

The Bush proposal would stimulate additional giving of $14.6 billion in 2000, an increase of 11.19 percent. The largest responses in percentage terms—about 25 percent in some income brackets—would occur among individuals whose incomes are under $70,000 (Table 3). In the $20,000–$30,000 income bracket, where the percentage response is greatest, the average contribution over all (giving and nongiving) tax-filing units would increase from approximately $611 to $767.

Increased contributions would come from three segments of the population:

- *New givers.* The proposal would encourage 11.7 million tax-filing units to become new givers, an increase of 16.6 percent in the number of givers. The greatest percentage increase in new givers would come in the lower income brackets (Table 3). Indeed, about three-quarters of the new givers would have incomes under $40,000. One might expect this outcome because the proposal is structured to benefit nonitemizers and most individuals with incomes under $40,000 (about 88 percent) do not itemize deductions under present law. By contrast, only 14 percent of tax-filing units with incomes above $70,000 do not itemize at present.
- *Current givers who don't itemize.* Some additional giving would come from individuals who are giving at present and are not itemizing deductions under present law. Unfortunately, we cannot estimate their number with this analysis.
- *Switchers.* There would be about 3.9 million "switchers" under the proposal. A switcher itemizes deductions under present law but would not itemize under the proposal. The profile of a switcher is a taxpayer whose itemized deductions consist mainly of charitable contributions. A switcher would be able to deduct more under the proposal by combining the standard deduction with an above-the-line charitable deduction than by using the itemized deductions of present law.

The technical property of the Bush proposal that generates large estimated increases in charitable contributions and particularly draws out new givers is its "first-dollar" coverage. That is, an individual would receive a tax benefit by giving just one more dollar, whatever the amount of his or her current giving. This feature differs from some other proposals that would allow no deduction for a threshold amount of giving—sometimes put at $500 to $2,000. With a $2,000 threshold there is no tax incentive to give anything more or anything at all unless one intends to give more than $2,000, and then the total benefit on $2,001 of giving is just 15 cents for an individual in the 15-percent tax bracket. Lower thresholds provide greater incentives to give and give more, and no threshold provides the greatest incentive of all.

State perspective

Under the Bush proposal the greatest increases in charitable contributions and about half of the national increase would arise in California, New York, Texas, Florida, Illinois, Pennsylvania, New Jersey, Ohio, and Michigan (Table 4). These are States that account for relatively large percentages of deducted charitable contributions and nonitemizing individuals under present law, the two factors used to apportion the nationwide change to the States.

Consistent with our analysis of increased giving nationwide, an additional factor that ideally would be used to apportion changes to the States is the residence of switchers. However, this information is neither available in nor readily inferred from IRS data that are ordinarily offered to the public. Thus, while the estimates shown in Table 4 should be useful indicators, further research into identifying the residence of prospective switchers would be desirable to see whether it would materially change the apportioned amounts.

Table 1.—Amount given, number of givers and number of itemizers

[2000]

	Amount given ($ billions)	Number of givers (millions)	Number of itemizers (millions)
Present law	130.3	70.7	39.5
Bush proposal	144.9	82.4	35.6

Source: PricewaterhouseCoopers LLP Individual Tax Model simulations.

Table 2.—Amount given and number of givers, by AGI

[2000]

AGI class	Amount of giving ($millions)		Number of givers (thousands)	
	Present law	Bush proposal	Present law	Bush proposal
Less than 0	199	199	171	171
0–5,000	726	907	1,435	1,955
5,000–10,000	2,546	2,950	3,548	4,708
10,000–15,000	3,981	4,818	4,825	6,334
15,000–20,000	4,935	6,181	5,451	7,144
20,000–30,000	11,515	14,455	10,514	12,994
30,000–40,000	10,456	12,872	8,598	10,239
40,000–50,000	9,878	11,706	7,283	8,263
50,000–60,000	10,026	11,271	6,618	7,214
60,000–70,000	10,284	11,595	5,539	5,940
70,000–80,000	7,490	8,213	4,058	4,342
80,000–90,000	7,158	7,560	3,048	3,166
90,000–100,000	5,024	5,315	2,218	2,304
100,000–200,000	20,205	20,743	5,733	5,912
200,000–500,000	10,333	10,480	1,326	1,373
500,000–1,000,000	4,234	4,275	203	215
1,000,000 or More	11,319	11,347	96	101
Total	130,310	144,887	70,664	82,375

"AGI" is adjusted gross income for federal income tax purposes.
Source: PricewaterhouseCoopers LLP Individual Tax Model simulations.

Table 3.—Percent change in amount given and number of givers, by AGI

[2000]

AGI class	Percent change in amount given	Percent change in givers
	Bush proposal	Bush proposal
Less than 0	0.00%	0.00%
0–5,000	24.93%	36.18%
5,000–10,000	15.87%	32.71%
10,000–15,000	21.02%	31.26%
15,000–20,000	25.25%	31.07%
20,000–30,000	25.53%	23.59%
30,000–40,000	23.11%	19.09%
40,000–50,000	18.51%	13.45%
50,000–60,000	12.42%	9.01%
60,000–70,000	12.75%	7.25%
70,000–80,000	9.65%	6.99%
80,000–90,000	5.62%	3.87%
90,000–100,000	5.79%	3.85%
100,000–200,000	2.66%	3.12%
200,000–500,000	1.42%	3.54%
500,000–1,000,000	0.97%	6.01%
1,000,000 or More	0.25%	5.97%
Total	11.19%	16.57%

"AGI" is adjusted gross income for federal income tax purposes.
Source: PricewaterhouseCoopers LLP Individual Tax Model simulations.

Table 4.—Additional amount given, by state

[2000–2004 total, in millions of dollars]

State	Bush proposal
United States	80,637
Alabama	1,266.66
Alaska	186.01

Table 4.—Additional amount given, by state—Continued

[2000–2004 total, in millions of dollars]

State	Bush proposal
Arizona	1,250.75
Arkansas	712.94
California	9,451.96
Colorado	1,245.31
Connecticut	1,110.12
Delaware	238.02
Florida	4,640.57
Georgia	2,429.75
Hawaii	312.03
Idaho	335.73
Illinois	3,600.85
Indiana	1,667.72
Iowa	780.06
Kansas	766.95
Kentucky	983.21
Louisiana	1,093.47
Maine	306.62
Maryland	1,731.75
Massachusetts	1,889.79
Michigan	2,836.97
Minnesota	1,480.95
Mississippi	727.02
Missouri	1,525.91
Montana	223.09
Nebraska	522.35
Nevada	565.26
New Hampshire	330.54
New Jersey	2,554.79
New Mexico	425.94
New York	6,103.47
North Carolina	2,329.17
North Dakota	166.62
Ohio	3,114.36
Oklahoma	928.20
Oregon	912.02
Pennsylvania	3,393.20
Rhode Island	259.09
South Carolina	1,153.50
South Dakota	206.55
Tennessee	1,654.39
Texas	5,591.82
Utah	866.95
Vermont	157.13
Virginia	2,081.97
Washington	1,695.14
West Virginia	394.95
Wisconsin	1,480.60
Wyoming	172.59

Source: PricewaterhouseCoopers LLP Individual Tax Model simulations.

The total for the United States includes the District of Columbia ($242 million) and other jurisdictions ($540 million) not shown separately.

The national total is apportioned to a State according to the percentages of nationwide nonitemizers in the State and nationwide charitable contributions deducted by residents of the State.

Attachment C

INDEPENDENT SECTOR

A Charitable Tax Deduction for Nonitemizers Should Be Enacted by Congress

Since Congress permitted the charitable tax deduction for nonitemizers to sunset in 1986, seven of ten taxpayers, the nonitemizers, can no longer deduct their charitable contributions and the resulting loss in charitable giving has been substantial.

This becomes obvious when a comparison is made of the amount contributed by itemizers and nonitemizers who are in the same income groups.

Income group	Amount contributed by itemizers	Amount contributed by nonitemizers	% of income contributed by itemizers	% of income contributed by nonitemizers
$1 < $5,000	$308	$29	10.6	1.1%
$5,000 < $10,000	$738	$138	9.3	1.8%
$10,000 < $15,000	$941	$216	7.4	1.7%
$15,000 < $20,000	$1,186	$285	6.8	1.7%
$20,000 < $25,000	$1,150	$330	5.1	1.5%
$25,000 < $30,000	$1,333	$364	4.8	1.3%
$30,000 < $40,000	$1,349	$465	3.9	1.3%
$40,000 < $50,000	$1,425	$654	3.2	1.5%
$50,000 < $75,000	$1,740	$965	2.8	1.6%
$75,000 < $100,000	$2,357	$1,333	2.7	1.6%
$100,000 < $200,000	$3,466	$1,254	2.6	1.0%
$200,000 < $500,000	$7,694	$2,934	2.7	1.0%
$500,000 < $1 million	$19,651	$6,876	2.9	1.0%
$1 million or more	$140,972	$21,015	4.7	1.0%

The average annual amount contributed per tax return for itemizers is $2,708; the average for nonitemizers is $328.

Eighty-seven million tax filers are nonitemizers. It is clear that if all nonitemizers raised their contributions to the amount given by itemizers, giving would increase greatly. In fact, charitable contributions by nonitemizers increased by 40% or $4 billion from 1985 to 1986, according to Internal Revenue

Service data. Nonitemizers were permitted to deduct only 50% of their charitable contributions and they gave $9.5 billion that year. In 1986, they could deduct a full 100% and, according to the IRS, they gave $13.4 billion—an increase of 40%. The message from that experience is apparent. Charitable tax deductions do stimulate substantially increased giving from middle income Americans.

Nonitemizers are low to middle income American households (70 million have incomes under $30,000 a year) who support services such as the Red Cross and the American Cancer Society. They give to churches and synagogues, environmental organizations, schools, colleges, hospitals, food programs for the homeless, and the Boy Scouts and Girl Scouts. They give to advocacy organizations, health research, the arts, international development, and myriad activities in the public interest that enrich our society and protect its people. Congress should enact a legislation that will permit these moderate income Americans to take a deduction for their contributions to charity.

Source: Data prepared for *The New Nonprofit Almanac and Desk Reference* (Jossey-Bass, 2001) using data from the IRS Statistics of Income Bulletin, Spring 2000.

Statement of Frederick J. Jaindl, Sr., Owner, Jaindl Family Farms

Mr. Chairman and Members of the Committee, I am Frederick J. Jaindl and I am the Owner of Jaindl Family Farms in Orefield, Pennsylvania.

In 1947, after serving time in the armed forces, I started a turkey farm with $600. Over the years, working long days, seven days a week, every day of the year, I was able to build our farm in to the largest singly owned turkey farm in the United States.

Like many American farmers, everything my wife and I earned was reinvested into the farm, except for monies for taxes and necessities. We worked hard at constantly improving the farm, investing in equipment, land and people. Today we employ over 100 hard working men and women. During the past 50 years we have purchased more that 13,000 acres of land to grow grain to feed our turkeys.

My wife and I have eight children and fourteen grandchildren. All their life we instilled the values of hard work and the importance of family. Today I am blessed to have all my children working beside me on the farm.

My concerns regard what I will be able to leave to my children. The current estate taxes will severely limit my ability to pass down the family farm. Everything my wife and children and I have worked for is in our land. With the current estate tax laws my children may lose everything we have worked a lifetime to build and be forced to liquidate our family farm. Our family legacy may become just another one of the 70% of the family farms that was killed by the death tax.

American farmers are faced with a daily lifetime of battles including droughts, floods, maintaining healthy flocks and herds, etc. and our reward for our years of hard work and dedication is knowing that our largest battle will have to be faced by our children in their battle to try to hold onto the family farm. We worked hard all our lives and always paid our taxes and when we die the government will tax our children on money they have already taxed us on.

This is an issue that all Americans should be deeply concerned about. The death of the American Family Farms doesn't just affect the farmers and their families it affects our entire nation. We farmers feed the nation, so the next time you take a bite out of apple, pour milk into a child's cup or when contemplating what you'd would like for breakfast, think about where the nation will be once all the family farms have been killed by the death tax.

I strongly urge the Committee on Ways and Means to support the elimination of the federal estate tax.

NATIONAL CONFERENCE OF STATE LEGISLATURES
WASHINGTON, DC 20001
February 8, 2001

The Honorable William M. Thomas, Chair
House Committee on Ways and and Means
United States House of Representatives
Washington, DC 20515

Re: Federal Tax Relief

Dear Chairman Thomas:

National Conference of State Legislatures is mindful of the role that tax relief can play in providing taxpayers increased flexibility to make economic choices. NCSL recognizes these fiscal dynamics particularly because many state legislatures have enacted a variety of tax relief measures over the past six years while maintaining balanced budgets. NCSL believes that any tax relief legislation must ensure that the federal budget remains balanced. It also should require that mandatory and entitlement spending for state-federal partnerships be solidified to avoid cost shifts to states. Federal tax relief must also be coupled with assurances for meeting current and future Medicare and Social Security obligations as well as debt reduction throughout the duration of any tax relief package.

The nation's state legislators believe that federal tax reform should encourage work, savings, equity and simplicity. There are many tax-related issues NCSL urges you to include in tax relief legislation, each of which would provide taxpayers additional assistance beyond general income tax changes. The following tax initiatives have broad bipartisan support. Each was included in various tax-related legislation during the last Congress. The National Conference of State Legislatures urges your support for the following in the 107th Congress:

(1) Comprehensive Retirement Security and Pension Reform: NCSL urges your support for comprehensive pension reform and modernization legislation designed to increase savings, enhance pension portability and simplification. Such legislation should facilitate the purchase of service credit by public employees and allow catch-up contributions to be made by older workers. It should also modernize rules related to governmental deferred compensation plans, repeal compensation-based limits that unfairly curtail retirement savings and restore benefit and contribution limits that are generally lower than they were eighteen years ago. Each of these provisions, included in H.R. 1102 during the 106th Congress, enjoyed broad bipartisan support, passing the House twice with 401 votes and approved unanimously by the Senate Finance Committee. We understand that Representatives Rob Portman and Ben Cardin will introduce a similar bill within the next few days.

(2) School Construction and Modernization: NCSL has long supported a broad approach to federal school construction assistance with the caveat that its form should reinforce state constitutional primacy over education and finance policy issues. That approach was included collectively in H.R. 4094, H.R. 1648 and H.R. 2614 in the 106th Congress. NCSL has consistently supported the lifting of arbitrage restrictions on school bonds and the expansion of the definition of private activity bonds to include school facilities. Current arbitrage rules essentially tax interest income on these bonds at a rate of 100 percent and thereby limit the states' abilities to leverage infrastructure funds for school construction and modernization.

No one proposal can address the $120 billion need for school repairs and renovations identified by the Government Accounting Office. Therefore, NCSL believes the creation of a school construction state revolving fund and a federal grant program would help address identified school construction needs. We are pleased that you have included a private activity provision in your tax relief proposals. We urge you to consider adding our additional suggestions to your overall tax relief package.

(3) Strengthening Investment in High-Speed Rail Development: NCSL believes that providing states with incentives for investment in high-speed rail corridors would bolster an underdeveloped transportation alternative. These incentives would also assist states that have invested in rail but do not yet have designated high-speed rail corridors. Additionally, development of this transportation alternative will ease burdens that persist with the nation's roadways and airways. The High Speed Rail Investment Act of 2001, recently introduced by Senators Joe Biden and Kay Bailey Hutchison, contains the bonding authority NCSL believes is necessary to make high-speed rail a financially viable transportation alternative for states. I am hopeful that it will enjoy your support and inclusion in any tax relief legislation.

(4) Earned Income Tax Credit: NCSL supports the federal EITC as a means of reducing poverty among working poor families and ensuring that the benefits of work surpass the benefits of public assistance. Because an expanded EITC supplements the wages of low-income working families without decreasing work incentives, NCSL supports federal efforts to increase the value of the credit and adjust it for family size. Similarly, NCSL supports removing the marriage penalty associated with the credit.

(5) Sales Tax Deductibility: H.R. 322, the Tax Deduction Fairness Act recently introduced by Representative Brian Baird and Bob Clement, would partially restore the deductibility of state sales taxes. It would give taxpayers the option of deducting states sales or income taxes when itemizing federal tax deductions. NCSL has long supported the restoration of sales tax deductibility on the grounds that the inability to deduct these taxes unfairly burdens taxpayers in states where no income tax is applied (Florida, Nevada, South Dakota, Tennessee, Texas, Washington and Wyoming).

We look forward to working with you as the federal budget and reconciliation process moves forward. If we can provide additional information, please have your staff contact Gerri Madrid (202–624–8670) or Michael Bird (202–624–8686).

Sincerely,

SENATOR JIM COSTA
California Senate
President, NCSL

LA MIRADA, CALIFORNIA 90638
February 21, 2001

Allison Giles
Staff Director, Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Ref: President Bush's tax relief proposal.

Dear Madam,

I would like to submit this written statement for consideration by the Committee and for the inclusion in the printed record of the hearing. It is my understanding that President's Bush's tax relief proposal includes, among other things, reductions in individual income tax rates.

First, I must applaud the President for keeping his campaign promise in regards to the tax issue. The President indeed understands how necessary his tax relief plan is to the nation. The President's proposal, however, does have a flaw. It requires government to work harder and to conjure new remedies for the "Social Security problem," which his existed for many years. In addition, I believe that potentially depriving government of additional monies creates fear for many government officials since they will be required to become more efficient and cost conscious. This fear is what may potentially stop the proposal from becoming law.

Second, opponents argue that the President's tax relief proposal isn't fair because the poor will not benefit. Doesn't the poor benefit by paying fewer taxes in the first place? Must we reward individuals that pay no taxes or who are in the 15 percent tax bracket? Furthermore, aren't these the same individuals that qualify for the earned income credit? The President's plan is to enact an across-the-board tax relief so that all Americans who pay taxes get something back. Isn't that fair?

Third, our economy has slowed down dramatically over the past year and continues. The last estimate I read indicates that consumer spending is about 68 percent of the gross domestic product. In other words, we depend on consumer spending to help make the economy grow. If all of this spending slows or drops, our economy is going to be in serious trouble. We need to cut taxes to create growth. Economists may argue that lowering interests rates will alleviate the economy from the slowdown. I tend to disagree. Thus far, our economy hasn't witnessed any positive signs despite the recent reductions in the federal funds rate.

Finally, to those who believe that we cannot afford the tax relief. Please be aware that just recently, tax surplus estimates jumped $1 trillion to $5.6 trillion over the next ten years. Also, the House voted to lock away much of that tax surplus to strengthen Social Security and Medicare. In other words, estimates indicate that there is plenty of tax surplus left over to give Americans tax relief, pay off our national debt, and increase resources for other priorities.

We need to support our new President. We need to make a real difference in the lives of taxpaying Americans. Let's stop making excuses. Let's stop punishing the taxpayers.

Thank you for your time.

Respectfully,

STACY SALAZAR
Taxpayer

○