AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

S. HRG. 108–521

CONCURRENT RESOLUTION ON THE BUDGET FOR FISCAL YEAR 2005

HEARINGS

BEFORE THE

COMMITTEE ON THE BUDGET UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

January 27, 2004—CBO BUDGET AND ECONOMIC OUTLOOK

February 5, 2004—THE PRESIDENT'S BUDGET PROPOSAL

February 12, 2004—THE PRESIDENT'S FISCAL YEAR 2005 BUDGET PROPOSAL

February 13, 2004—THE PRESIDENT'S FISCAL YEAR 2005 BUDGET PROPOSAL

February 25, 2004—THE PRESIDENT'S HOMELAND SECURITY

U.S. GOVERNMENT PRINTING OFFICE

94–065pdf WASHINGTON : 2004

Printed for the use of the Committee on the Budget

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON THE BUDGET

DON NICKLES, Oklahoma, *Chairman*

PETE V. DOMENICI, New Mexico
CHARLES E. GRASSLEY, Iowa
JUDD GREGG, New Hampshire
WAYNE ALLARD, Colorado
CONRAD BURNS, Montana
MICHAEL ENZI, Wyoming
JEFF SESSIONS, Alabama
JIM BUNNING, Kentucky
MIKE CRAPO, Idaho
JOHN ENSIGN, Neveda
JOHN CORNYN, Texas

KENT CONRAD, North Dakota
ERNEST F. HOLLINGS, South Carolina
PAUL S. SARBANES, Maryland
PATTY MURRAY, Washington
RON WYDEN, Oregon
RUSSELL D. FEINGOLD, Wisconsin
TIM JOHNSON, South Dakota
ROBERT C. BYRD, West Virginia
BILL NELSON, Florida
DEBBIE STABENOW, Michigan
JON S. CORZINE, New Jersey

HAZEN MARSHALL, *Majority Staff Director*
MARY ANN NAYLOR, *Staff Director*

CONTENTS

HEARINGS

	Page
January 27, 2004—CBO Budget and Economic Outlook	1
February 5, 2004—The President's Budget Proposal	71
February 12, 2004—The President's Fiscal Year 2005 Budget Proposal	123
February 13, 2004—The President's Fiscal Year 2005 Budget Proposals	203
February 25, 2004—The President's Homeland Security	263
February 26, 2004—The President's International Affairs Budget	331

STATEMENTS BY COMMITTEE MEMBERS

Chairman Nickles 1, 71, 123, 203, 263, 331
Senator Bunning 161, 242, 301, 370
Senator Conrad 2, 71, 124, 207, 264, 332
Senator Domenici 162, 242, 340, 367
Senator Enzi 136, 115
Senator Feingold 167, 113, 299
Senator Johnson 192

WITNESSES

Bolten, Joshua, Director, Office of Management and Budget	83
Holtz-Eakin, Douglas, Director, Congressional Budget Office	22
Powell, Hon. Colin L., Secretary, United States Department of State	355
Ridge, Tom, Secretary, Department of Homeland Security	291
Snow, John, Secretary, United States Department of the Treasury	211
Thompson, Hon. Tommy G., Secretary, United States Department of Health and Human Services	167

QUESTIONS AND ANSWERS

Questions and Answers 116, 243, 303, 381

ADDITIONAL MATERIALS AND CHARTS SUBMITTED

Testimony, charts, and graphics submitted 371

THE CONGRESSIONAL BUDGET OFFICE BUDGET AND ECONOMIC OUTLOOK

TUESDAY, JANUARY 27, 2004

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:07 a.m., in room SD–608, Dirksen Senate Office Building, Hon. Don Nickles (chairman of the committee) presiding.

Present: Senators Nickles, Domenici, Gregg, Allard, Enzi, Sessions, Bunning, Crapo, Ensign, Conrad, Hollings, Sarbanes, Wyden, Nelson, and Stabenow.

Staff present: Hazen Marshall, majority staff director; and Cheri Reidy, senior analyst for budget review/revenues.

For the minority: Mary Ann Naylor, staff director; and Jim Horney, deputy staff director.

OPENING STATEMENT OF CHAIRMAN NICKLES

Chairman NICKLES. Good morning. This morning, we will hear testimony on CBO's budget and economic outlook for the years 2005–2014. We are delighted that Dr. Holtz-Eakin is with us again. We look forward to his presentation before the committee.

For the information of our members, we have scheduled several hearings in a rather aggressive schedule, trying to comply with our statutory deadline of completing the budget resolution conference agreement by April 15th. The House is going to be in recess for 2 weeks prior to that. We are going to be in recess 1 week prior to that. So we are going to have a fairly aggressive schedule, about a week faster than we did last year, to complete our work by the deadline. We actually have to be—for the Senate, we have to complete by April the 9th because we are in recess on April the 12th. So we are going to have a fairly aggressive schedule.

Next week, we will have OMB testify on Tuesday. Then we also have a hearing scheduled a week from tomorrow with Secretary Snow. And then following that, we have a hearing scheduled with Secretary Thompson, Secretary Colin Powell, and we also hope to have Defense and Homeland Security hearings scheduled.

So we are going to have a fairly busy couple of months to have this completed really by the end of March, and I want to thank my colleagues for their cooperation in that. I also want to thank colleagues for the tenor and the tone of the hearings that we had last year as well as the markup in committee and debate on the floor. I think we were able to proceed senatorially, and I thank my colleagues, especially my colleague from North Dakota. And I will call

upon him for his opening remarks as well, and then I might make a few remarks afterwards.

Senator Conrad.

OPENING STATEMENT OF SENATOR CONRAD

Senator CONRAD. Thank you, Mr. Chairman, and thank you for the many courtesies that you and your staff have extended to our side of the aisle. I do think we can have differences, very serious policy differences, but do it in a way that is in the spirit of cooperation, and I think we have done that, and that is much to your credit.

I would also like to welcome the Director here today. As a native of Syracuse, I am not surprised you were able to make it. It is amazing what happens in this town with a little bit of snow. All of a sudden, everything shuts down. But I am glad to see that you are here.

Mr. Director, I very much appreciate the analysis that you have put before us because I think it is important to the work of this committee and important to the work of the Congress.

This was the headline this morning in the Washington Post: CBO says the deficit will reach $477 billion this year. Pretty stunning. That is $100 billion more than the biggest deficit we have ever had in this country. And the sub-headline says, "Extending Tax Cuts Could Double Debt." The President is fond of saying it is the people's money, we ought to give it back to the people. It is also the people's debt. And, in effect, what the President is doing is borrowing money from the people in order to give it back to some people and dramatically increased the debt. And I think we have to question very carefully whether this set of policies that is exploding the deficit and debt, not just in the short term—I want to make clear, I am much less concerned about the short term than I am the long term. I think it is the long-term implications of deficits and debt that is growing geometrically that we have to worry about.

The Washington Post
TUESDAY, JANUARY 27, 2004

CBO Says '04 Deficit Will Rise to $477 Billion

Extending Tax Cuts Could Double Debt

By JONATHAN WEISMAN
Washington Post Staff Writer

The federal deficit will reach $477 billion this year, up sharply from last year's $375 billion level, and the government is on track to accumulate nearly $2.4 trillion in additional debt over the next decade, the nonpartisan Congressional Budget Office said yesterday.

The government's $4 trillion debt could more than double if President Bush succeeds in making permanent an array of tax cuts that are set to expire by 2011, the CBO's annual budget report added.

Measured against the size of the economy, this year's deficit—a record in dollar terms—will still be smaller than those in six deficit years under Presidents Ronald Reagan and George H.W. Bush. CBO officials acknowledged that the cumulative deficit would shrink dramatically from 2005 to 2014—from $1.9 trillion to $785 billion—if all spending in Iraq and Afghanistan were to end this year. That is a scenario the White House and Congress do not envision.

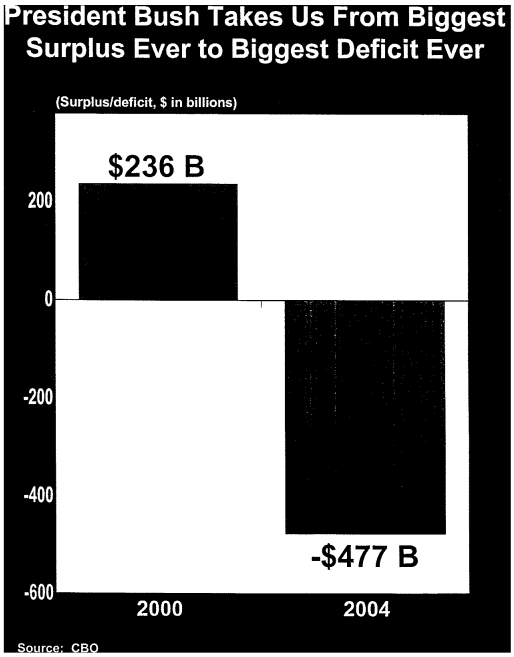
Where the deficit goes from here, the CBO said, will depend in part on a major decision facing Congress: whether to follow Bush's admonitions and make permanent the $1.7 trillion in tax cuts passed in 2001 and 2003, or to let them expire by 2011.

If they do expire, the 2004 peak deficit would gradually decline until the books bal-

See DEFICIT, *A9, Col. 1*

Let's go to the next.

In the last year of the Clinton administration, we enjoyed a $236 billion surplus. Now, in the third year of President Bush's term, we have a $477 billion deficit, by far the largest in dollar terms we have ever had. But it is not just in dollar terms that we see a large deficit. Some have said, well, the deficit is relatively small as a percentage of GDP. I think when fairly judged, one does not see that. One sees, in fact, that the deficit as a percentage of gross domestic product, excluding Social Security, looking at it on an operating basis, is extremely high by that measure as well—5.5 percent of GDP, a level that has only been exceeded once since World War II, and that was in 1983.



But it is not just the short-term deficits that alarm me. The thing that is of much greater concern is that we face an unending flood of red ink, massive budget deficits for as far as the eye can see. This result comes from building on your CBO baseline, making permanent the tax cuts that the President advocates, and fixing the alternative minimum tax, just making those two changes, no other changes—making the tax cuts permanent, which the President advocates, and fixing the alternative minimum tax, which will apply to over 40 million taxpayers by the end of this decade if we do not take action. And what you can see is deficits that are massive throughout the 10-year period.

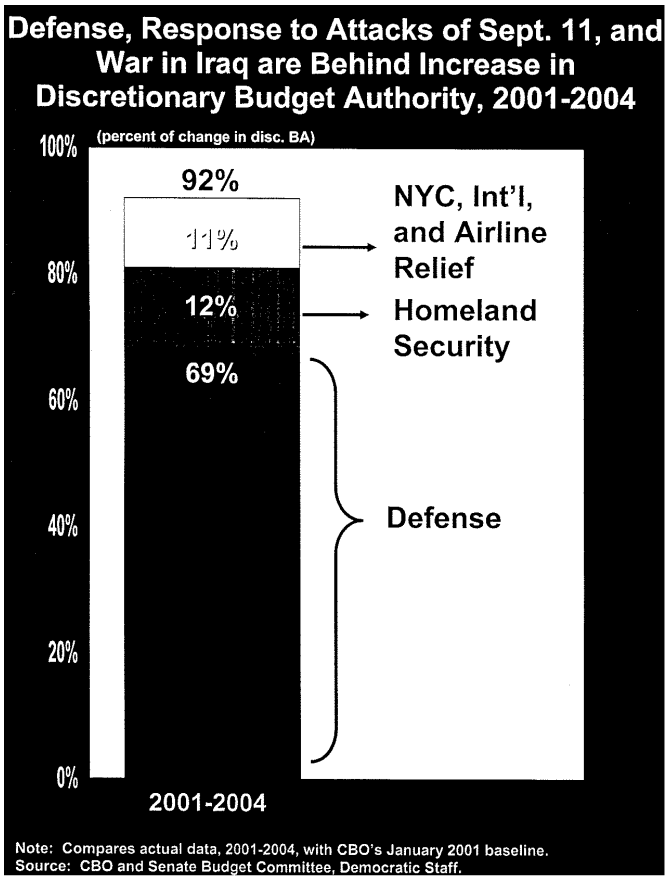
Let's go to the next chart.

Some have said, well, it is because of spending, it is a spending explosion that has created the problem. First of all, I think all of us have to acknowledge spending has gone up. But, most of the spending increase has been for defense and homeland security. That is where the big increases have occurred.

But if you look, the red line is total outlays of the Federal Government since 1980. The trend on spending as a share of gross do-

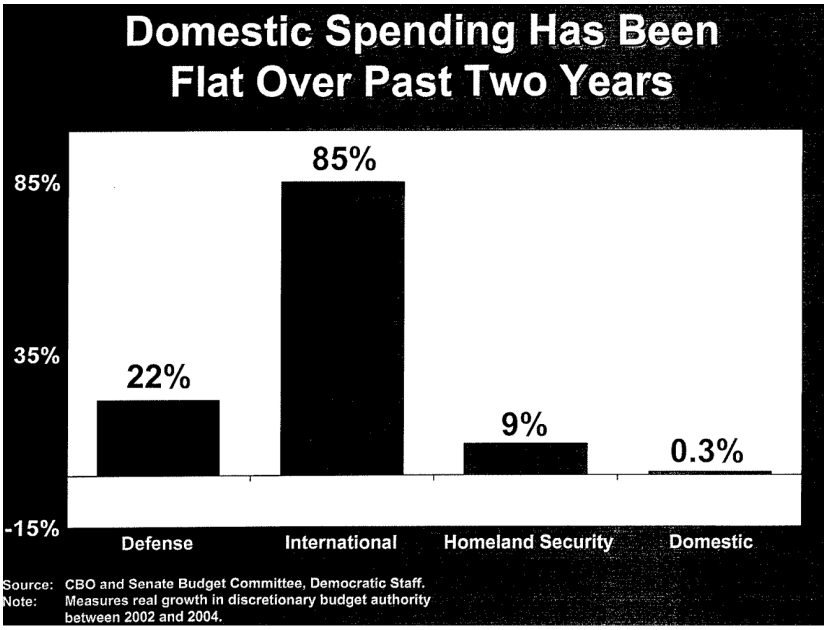
mestic product has actually been sharply downward. Yes, there has been a substantial uptick as a result of September 11th, the increased expenditures for defense and homeland security being the primary culprits. But you can see, even with those increases, we are well below the levels of the 1980's and 1990's.

Let's go to the next chart that shows where the increase has occurred. The increase in spending, 92 percent of it has been in just these categories: defense, of course, by far the biggest, which all of us supported as a response to September 11th and the other events that have transpired. The next biggest increase is homeland security. The third category is rebuilding New York, the airline bailout, and increased international spending. That is where the increases have been.



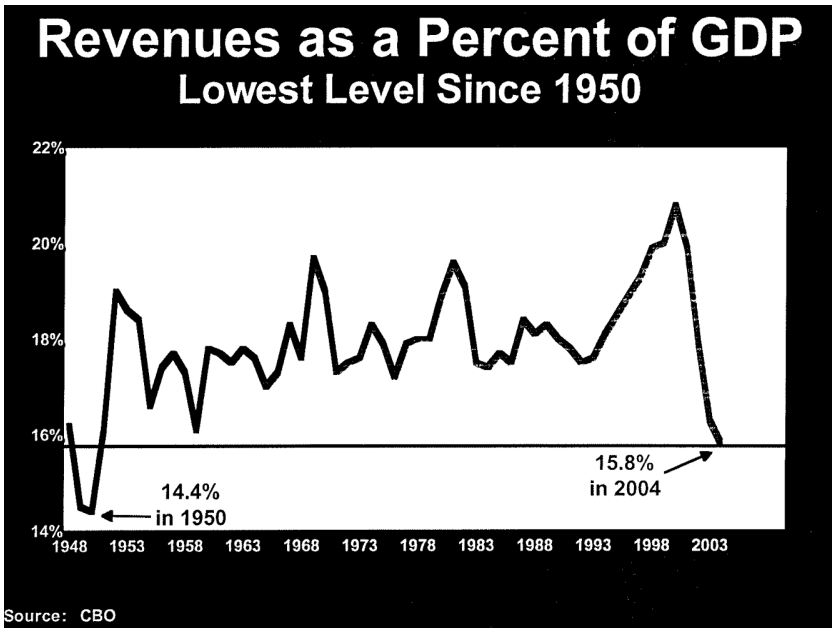
Let's go to the next chart. The President is now focused on domestic spending, which is a very small part of Federal spending. He says he is going to restrain the growth of domestic non-homeland security spending. The fact is there has been very little growth in domestic spending. Not discretionary spending. Many of us talk about discretionary spending that would include all four of these categories. But you see that domestic spending has been almost flat in real terms—in real terms there has been very little

growth. In real terms, the growth has been in defense, international, and homeland security.



Let's go to the next chart.

It is the revenue side of the equation where we have really seen things fall out. As a share of GDP, we now anticipate, with CBO's numbers, that revenue as a share of gross domestic product will reach its lowest level since 1950. So we have clearly got a serious revenue problem.



The President tells us not to worry, that he will cut the deficit in half. But if we look back on what he has told us every year, it turned out to be wrong. He told us in 2001, "We can proceed with tax relief without fear of budget deficits." That was wrong. In 2002, he told us, "Our budget will run a deficit that will be small and short term." He was wrong again. Last year, he told us, "Our current deficit is not large by historical standards." He was wrong again.

Bush Administration Claims on Deficit Have Been Consistently Wrong

2001	"[W]e can proceed with tax relief without fear of budget deficits..."	Wrong
2002	"[O]ur budget will run a deficit that will be small and short-term..."	Wrong
2003	"Our current deficit...is not large by historical standards and is manageable..."	Wrong
2004	"[T]he deficit will be cut in half over the next five years..."	Wrong Again?

Now he tells us, "The deficit will be cut in half over the next 5 years." Will he be wrong again? Well, I don't know. But I think it really misses the point because the larger truth is, whatever happens in the near term is dwarfed by the long-term implications of his budget policies.

We can see the dollar has declined precipitously against the euro, which confirms a warning that has just been made. Let's go to the next chart, and I am going to conclude on this. This was in the Washington Post of yesterday. "Currency traders, fretting over that dependency"—referring to our need to borrow money—"have been selling dollars fast and buying euros furiously. The fear is that foreigners will tire of financing America's appetites. Foreign investors will dump U.S. assets, especially stocks and bonds, sending financial markets plummeting. Interest rates will shoot up to entice them back. Heavily indebted Americans will not be able to keep up with rising interest payments. Inflation, bankruptcies, and economic malaise will follow."

Economists Worry About Long-Term Effects of Weak Dollar and Heavy U.S. Borrowing

"Currency traders fretting over that dependency have been selling dollars fast and buying euros furiously. The fear is that foreigners will tire of financing America's appetites. Foreign investors will dump U.S. assets, especially stocks and bonds, sending financial markets plummeting. Interest rates will shoot up to entice them back. Heavily indebted Americans will not be able to keep up with rising interest payments. Inflation, bankruptcies and economic malaise will follow."

– *Washington Post* article
"Weak Dollar Helps U.S. Firms, for Now"
January 26, 2004

Now, none of us know when that line is crossed, when these twin deficits, the budget and trade deficits, will lead to the kind of results that were being discussed by economists yesterday in the Washington Post. But goodness knows we have lots of warnings: the Comptroller General of the United States, warning us of the growth of deficits and debt; the International Monetary Fund, saying the growth of deficits and debt in this country threaten not only our own economic security but global economic security.

Mr. Chairman, these are serious questions and really require serious responses by this committee, the Congress, and the administration.

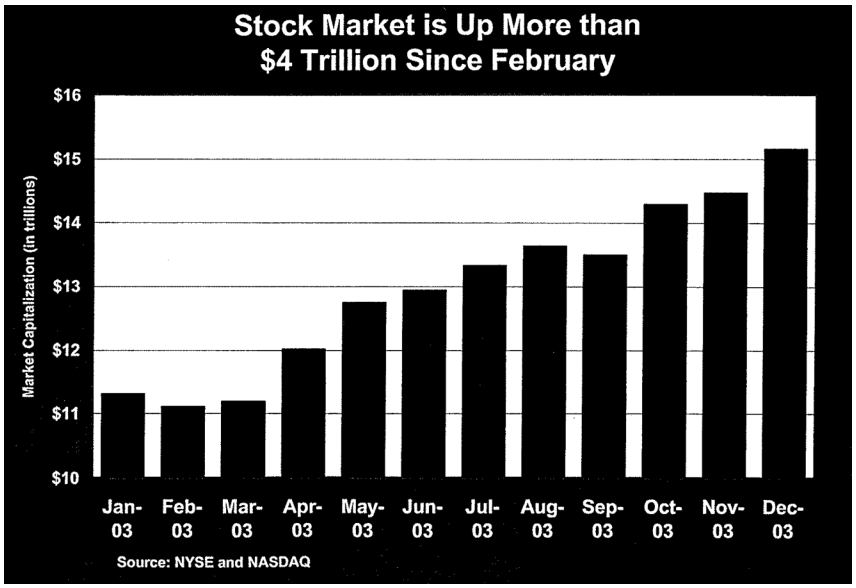
Chairman NICKLES. Senator Conrad, thank you very much.

Would you mind repeating for Senator Ensign and others the growth rate on non-defense? It might help us on our side.

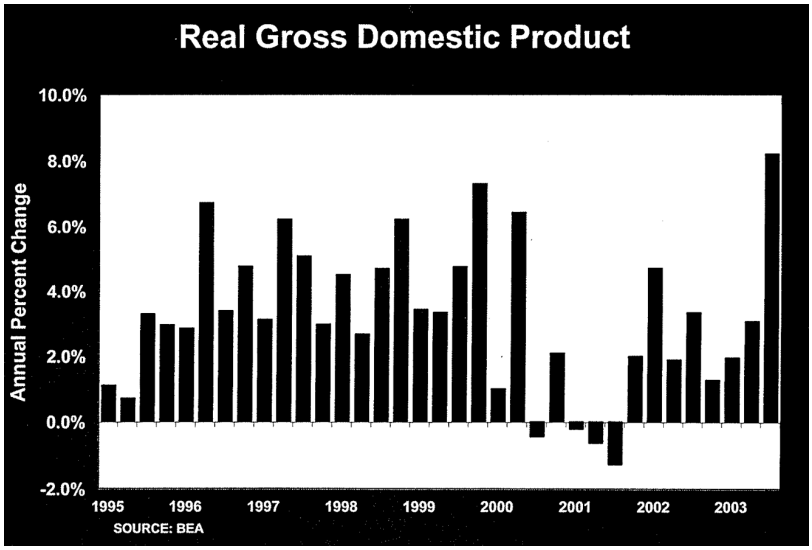
I pointed out to some of our colleagues, my good friend Senator Conrad used real growth, which is adjusted for inflation—correct me if I am wrong—and it showed not too much real growth in non-defense, non-homeland security spending for last year, and that is correct. I just wanted that to be known because we have heard otherwise, mainly because a lot of people, Heritage and others, were using growth in outlays rather than growth in budget authority, which, frankly, goes back to 2001, 2002, and 2003, things that were in progress, and so on.

Let me just make a couple of comments, and I very much appreciate my colleague. One, we did pass a stimulus package last year. I supported it. Actually, I think Democrats had a stimulus package; we had a stimulus package. We passed a stimulus package, and it worked. I have a couple of charts to show that.

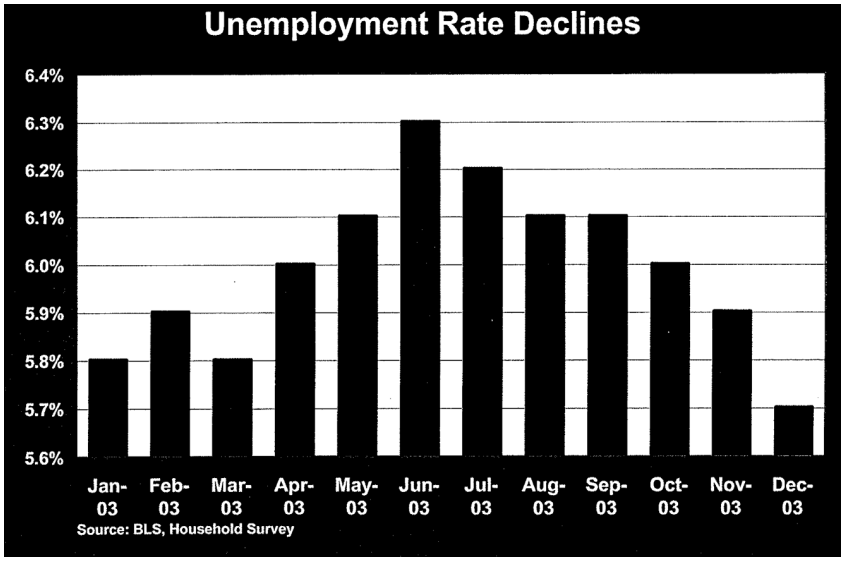
The stock market is up by several trillion, from about $11 trillion to over $15 trillion since February of last year. That is a very significant increase. I believe the New York Stock Exchange is up about 25 percent and Nasdaq up about 50 percent, and combined, a total of about 35 percent. Our tax changes that we made where we cut the rates on dividends and capital gains worked. It did stimulate the economy.

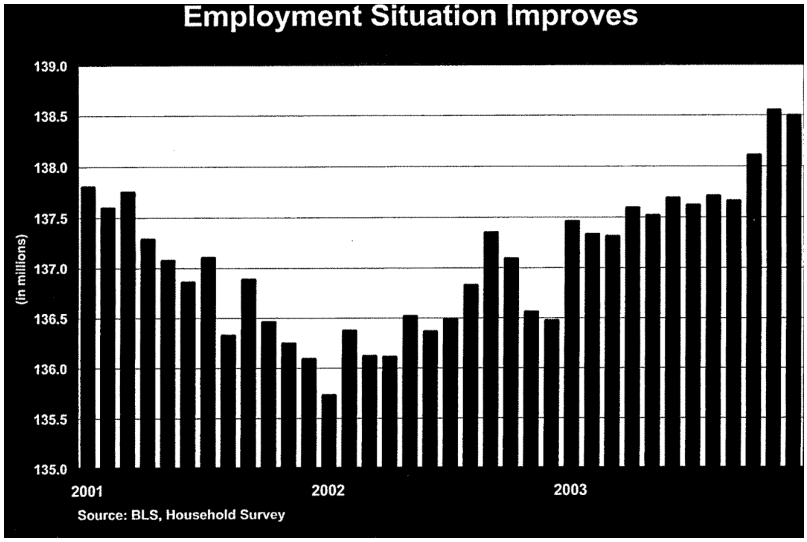


The gross domestic product, which had its first decline in 2000 and then went further down in 2001, has shown significant appreciation, particularly the last couple quarters. And so the economy is starting to move, and that is very positive.

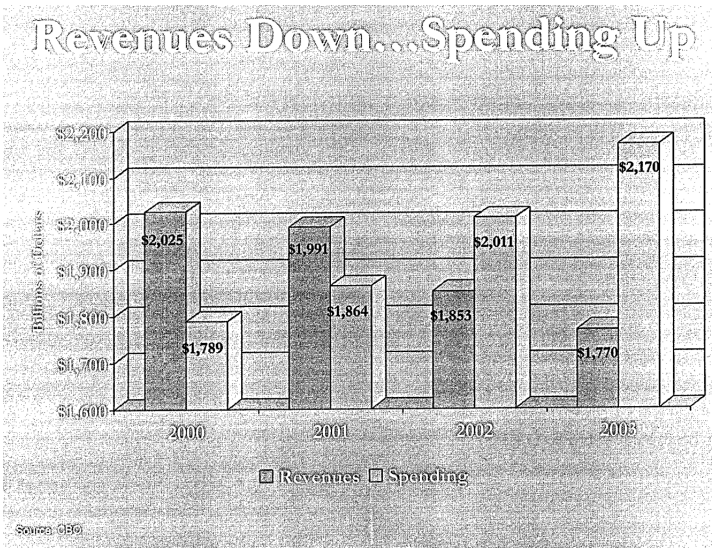


The unemployment rate has declined. It has declined from a high of about 6.3 percent to 5.7 percent, so that is positive. Total employment has improved, and improved dramatically. If you use the household survey, which includes self-employed and others, the total employed has risen rather dramatically, particularly in the last three quarters. So we are seeing some positive signs.





I also agree with Senator Conrad; there are two reasons for this big deficit. One is that revenues have gone down, and you might show that chart. The revenues are in the green. Revenues in the year 2000 were over $2 trillion. Now, last year, the year completed, 2003, they are at $1.78 trillion. That is about a $240 billion reduction, a reduction every year, the first time in history that has happened. That did not happen solely because of the tax cuts. It happened primarily because the economy really did drop—tank—in the year 2000. Nasdaq declined by about 50 percent in the year 2000. It is kind of interesting reading these articles. When did the recession start? Well, if you look at the stock market, the recession started in March of 2000 because Nasdaq was about 4,000 and Nasdaq was at 2,000 in December. So that has caused a precipitous decline in revenue.



And then Senator Conrad is also correct, we have had a lot of new spending primarily to fight the war on terrorism. We have had a total of $242 billion in supplemental appropriations to fight the war on terrorism. Between the aid for New York and the Pentagon as a direct result of September 11, that was about $40 billion, and then we have had a supplemental last year of $87 billion, the year before that I think $91 billion to fight the war in Afghanistan and Iraq. So a total of $242 billion.

Now, there are some other things that were added to that. We had about $30 billion in emergency unemployment benefits and so on, but a very significant increase in spending, I believe one-time spending. Now, correct me if I am wrong, Mr. Director, but under your proposal—or under your snapshot, you assume that the $87 billion that was in the supplemental last year would be ongoing throughout the next 10 years. That is not going to happen. We may have some additional supplemental spending for our efforts in Iraq and Afghanistan, but I do not believe they will be anywhere near the $87 billion. So that is inflated in the baseline and will be reduced.

Also, the assumption that, well, all tax cuts that were enacted will be extended is false. I do not believe that is intended by this Senator. We had some things that were done temporarily to stimulate the economy: the accelerated bonus depreciation, which most people supported. It had strong bipartisan support, but the policy was for a short period of time to encourage investment in the next year or so, to get the economy going, to break out of that doldrum, to get some economic activity, to create some jobs. And so we did that.

I think you can paint lots of scenarios that are very bad, but I do not think that is going to happen. And will we get the deficit down in half? It is very much this Senator's intention to do that and more. And so we will see if we cannot work together to do it.

I also want to agree with Senator Conrad, long term there are serious problems, and particularly demographically when you look at Medicare, and we added to that last year when we passed the prescription drug bill. My guess is the cost of that will greatly exceed expectations, and I will ask Director Holtz-Eakin about that in a little bit. But long term, that is a big, big, big challenge, and we need to be able to address it.

But I might mention that was supported by members of both parties, and I might mention, too, that there were amendments on the floor that would have had a much more expensive proposal than what we ended up enacting. I believe 50 percent more was supported by a majority of members on the Democrat side.

So long term, we have big challenges, and we need to work together. They will never be solved by one party or another. We need to work together to solve those, and I look forward to working with any of my colleagues that show an interest in trying to do that. And this Senator for one is willing to bite off as much as we can bite off this year. I realize it is an election year, but I am more than happy to work with my colleagues to try and fashion a package. I would love to have a bipartisan budget this year, and I would love to see us work together to solve some of these problems, both short term and long term. So I thank my colleagues.

Unless colleagues are just dying to make an opening statement, I would like to call upon Dr. Holtz-Eakin to make his remarks, and then we will alternate back and forth according to time of appearance for colleagues to ask questions. Is that agreeable?

Dr. Holtz-Eakin, thank you very much for your appearance this morning.

Senator SARBANES. Will the chairman appropriately note that many of us gave up making opening statements and keep that in his ledger book?

Chairman NICKLES. We will always give the Senator from Maryland great points for that, and I would ask Dr. Holtz-Eakin if he could keep his remarks to 10 or 12 minutes, and then ask my colleagues to try to keep their questions to a 5- or 6-minutes per round.

Dr. Holtz-Eakin?

STATEMENT OF DOUGLAS HOLTZ-EAKIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. HOLTZ-EAKIN. Mr. Chairman, Senator Conrad, members of the committee, thank you for the opportunity to appear today. You have our report outlining the economic and budget outlook for fiscal years 2005–2014. We have also submitted an abbreviated version of that report as written testimony for the record. I will provide an even more abbreviated version in my oral remarks so that we can turn to any questions that might remain.

Let me begin with the numbers. The CBO projects that the Federal Government will experience a deficit of $477 billion in fiscal year 2004. This will decline over the budget window. In 2005, we project $362 billion; in 2006, it would be down to $269 billion and would steadily diminish thereafter, until the budget reaches balance in the years, roughly speaking, after 2011. In particular, the $477 billion, as noted, is a record dollar deficit for the Federal Gov-

ernment. As a fraction of GDP, or national income, and a measure of our resources to service all commitments, it is 4.2 percent, and the projections are that it will diminish first to 3 percent and then down to 2.1 percent.

CBO's Baseline Budget Outlook

	Actual 2003	2004	2005	2006	Total, 2005-2009	Total, 2005-2014
	In Billions of Dollars					
Total Revenues	1,782	1,817	2,049	2,256	11,840	28,004
Total Outlays	2,158	2,294	2,411	2,525	13,282	29,897
Total Deficit	-375	-477	-362	-269	-1,443	-1,893
	As a Percentage of GDP					
Total Deficit	-3.5	-4.2	-3.0	-2.1	-2.2	-1.3
Debt Held by the Public at the End of the Year	36.1	38.3	39.5	39.9	n.a.	n.a.

01-27-04 1

Another measure of the fiscal condition is the debt-to-GDP ratio, and these projections have a debt-to-GDP ratio that rises from about 38 percent, reaches between 40 and 41 percent, and plateaus there until after 2011, at which point it begins to diminish down to about 35 percent.

Now, as has been noted, the CBO projections are built on several pieces. The first pieces are economic forecasts, which I will touch on briefly. They are also built on the baseline concept of a neutral benchmark against which further legislation can be measured. That neutral benchmark requires us to extend current law in the course of the projection period.

In this particular context, that has implications on both sides of the budget. On the receipt side, we assume that the tax cuts passed in 2001 and 2003 sunset on schedule, as written in law. And on the spending side, we assume not only that current mandatory programs will evolve according to the demographics and structure of those programs, but that all discretionary spending currently on the books, inclusive of the $87 billion supplemental, will remain on the books over the 10-year projection window and that the spending will rise only at the rate of inflation. So our assumptions in this baseline show discretionary spending rising at 2.5 percent per year, and they include the $87 billion supplemental.

Now, in terms of changes in the budget outlook since we last reported in August, there are really two major developments. The first is the economy, which has grown even faster than we had projected in August. Our August projection included a fairly robust cyclical recovery. In the third quarter of this year, we saw GDP growth really much stronger than we had projected. And, indeed, it may be the case that the fourth quarter turns out to be stronger

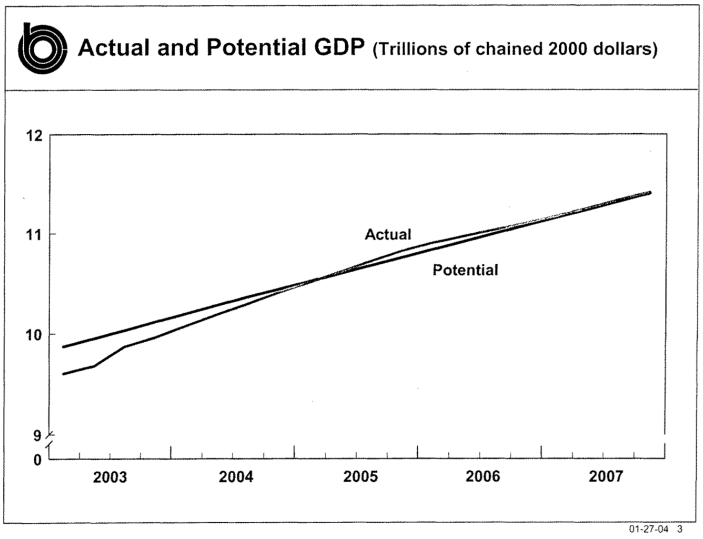
than even this projection anticipated. We had something on the order of a little below 4 percent built into this projection, and there are estimates that range north of that, perhaps nearer 5 percent, depending on how things play out.

So one change since August has been the economy. That has near-term benefits, not dramatic because we had a fairly strong recovery in there to begin with, but it has improved the picture from an economic point of view.

A second major development is legislative. The laws passed by Congress since our August update have contributed about $680 billion to the deficit over the 10-year window. That is in contrast to a total of about $300 billion, in round numbers, attributed to economic and technical revisions.

And so those are the two big changes. I think the lesson there is that, from the point of view of the path going forward, it will be policy choices that largely dictate the condition of the budget, as opposed to the economic future, at least to the extent it can be anticipated.

Now, I will go briefly over economic forecasts. This one chart is meant to summarize the entire forecast; we do the best we can on that. What we see is an economy that is currently operating below potential. We have had a recession. Our forecast is that the economy will grow rapidly, at 4.8 percent this year, 4.2 percent next year. As a result of that, we will see unemployment decline from something that averages around 5.8 percent this year down to 5.3 percent next year. And that cyclical recovery will close the gap between the light-blue line at the bottom and the dark-blue line which represents the capacity of our economy to produce.

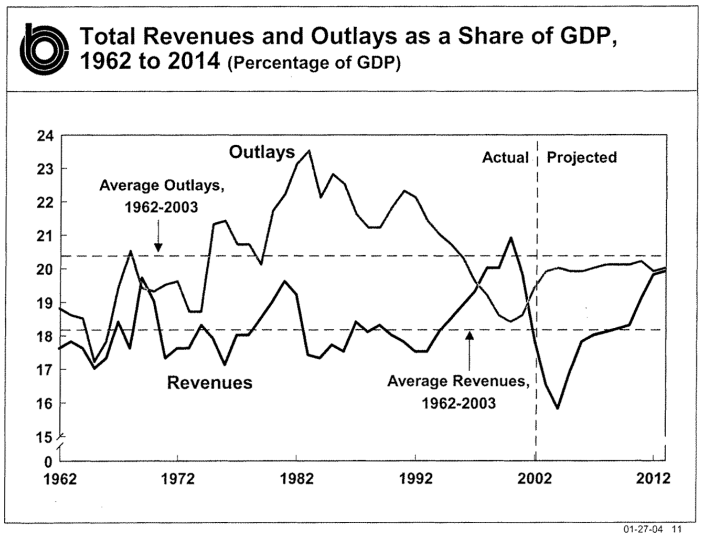


Over the long term, however, it is that capacity which is central to the amount of income in the economy. So closing the gap more rapidly——being wrong in the fourth quarter or having a bit faster growth than we anticipate next quarter——really just serves to close more quickly and does not change the long-run budgetary pic-

ture very much. Instead, the large uncertainty from an economic point of view, in terms of the long-term budget outlook, is how fast that potential will grow, and there the major issue is how one thinks about the productive capacity and particularly the labor productivity growth that we have seen recently.

As is discussed at length in the report, we have experienced very rapid productivity growth in this recession and recovery, comparable only to that during a brief period in the 1950's. And it has raised lots of questions in the minds of analysts about the future path of productivity. What we have done in our projections is to acknowledge that rapid productivity growth by raising our estimate of the productive capacity of our economy, moving it up, but not dramatically changing our growth rate of that productive capacity. So there is some benefit to that, but it is not something we have extrapolated beyond the historical increase, largely on the grounds that we cannot in our digging through the numbers find a solid case that there has really been a change in the trend in the economy. But from the economic point of view, that is the central piece of the forecast. It is our expectation that we will continue to operate in a rapidly growing, low inflationary environment. Interest rates will begin to move up, but not dramatically so, until a couple years from now.

Now, built on top of that economic forecast are projections for receipts and outlays. Revenues here are shown in the dark-blue line. Over the 10-year projection period, revenues are projected to grow overall at about 7.2 percent per year. That is in contrast to the average rate of growth of nominal GDP, which is 4.7 percent. So as a consequence, receipts will rise as a fraction of GDP from their low in 2004 of 15.8 percent to a total of 20.1 percent in 2014.



Shown in a dotted line at the bottom is the average receipts collected out of our national income of about 18 percent over the period since 1962. We will start below that and rise above. The increase in receipts in our baseline is largely due to the action of the

individual income tax. The remainder of the tax bases, with the exception of the expiration of the partial expensing at the end of this year, do not show a great deal of action.

The rise in the individual income tax comes from two sources. First is the sunsets of the tax cuts in 2001 and 2003, which are shown in our baseline. Of the 4.3-percentage-point rise in revenues as a fraction of GDP, about 2.3 percent comes from that source. However, the remainder, the remaining 2 percentage points of increase in receipts, comes from a variety of other sources.

The first is the fact that with a growing economy, people will become better off in real terms, and they will move into higher tax brackets and pay more in income taxes.

The second is that we anticipate a resumption in the realization and taxation of capital gains closer to historic norms. We have seen a large drop-off in the capital gains component. We anticipate that to rise in our projection period.

The third is the beginning of the retirement of the baby-boom population that carries with it the taxation of tax-deferred savings accounts, IRAs, 401(k)'s. Some of those revenues will appear in the Federal budget.

And, finally, included in our projections is a rise in the importance of the alternative minimum tax. The alternative minimum tax is not indexed for inflation, and even given the low inflation outlook that we have in our projections, we will see an increasing number of taxpayers become subject to the alternative minimum tax. At present, about 3 million taxpayers are subject to the AMT. Over the period to 2014, that could rise to as high as 30 million taxpayers.

So those are all sources of increase in receipts in this baseline under current law.

On the outlay side, we have built this to be inclusive of the legislation just passed by the Congress, signed by the President. So we have the omnibus built into our baseline, and it correctly captures all the appropriations therein. As I mentioned earlier, it includes the $87 billion supplemental appropriation and essentially puts that in for every year and raises it with the rate of inflation. Ten times 87 gives you $870 billion to begin with. With debt service, that contributes about $1.1 trillion to the 10-year deficit number in our projections.

On the mandatory side, we have mandatory spending rising at an average rate of 5.5 percent per year. That is driven largely by the entitlement programs—Social Security, Medicare, and Medicaid. And, indeed, in those programs, the rate of growth will rise over the course of the projection period. By 2014, those programs are rising at 6.5 percent per year, and that is the beginning of what one would anticipate to be a large increase in the demand for budgetary resources by those programs. The combination of an aging population, the retirement of the baby-boom generation, and rising health care costs in particular place those entitlement programs on track to demand ever larger fractions of our national income.

The last point that I will note before turning to the closing slide is that there has been a great deal of discussion in the preparation of this report and even in the opening remarks by the Chairman

and Senator Conrad about the growth rate of different discretionary spending categories. I will simply note—and we can return to this in questions—that there is a large divergence between growth measured as outlays versus growth measured in budgetary resources, particularly on a program-by-program basis. And that is built into our baseline as well.

Finally, in an effort to give the Congress some sense of the degree to which the budget outlook depends on choices made by Congress and the administration, we outlined a series of variations from the statutory baseline and their implications for the long-run budget outlook. These are intended to give you orders of magnitude and stylized notions of the kinds of budgetary resources that are at stake.

The top panel shows those that would reduce any surplus that might emerge or increase the deficit. There the first policy alternative that is shown is to extend all expiring tax provisions. There are really three classes of expiring tax provisions, which we have tried to lay out in a table in Chapter 4 of the report. One type is the tax cuts in 2001 and 2003, EGTRRA and JEGTRRA. The second is the partial expensing, which has been scheduled to end at the end of 2004. And the third is a variety of smaller individual items that collectively contribute to this estimate. But if one were to make all those tax provisions permanent and not allow them to sunset, the total impact on the budget would be $2.2 trillion over the 10-year window.

A second tax item that has gotten attention, as I mentioned earlier, is the alternative minimum tax. To give you a sense of the magnitude involved, we included a reform of the alternative minimum tax, which is very simple. It is a plain-vanilla reform in which the AMT is indexed for inflation so that no one moves from the individual income tax to the AMT strictly due to inflation alone. Instead, to have the AMT apply, you have to really be richer, have your income rise in real terms. That reform of the AMT would cost about $470 billion over the 10-year window. I would point out there are many different possibilities for changes in the AMT, and the particular cost would depend on the proposal itself.

Then, finally, you can see that, instead of assuming a fairly stringent policy baseline of 2.5 percent growth in discretionary spending a year, we could have spending essentially remain constant as a share of GDP, in which case it would rise about 4.7 percent per year; that would cost $1.6 trillion in increased outlays over the 10-year window. And then the final alternative is increasing spending at the rate that has occurred in the past 5 years, which is 6.9 percent; spending increases over the 10-year window at that rate would add $3.2 trillion.

The bottom panel goes the other direction. You could exclude the supplemental. As I mentioned, that is worth about $1.1 trillion. One might imagine a freeze in total discretionary spending, so declining in real terms. That would raise the budget surplus or reduce the deficit by $1.3 trillion.

And I think the hope is that that will provide Congress with some information about the kinds of things that would be on the table in terms of policy options. And given the CBO forecast of a solid cyclical recovery and an economy that is reaching its produc-

tive capacity and then growing at a healthy rate thereafter, such figures suggest that in terms of budgetary outcomes, it will be policy decisions made by the Congress and the administration much more than the anticipated path of the economy at this point which will be central.

So, with that, I will close, and I would be happy to answer your questions.

[The prepared statement of Dr. Hotltz-Eakin follows:]

CBO TESTIMONY

Statement of
Douglas Holtz-Eakin
Director

The Budget and Economic Outlook: Fiscal Years 2005 to 2014

before the
Committee on the Budget
United States Senate

January 27, 2004

This statement is embargoed until 10:00 a.m. (EST) on Tuesday, January 27, 2004. The contents may not be published, transmitted, or otherwise communicated by any print, broadcast, or electronic media before that time.

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Chairman Nickles, Senator Conrad, and Members of the Committee, thank you for giving me this opportunity to present the Congressional Budget Office's (CBO's) budget and economic outlook for fiscal years 2005 to 2014. CBO projects that under current laws and policies, the federal government will incur a total budget deficit of $477 billion this year and $362 billion in 2005 *(see Table 1)*. Such a deficit for this year would set a record in dollar terms, but at 4.2 percent of the nation's gross domestic product (GDP), it would represent a smaller share of the economy than the deficits of the mid-1980s and early 1990s. In the absence of further legislative changes, deficits would diminish after their peak in 2004, although outlays would continue to exceed revenues for most of the next 10 years. Deficits are projected to total $1.4 trillion for the five years after 2004 and $1.9 trillion for the 2005-2014 period.

By statute, CBO's baseline projections must estimate the future paths of federal revenues and spending under current laws and policies. The baseline is therefore not intended to be a prediction of future budgetary outcomes; instead, it is meant to serve as a neutral benchmark that lawmakers can use to measure the effects of proposed changes to taxes and spending.

New legislation can significantly affect the budget outlook. For example, laws enacted since CBO's previous baseline projections were published in August have increased spending by an estimated $681 billion (0.5 percent of GDP) between 2004 and 2013.[1] Much of that total stems from the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Public Law 108-173). The outlays resulting from that law will steadily increase between 2006 and 2013, totaling nearly $400 billion over the 2004-2013 period (not including debt-service costs).

The baseline projections reflect CBO's forecast of robust economic growth for the next two years. By late 2003, stronger investment by businesses, a weaker dollar, and a rising stock market—augmented by expansionary monetary and fiscal policies—were spurring economic activity. CBO forecasts that real (inflation-adjusted) GDP will grow by 4.8 percent in calendar year 2004 and by 4.2 percent in 2005 and that the unemployment rate will fall to 5.8 percent in 2004 and 5.3 percent in 2005. Between 2006 and 2014, the annual rise in real GDP will average 2.7 percent, CBO projects.

Even if economic growth turns out to be greater than projected, however, significant long-term strains on the budget will start to intensify within the next decade as the baby-boom generation begins to reach retirement age. Federal outlays for the three largest retirement and health programs—Social Security, Medicare, and Medicaid—will consume a growing share of budgetary resources even under moderate assumptions about the programs' growth, rising from over 8 percent of GDP in 2004 to more than 14 percent in 2030. Such increasing demands on spending will exert pressure on the budget that economic growth alone is unlikely to alleviate.

The Budget Outlook

CBO projects that if current laws and policies remain unchanged, federal deficits will begin to decline after this year. In the ensuing years, under CBO's baseline, deficits drop as a percentage of GDP, from 4.2 percent in 2004 to 3.0 percent in 2005 and 1.7 percent in 2010. After 2011—if the tax cuts enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) expired as scheduled, growth in discretionary spending continued to be limited to the rate of inflation, and other policies stayed the same—the budget would essentially be in balance.

Over the 2004-2014 period, outlays are projected to grow at an average annual rate of 4.7 percent and to remain near 20 percent of GDP. That level would be slightly below the average share of the economy devoted to federal spending since 1962 *(see Figure 1)*.

The constant share of outlays as a percentage of GDP, however, masks opposing trends in mandatory and discretionary spending. Under the assumption that no changes in policy take place, spending for entitlements and other mandatory programs is projected to grow by 5.5 percent a year—faster than the rate projected for the economy as a whole. Such growth is driven largely by spending for Medicare and Medicaid, which is projected to rise at average rates of 9.0 percent and 7.2 percent a year, respectively, from 2004 through 2014. Toward the end of that period, Social Security spending is also expected to grow faster than the economy as the baby-boom generation begins to retire.

1. That estimate includes the increased interest payments on federal debt attributable to legislative changes.

Table 1.

CBO's Baseline Budget Outlook

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
						In Billions of Dollars								
Total Revenues	1,782	1,817	2,049	2,256	2,385	2,506	2,644	2,786	3,036	3,272	3,441	3,629	11,840	28,004
Total Outlays	2,158	2,294	2,411	2,525	2,652	2,783	2,912	3,047	3,198	3,296	3,457	3,616	13,282	29,897
Total Deficit (-) or Surplus	-375	-477	-362	-269	-267	-278	-268	-261	-162	-24	-16	13	-1,443	-1,893
On-Budget	-536	-631	-535	-464	-477	-504	-507	-511	-421	-299	-294	-277	-2,487	-4,288
Off-Budget[a]	161	154	174	195	211	226	239	249	259	275	278	290	1,045	2,395
Debt Held by the Public at the End of the Year	3,914	4,393	4,771	5,055	5,338	5,630	5,912	6,185	6,356	6,388	6,409	6,399	n.a.	n.a.
						As a Percentage of GDP								
Total Revenues	16.5	15.8	16.9	17.8	18.0	18.1	18.2	18.3	19.1	19.8	19.9	20.1	17.8	18.7
Total Outlays	19.9	20.0	19.9	19.9	20.0	20.1	20.1	20.1	20.2	19.9	20.0	20.0	20.0	20.0
Total Deficit (-) or Surplus	-3.5	-4.2	-3.0	-2.1	-2.0	-2.0	-1.8	-1.7	-1.0	-0.1	-0.1	0.1	-2.2	-1.3
Debt Held by the Public at the End of the Year	36.1	38.3	39.5	39.9	40.3	40.6	40.7	40.7	40.1	38.6	37.0	35.4	n.a.	n.a.

Source: Congressional Budget Office.

Note: n.a. = not applicable.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds as well as the net cash flow of the Postal Service.

CBO projects discretionary spending as specified in the Balanced Budget and Emergency Deficit Control Act of 1985 (using the GDP deflator and the Employment Cost Index for wages and salaries). The combined rate of growth of those factors is about half of that projected for nominal GDP. As a result, the baseline projection for discretionary outlays falls from 7.8 percent of GDP in 2004 to 6.4 percent in 2014. If instead such spending kept pace with the growth of GDP (and the other assumptions incorporated in the baseline remained the same), discretionary outlays would maintain a share of about 7.8 percent of GDP throughout the projection period and the deficit in 2014 would be $323 billion, or 1.8 percent of GDP (compared with a small surplus for 2014 under the baseline's assumptions).[2]

2. That projection includes an extrapolation of the $87 billion in supplemental appropriations for 2004 enacted in November 2003 to fund defense spending and reconstruction in Iraq and Afghanistan.

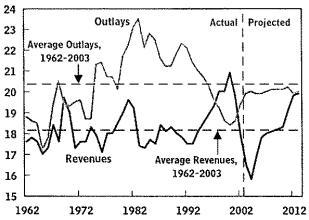
Revenues are projected to total 15.8 percent of GDP this year—about 2.5 percentage points below the average since 1962 (18.2 percent). As the economy continues to improve and certain tax provisions expire, revenues will increase to 16.9 percent of GDP in 2005, CBO projects. In 2006 through 2010, rising income and the expiration of more tax provisions will push revenues up to about 18 percent of GDP, by CBO's estimates. In the baseline, projected receipts rise more rapidly after the major provisions of EGTRRA expire at the end of 2010, reaching 20.1 percent of GDP in 2014. If those provisions—together with the expiring provisions of other tax laws—were instead extended and all of the other assumptions underlying the baseline were held constant, receipts would be 18.1 percent of GDP in 2014, and the deficit would total $443 billion, or 2.4 percent of GDP.

Debt held by the public (the most meaningful measure of federal debt in terms of its relationship to the economy) is anticipated to equal 38 percent of GDP at the end of this

Figure 1.

Total Revenues and Outlays as a Share of GDP, 1962 to 2014

(Percentage of GDP)



Sources: Congressional Budget Office (projections); Office of Management and Budget (historical budget data).

fiscal year. Under CBO's baseline, that debt will stabilize at around 40 percent of GDP through 2011, at which point the federal government's diminished need to borrow will reduce the growth of such debt.

Since CBO last issued its baseline (in the August 2003 *Budget and Economic Outlook: An Update*), the cumulative deficit over the 2004-2013 period has increased by nearly $1 trillion, or 0.7 percent of GDP *(see Table 2)*. About 70 percent of that total results from new legislation, such as the Medicare law. Another $171 billion stems from economic factors—mainly the decline in CBO's forecast for inflation, which reduces estimates of both revenues and outlays (although the effect on revenues is moderately larger). Changes in projections of the unemployment rate, real GDP, and other variables also play a role. Technical revisions to CBO's baseline—mostly on the revenue side of the budget—account for another $134 billion of the addition to the cumulative deficit over the 2004-2013 period.

The Economic Outlook

CBO's forecast for the next two calendar years anticipates continued robust growth in overall demand. Stronger business investment will lead the way as firms spend more than they have spent in the past few years on their fixed assets (such as buildings and equipment) and switch from drawing down inventories to restocking their shelves. The rapid growth of productivity over the past three years has contributed to the economy's capacity to expand quickly without boosting inflation significantly. Indeed, the unexpected strength of productivity during 2003 has caused CBO to raise its expectation for potential GDP (the level of GDP consistent with a high rate of resource use) and, in turn, for GDP. CBO expects real GDP to expand by 4.8 percent in calendar year 2004 and 4.2 percent in 2005 and then to grow at an average annual rate of 2.7 percent from 2006 to 2014 *(see Table 3)*.

The unemployment rate is forecast to fall from 6.0 percent in 2003 to 5.8 percent in 2004 and 5.3 percent in 2005, reflecting the expected closing of the gap between GDP and potential GDP. After briefly dipping to 5.0 percent in 2006, the unemployment rate will average 5.2 percent from 2007 through 2014, according to CBO's projections.

In CBO's estimates, inflation and nominal interest rates will remain low by historical standards from 2004 to 2014, even though interest rates will rise from current levels. The consumer price index for all urban consumers (CPI-U) will fall from 2.3 percent in 2003 to 1.6 percent in 2004 and then gradually rise to average 2.2 percent from 2006 to 2014. Since its previous forecast in August, CBO has reduced the projected rate of CPI-U growth by 0.7 percentage points for 2005 and by about 0.3 percentage points annually beyond 2006. That outlook reflects CBO's view that the Federal Reserve will act to maintain the underlying rate of CPI-U inflation at between 2.0 percent and 2.5 percent, on average.

The interest rate on three-month Treasury bills for calendar year 2003 was just 1.0 percent. The rate for such bills will remain very low for 2004, CBO anticipates, but will increase to 3.0 percent in 2005. By CBO's projections, the rate will reach 4.6 percent in 2007 and remain at that level through 2014. The yield on 10-year Treasury notes will rise from an average 4.0 percent in 2003 to 4.6 percent in 2004, 5.4 percent in 2005, and 5.5 percent from 2006 through 2014, CBO projects.

Table 2.

Changes in CBO's Baseline Projections of the Deficit or Surplus Since August 2003

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total, 2004-2008	Total, 2004-2013
Total Deficit (-) or Surplus as Projected in August 2003	-480	-341	-225	-203	-197	-170	-145	-9	161	211	-1,445	-1,397
Changes												
Legislative												
Revenues	*	-1	*	*	*	*	*	*	*	*	-1	*
Outlays[a]	5	17	45	62	70	78	86	95	106	118	199	681
Subtotal, legislative	-5	-17	-45	-62	-70	-78	-86	-95	-106	-117	-200	-681
Economic												
Revenues	7	1	-15	-36	-55	-72	-89	-109	-132	-158	-98	-659
Outlays[a]	-7	-15	-24	-34	-46	-56	-65	-73	-80	-88	-126	-488
Subtotal, economic	14	17	9	-2	-10	-16	-24	-37	-52	-70	28	-171
Technical												
Revenues	-15	-16	-4	1	-3	-7	-5	-20	-25	-35	-38	-130
Outlays[a]	-8	5	3	*	-2	-3	1	1	2	5	-3	4
Subtotal, technical	-7	-20	-7	1	-1	-4	-6	-21	-27	-40	-35	-134
Total Effect on the Deficit or Surplus[b]	3	-21	-43	-64	-81	-98	-117	-153	-185	-227	-207	-986
Total Deficit as Projected in January 2004	-477	-362	-269	-267	-278	-268	-261	-162	-24	-16	-1,652	-2,383

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million.

a. Includes net interest payments.

b. Negative numbers represent an increase in the deficit or a decrease in the surplus.

Table 3.

CBO's Economic Projections for Calendar Years 2004 Through 2014

	Estimated 2003	Forecast 2004	Forecast 2005	Projected Annual Average, 2006-2014
Nominal GDP (Billions of dollars)	10,980	11,629	12,243	18,266[a]
Nominal GDP (Percentage change)	4.8	5.9	5.3	4.5
Real GDP (Percentage change)	3.2	4.8	4.2	2.7
GDP Price Index (Percentage change)	1.6	1.1	1.1	1.8
Consumer Price Index[b] (Percentage change)	2.3	1.6	1.7	2.2
Unemployment Rate (Percent)	6.0	5.8	5.3	5.2
Three-Month Treasury Bill Rate (Percent)	1.0	1.3	3.0	4.5
Ten-Year Treasury Note Rate (Percent)	4.0	4.6	5.4	5.5

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: Percentage changes are year over year.

a. Level in 2014.

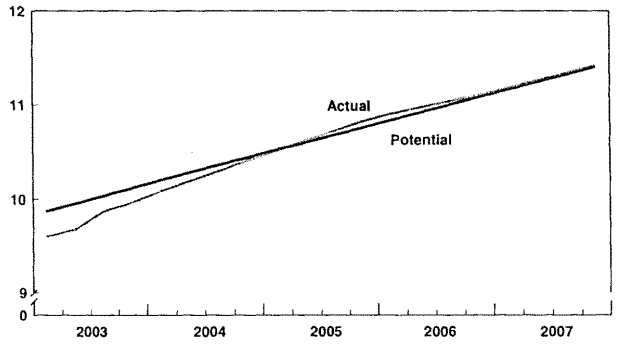
b. The consumer price index for all urban consumers.

CBO's Baseline Budget Outlook

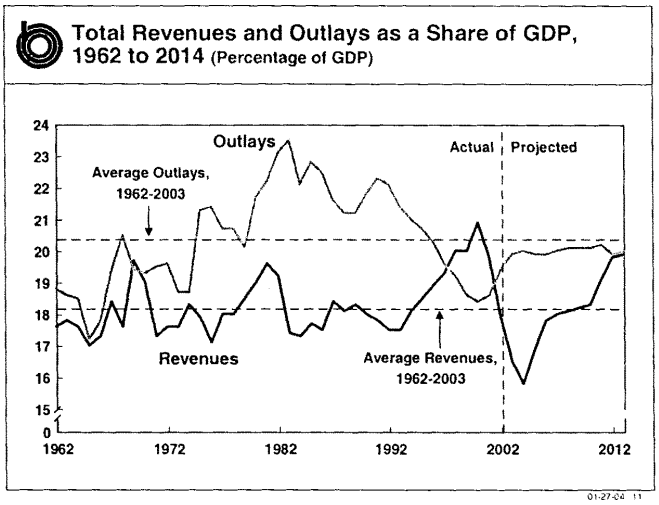
	Actual 2003	2004	2005	2006	Total, 2005-2009	Total, 2005-2014
	In Billions of Dollars					
Total Revenues	1,782	1,817	2,049	2,256	11,840	28,004
Total Outlays	2,158	2,294	2,411	2,525	13,282	29,897
Total Deficit	-375	-477	-362	-269	-1,443	-1,893
	As a Percentage of GDP					
Total Deficit	-3.5	-4.2	-3.0	-2.1	-2.2	-1.3
Debt Held by the Public at the End of the Year	36.1	38.3	39.5	39.9	n.a.	n.a.

01-27-04 1

Actual and Potential GDP (Trillions of chained 2000 dollars)



01-27-04 3



The Budgetary Effects of Policy Alternatives Not Included in CBO's Baseline (Billions of dollars)

	Total, 2005-2009	Total, 2005-2014
Policy Alternatives That Increase the Deficit or Reduce the Surplus		
Extend Expiring Tax Provisions	-553	-2,230
Reform the Alternative Minimum Tax	-161	-469
Increase Discretionary Appropriations by the Growth Rate of Nominal GDP After 2004	-374	-1,618
Increase Discretionary Appropriations by 6.9 Percent a Year After 2004	-641	-3,157
Policy Alternatives That Reduce the Deficit or Increase the Surplus		
Increase Discretionary Appropriations (Excluding Supplemental Appropriations for 2004) by the Rate of Inflation After 2004	421	1,108
Freeze Total Discretionary Appropriations at the 2004 Level ($876 billion)	280	1,320
Memorandum:		
Total Deficit in CBO's January 2004 Baseline	-1,443	-1,893

01-27-04 7

Chairman NICKLES. Thank you very much. I have just one comment.

CBO and OMB and all the economists missed the revenue projections greatly in 2000, or I guess when testimony was made in 2001. They greatly overestimated revenues. Senator Conrad and I have wrestled around—well, President Clinton gave us a $5.6 trillion surplus. That was the projection in 2001, but way off the mark, greatly underestimating what the decline in the stock market bubble did to revenues. Just look at NASDAQ in 2000—now it has

started to come up, but the revenues really dropped as a result of that, and not just that year, but frankly for a couple of years, because you had capital losses.

Now we have had just in this year alone an enormous increase in stock market values. Just as an editorial comment, I hope you are greatly missing it again. I cannot help but think if you have $4 trillion of new equity, those capital gains, even though we are taxing them at a lower rate, we should collect more revenue. Every time we reduce capital gains rates and we have had an increase in turnover in sales and so on, there has been a lot of new revenue—just an editorial comment. It was missed greatly going down, and I hope it is missed greatly going up. There is a lot of economic activity out there to create that kind of robust increase in market value. Thank goodness there is. I am hopeful that you greatly underestimate it again. Maybe not. I do not know. That is just my hope.

As a matter of fact, I am disappointed. Because we enacted the growth package, and we have had more robust growth than most, I was leading the charge saying let us have zero tax on dividends, and we ought to have 10,000 Dow Jones index, and we have exceeded that at a 15 percent rate. So I am thinking there should really be some real positive revenues. Yet you came out and said, well, we have done economic assumptions, and between our economic assumptions and our technical assumptions, we think it is about $350 billion worse over the 10-year period. We think inflation is lower and so on. I find that kind of hard to deal with. I understand you said that short-term, we get a little bump, but long-term, it does not make any difference. And then I look at your 10-year projections, and with the two of them combined, a $171 billion increase in deficit due to economic factors. The economic factors are all positive. And then, technical revisions to your baseline are another $134 billion. I do not know. There may be too much pessimism for me. I cannot understand it. If you want to comment on that, you can, but let me make just two other points that are very critical.

The legislative changes that were enacted since the August baseline, $681 billion over 10 years, all that was on the outlay side; is that correct?

Mr. HOLTZ-EAKIN. Yes, sir.

Chairman NICKLES. And that was primarily the Medicare bill, adding prescription drugs and the other Medicare changes, and what else?

Mr. HOLTZ-EAKIN. The Medicare bill is a little under 70 percent of that, and then there is the increase in appropriations above and beyond last year's, the difference in the supplementals (between $87 billion and $79 billion), carried out over 10 years. And there is some debt service attached to that number as well.

Chairman NICKLES. OK. I would appreciate a breakdown of that if you could give me a breakdown.

Mr. HOLTZ-EAKIN. We can get you all those figures.

Chairman NICKLES. And maybe it is in your figures, and I have not had a chance to review it.

The Medicare bill—Senator Conrad and I both alluded to the long-term problems that we are going to have in entitlement pro-

grams, primarily Medicare. Medicare Part D—correct me if I am wrong; I am looking at page 13 of our Budget Outlook—it says the total cost of Part D, the new Medicare prescription benefit, is $771 billion; offsets, some changes, but basically, the increase in outlays is $758 billion; receipts from beneficiaries, $134 billion; and receipts that we get back from the States, $88 billion, for a net of $535 billion. And then, we expect savings on Medicaid, since we are assuming Medicaid, $138 billion. That is how you get to your net of $395 billion over the 10-year period of time.

But gross outlays, you are talking about $771 billion.

Mr. HOLTZ-EAKIN. Yes.

Chairman NICKLES. What is your estimate on the cost of the program over the next 10 years?

Mr. HOLTZ-EAKIN. Over the years 2004 to 2013, if you just take the bottom line impact, $395 billion. But dropping fiscal year 2004, where there are essentially no outlays because the program has not started up yet and then adding the last year, where it will cost about $80 billion on net, moves the cost from $395 billion to something on the order of $475 billion over this 10-year budget window.

Chairman NICKLES. OK. What about the next 10 years; have you done a guesstimate on that?

Mr. HOLTZ-EAKIN. In preparation for House testimony last year in August, we did take a look at the second 10 years of any such program. We did not examine the particulars of this bill as passed. It was preliminary at that time. We simply extrapolated the final year net cost, something on the order of $70 or $80 billion, looking at growth rates and costs of prescription drugs. Doing that kind of calculation leads one to a second 10 years that is somewhere in the vicinity of $1 to $2 trillion, depending on the range of uncertainty on the growth rate of drug prices.

Chairman NICKLES. So, for the next 20 years, you think the cost of the bill would be pretty close to $2 trillion?

Mr. HOLTZ-EAKIN. If you do 20 years, yes—within the range of possibilities.

Chairman NICKLES. Well, I read your comment, and I just wanted to clarify it, because it is on a ramp like this, and people should be aware of it. A lot of people will say, well, over 10 years, if it is $400 billion, that is $40 billion a year—that is not what we passed. We passed something that has very little cost the first couple years, and then it increases rather dramatically in the outyears and continues to escalate. I saw your comment where you thought it might be a couple of trillion dollars.

This is not paid for. This is outside the beneficiaries' contributions, so it would be paid for out of general revenues. I might make mention of that.

One other comment. I notice your letter to Senator Frist dealing with non-interference, or having the Government negotiate drug prices—would you care to comment on that? Would removing that language in the bill have any significant impact on the cost of the program or on drug prices?

Mr. HOLTZ-EAKIN. Our view of the private prescription drug delivery in the bill is that those at-risk private firms will have tremendous incentives to drive very good bargains with pharmaceutical companies, and as a result, removing the language prohib-

iting the Secretary from negotiating would have negligible impact on the overall cost of the bill. There are already plenty of incentives for cost control.

Chairman NICKLES. I appreciate your comments.

Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

Again, thank you, Dr. Holtz-Eakin, for your testimony.

Your analysis shows that the debt will increase by how much over the next 10 years?

Mr. HOLTZ-EAKIN. The debt-to-GDP ratio will rise——

Senator CONRAD. No—I am talking now the debt in dollar terms. How much will the debt in dollar terms increase over the next decade if there are no additional tax changes or spending changes?

Mr. HOLTZ-EAKIN. Between 2005 and 2014, debt held by the public will rise from $4.8 trillion to about $6.4 trillion——so $1.6 trillion.

Senator CONRAD. One-point-six trillion. And debt held by the public now is $4.8 trillion?

Mr. HOLTZ-EAKIN. That's the fiscal year 2005 projection.

Senator CONRAD. OK. How much would it add to the debt if the tax cuts were to be made permanent? How much would it add to the debt over this period?

Mr. HOLTZ-EAKIN. I have not done a specific calculation of the debt outstanding if the 2001 and 2003 tax cuts alone were made permanent, but we could certainly do that calculation and would be happy to get it to you.

Senator CONRAD. I notice on your chart, you have "Extending the expiring tax provisions." How much would that add to the debt?

Mr. HOLTZ-EAKIN. Well, there is a cumulative deficit of $2.2 trillion, but because of the variety of financing mechanisms, that does not map directly into debt outstanding. Again, it is a calculation we would be happy to provide to you.

Senator CONRAD. Can you give us a rough—would it be more than the $2.2 trillion or somewhat less than the $2.2 trillion?

Mr. HOLTZ-EAKIN. It is as good a guess as we have. We do not know if there is a particular bias one way or the other on the timing.

Senator CONRAD. So roughly, making the tax cuts permanent would add another $2 trillion to the debt over the next 10 years?

Mr. HOLTZ-EAKIN. Ballpark, yes.

Senator CONRAD. So then, we would have a debt of $8.4 trillion instead of the $4.8 trillion we expect at the end of this year.

Mr. HOLTZ-EAKIN. Right.

Senator CONRAD. You know, there has been a lot of talk by some that deficits do not matter, that this buildup of debt and these deficits do not matter. In your judgment, do deficits matter?

Mr. HOLTZ-EAKIN. Yes, I do think deficits matter. On balance, deficits shift national resources away from saving toward current consumption, and the impact of deficit spending as a result differs depending on the state of the economy. In those situations where the economy is weak, and there is very little spending demand from private sources, that shift from saving to consumption will bolster demand, and looking back, we have seen that. At times when the economy is already fully employed and there is plenty of

private-sector demand, that shift from saving to consumption has not the same benefits of supporting the economy. Instead, it affects the supply side and the accumulation of saving and national investment and the growth in the capacity of the economy to produce. In both cases, deficits matter, and their impacts differ.

Senator CONRAD. Well, you have made a very good point here. You have really differentiated the effect of deficits depending on the state of the economy. As I hear you saying it, when the economy is weak, deficits can give lift to the economy; when the economy has recovered, then running deficits will actually hurt long-term economic growth. Is that correct?

Mr. HOLTZ-EAKIN. Running sustained large deficits in the face of a full employment economy will have negative economic growth consequences.

Senator CONRAD. So as you look at these deficits going forward, and you say there is going to be $1.6 trillion of added debt if we do nothing, we will approximately double the debt if we make the tax cuts permanent and address the alternative minimum tax problem that you have described as growing geometrically, so you would take that to be negative for the economy if we run these deficits going forward and the economy is growing as you project it to?

Mr. HOLTZ-EAKIN. We incorporate into our baseline projection, including the economic forecast, the deficit and its consequences. In our forecast, that shows up mechanically in the degree to which there is capital accumulation in the economy, and as a result, the rate at which labor productivity grows. Those impacts are not very large in the near term, but they build over time.

Senator CONRAD. Actually, you are quoted in The Washington Post, and I want to see if that is a correct quote. "The cumulative corrosive impacts of sustained deficits in the face of a full employment economy would on balance make the extension of the tax cuts a 'modestly negative policy choice,' Holtz-Eakin said."

CBO Director Holtz-Eakin Cites Negative Impact From Extending Tax Cuts

"The cumulative corrosive impacts of sustained deficits in the face of a full-employment economy" would, on balance, make the extension of the tax cuts "a modestly negative" policy choice, [Holtz-Eakin] said."

– *Washington Post*
"CBO Says '04 Deficit Will Rise to $477 Billion: Extending Tax Cuts Could Double Debt"
January 27, 2004

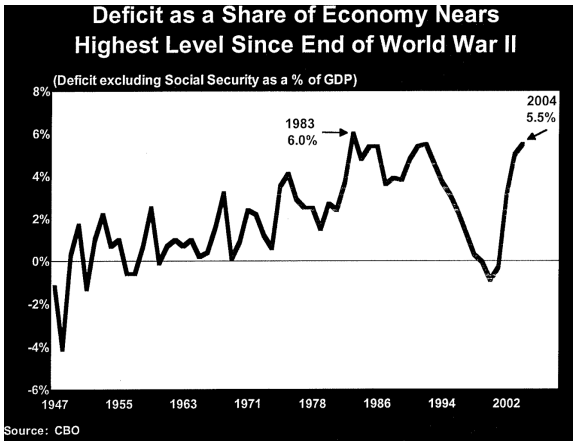
Is that a correct——

Mr. HOLTZ-EAKIN. I will assume that it is a correct quote. The context in which the question arose is exactly the question you are raising. But in terms of the budget projections over a 10-year window, the impact of the tax cuts sunsetting in 2011 in the near term has negative impacts when marginal tax rates go up for labor supply and thus GDP growth, and we lay those out in the report. The other impacts of either making them permanent or letting them sunset take longer, and they go outside the budget window. So this sort of trade-off is really one that has to be framed carefully in terms of the time period over which you want to do the analysis.

Senator CONRAD. OK. Let me ask you this. Spending—spending and revenue—that relationship is what leads to deficits. When we spend more—and right now, we are spending $900,000 a minute more than we are taking in—it is kind of stunning—this year, we are spending $900,000 more a minute than we are taking in. What is the relationship of spending now as a share of our gross domestic product to what spending was in the eighties and nineties? Is spending more now or lower now?

Mr. HOLTZ-EAKIN. In these projections, spending averages about 20 percent of GDP, which is close to the post-war historical average.

Senator CONRAD. Close to the post-war historical average. Let me put up—here is what my chart shows, that spending, which has picked up now because of increases in defense and homeland security, is still quite a bit below where it was in the eighties and nineties. You were talking about post-war. I was asking eighties and nineties, spending as a share of GDP. This chart shows that spending now is below where it was in the eighties and nineties. Is that correct?



Mr. HOLTZ-EAKIN. I will assume it is correct. There have been variations over the post-war, certainly.

Senator CONRAD. And in terms of revenue, what do you anticipate revenue as a share of GDP being this year in relationship to where it has been since World War II?

Mr. HOLTZ-EAKIN. It is 15.8 percent in 2004 in these baseline projections. The average is about 18 percent, as I mentioned in my remarks.

The Chairman also raised the question of the path of receipts in these projections. The amount in 2004 is low for several reasons, some understood, some not well understood. Certainly, policy has lowered receipts in 2004, and some of that policy will go away—the partial expensing provision.

There has also been economic performance which is now turning around, and we are seeing faster growth. But in contrast to the rapid rise in GDP, production, we have not yet seen evidence of a comparable rapid rise in taxable incomes, so that economic growth really has not translated as much into the tax base as one might have expected.

We have data at this point only through tax returns filed in 2001, so we cannot fully diagnose the relationship between what is going on in the economy and what we are seeing in taxable incomes as well as we would like to, and some of these mysteries will be resolved with time, and some, I think we will get a better handle on sooner than that, as we see what happens to measured wage compensation, for example, in the economy as measured by the BEA over the next year.

So in terms of the revenue picture, we expect 2004 to be transitorily low for a variety of reasons and then to pick up thereafter.

Senator CONRAD. And our numbers show the revenue as a share of gross domestic product being the lowest since 1950. Do you agree with that?

Mr. HOLTZ-EAKIN. That's right.

Senator CONRAD. I thank the Chairman.

Chairman NICKLES. Senator Conrad, thank you very much.

Senator Enzi.

I might note for the interest of our colleagues that Senator Crapo was actually here first. He beat me here, and then he left, so I might have to put him back in the queue when he returns.

Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman.

Mr. Holtz-Eakin, I particularly thank you for being here and the difficulty of your job. It always occurs to me that making these predictions is very difficult—but only when we are talking about the future.

I can see from the material that I have been through why it is easy to miss on the projections whether you are the director of CBO or the President of the United States or one of the Senators, or even somebody from the House or somebody from the public. There are just so many interacting things.

First of all, I would like to ask that my entire statement be made a part of the record.

Chairman NICKLES. Certainly.

[The prepared statement of Senator Enzi follows:]

Budget Hearing
Senator Mike Enzi
Opening Statement
January 27, 2004

Thank you, Mr. Chair.

Let me also express my thanks to Director Holtz-Eakin for coming to Capitol Hill on such a cold and snowy day in order to testify on the 10-year budget outlook.

This is an important hearing. It will help lay the foundation for our work on the fiscal year 2005 budget resolution. The report Mr. Holtz-Eakin will be discussing provides a snapshot of our economic position, and sets a benchmark for this year's decisions on fiscal policy. While reading the report is not like looking into a crystal ball, it helps paint a picture of where we are and where we're headed if our spending and legislative policies remain exactly the same over 10 years. Of course, we know that will not happen.

That's why it's important to recognize that these numbers are not set in stone. Like the President's Economic Jobs and Growth Package last year, we will take steps this year to improve the economy and help balance the

budget down the road.

The key to balancing the budget is growing the federal pot by encouraging investment and business development. Many of our budgetary challenges over the last three years have been the result of lower than average revenues. I noted in the CBO report that revenues are projected to total 15.8 percent of GDP this year, which is still 2.5 percentage points below the average since 1962. We need to increase the gross domestic product. Although the economy is rebounding, we should continue to facilitate business growth and individual investment while controlling our spending.

This Congress must slow our rate of spending. The average rate of increased spending for the last 6 years was 6.9%. That is unsustainable. While we must continue to fully support the efforts of our troops in Iraq and Afghanistan and fund certain domestic priorities, we must take a careful look at areas of spending that are wasteful and unnecessary. The deficit emphasizes our need to prioritize spending. It should help us control the urge to start another program, create another agency or make the government more difficult and costly to operate with cumbersome regulations. It should encourage us to look for ineffective programs to

reduce or eliminate.

This year's budget will be a challenge. But, the CBO's Budget and Economic Outlook is a good place to start. We have a massive task ahead, and I hope we can count on the Congressional Budget Office to continue providing useful information. I look forward to hearing Director Holtz-Eakin's testimony.

Thank you Mr. Chair.

Senator ENZI. I notice that CBO kind of isolated some things and said that the economy and technicals put about 40 percent into the deficit in spending increases, 37 percent, and the tax cuts, 23 percent. Is that a figure from——

Mr. HOLTZ-EAKIN. That is a historical analysis, and we have done a variety of——

Senator ENZI. And 2002 to 2011 was actually the baseline that you were doing that on. And I appreciate Senator Conrad's chart that shows where the bulk of this spending came from—the war and national security, and the bailouts we did to take care of the damages that were done as a result of September 11, and I think we also had some that we did for all of the States that were having some difficulties. I think you said that in your projections, you continued about an $87 billion expense through each of the years?

Mr. HOLTZ-EAKIN. That is correct.

Senator ENZI. There are a lot of things that we cannot do anything about. Spending, we can, I think. The average rate of increased spending for the last 6 years was 6.9 percent when you take all those things into consideration. I think that that is unsustainable. We have to continually and fully support the troops in Iraq and Afghanistan and all the other places in the world. There are certain domestic priorities that we are going to have to fund. But we still have to look at the areas of spending. And people say, well, that is a pretty small part of what there is out there, but that is all that we can work with, so that is what we have to work with.

I am reminded of that old phrase, "A billion here, a billion there, and pretty quickly, it runs into money." We are not very good at cutting anything. We are not even good at slightly reducing things. What we go into—particularly in an election year, and this is a Presidential election year, so I think it might even be worse—is a phase of trying to outbid each other on every program that comes along.

Now, business out there is not given the same options that we are given. They have a revenue that they project, and they budget against that, and somehow they have to make it come out. I haveten to look at some of those private business budget plans, and I am amazed at the minute detail that they go into making extremely small cuts but realizing that the extremely small cuts add up to something much bigger that actually helps them to balance or get close to or to follow their business plan. So I am going to encourage everybody to look for ineffective programs that we can reduce—I am not going to even suggest eliminate, because I know that that is an impossibility. There is a huge constituency out there for every program that we have developed, and those people are making some money out of the program, and they will spend some money to make sure that we do not eliminate their program. But we should be able to take a look at and at least reduce some of those that are out there.

When we are debating our economic policies, I mentioned that from 2002 to 2011, we had the 40 percent drop in the economy. Do you think the tax cuts have had a positive side on the economy? It appears to be reflected in your numbers.

Mr. HOLTZ-EAKIN. Well, certainly, looking back, the swing—both as a matter of policy and the fact that the budget response to the economy has supported an economy that has been hit with a wide variety of adverse economic shocks, if one goes through the list—it has been quite dramatic: between war in the Middle East, terrorism events, equity market decline, and a large fall-off in business, fixed investment. It has been a period of lots of downward economic shocks, and the fiscal policy has served to support the economy in that period.

Senator ENZI. I think you also mentioned that during the year, there was a tremendous increase, at least in the third quarter. Now, that would not be reflected through all of your projections; you are not allowed to do that, are you?

Mr. HOLTZ-EAKIN. We did in fact include the information from the third quarter in our projections for the entire period. The fourth quarter data have not yet been released, and we had to project that in doing our forecast.

Senator ENZI. I guess the point that I am trying to make is that if we increase the gross domestic product, everything looks a lot better; taxes probably come in a little bit higher. So I appreciate all the effort that you put into those numbers. I recognize the difficulty of predicting, and you have been a tremendous help.

Thank you.

Chairman NICKLES. Thank you, Senator Enzi.

Next, I call upon Senator Hollings. I might note that both Senator Hollings and I are having our last year on this Committee. I have only been on it for 24 years, which pales compared to Senator Hollings' 30 years on this Committee, and I compliment him for that and recognize Senator Hollings.

Senator HOLLINGS. You are might generous, Mr. Chairman, and I appreciate it very much. I particularly appreciate us having a Director of the Congressional Budget Office who believes that deficits count.

Otherwise, in all sincerity, we have just heard from the distinguished Senator from North Dakota, our ranking member, the true state of the Union, and I am going to make a public request, and if he will not, I will. I want that printed up what Senator Conrad in his opening comment stated. If we can get that printed up and mailed to all the Members, you will have a true state of the Union message. And thank you—I know that Senator Conrad has to go to an Agriculture meeting, but I cannot thank him enough, because he covered our true situation.

Mr. Chairman, you have been very generous. We both work together. But I could not help but smile when you were talking about how the stimulus worked. I would hope so. I would hope the stimulus of tax cuts worked some, for the main and simple reason that last year, we ended up with a deficit of $562 billion—$562 billion—I do not want anybody to question the accuracy of that.

Otherwise, we had approximately a current account deficit and balance of trade of around $480 billion. So in the last year, we have goosed the economy, we have infused the economy one trillion bucks. Tax cuts—come on—that little tax cut was just a minor part of it. We have put in 562 plus 480—we have put in over $1 trillion

into the economy, and it is still limping along. They are wanting more tax cuts.

I do not think they would ever mention more tax cuts if they understood the exact situation that we are in, and that is why I ask that the comments of the Senator from North Dakota be printed up and sent around—because Mr. Chairman, I remember you were hearkening the days—you were talking about stimulus—Senator Sam Ervin of North Carolina and I were trying to stimulate the economy about 25 years ago with $5 billion in highway spending. It had already been approved at the Highway Administration, but we had to go out, and we were trying, and it took us 3 days to persuade our colleagues to approve borrowing $5 billion to get the economy going and to get jobs created.

Now, here we are stimulating over $1 trillion in a year's time, which brings me to my hope and mission this morning, which is to get truth in budgeting. And I am not playing games, Mr. Director, and I am not trying to be cute, but as between the word "gross" and the word "total," do you find a difference?

I will be specific with you. I had to just pull out my little Webster's Collegiate Dictionary, and "total" was "gross," and "gross" was "total"—in fact, the exact definition in Webster's. "Gross" is "an overall total exclusive of deductions."

Do you find a difference when you use the word "total" and when you use the word "gross"?

Mr. HOLTZ-EAKIN. Off the top of my head, they sound like similar concepts. I do not know if there is a technical definition involved. I think it is about the context.

Senator HOLLINGS. The reason I ask that—if you take the first page of the—well, let me get to what the people understand. Here you go. I had some of this this morning. Total is 100 percent. That is the headline, right? That is 100 percent Total. Now, if Total is 100 percent in the public's understanding and your understanding and my understanding, I notice on page 1 of the summary, you say "Total budget deficit of $477 billion." That is really only 68 percent; that is not 100 percent, because if you turn to page 19 of the regular budget report that you have here, you can see that the debt in 2003 actual—you use the word "actual," which I like—"total," "actual," "gross," so everybody is singing from the same page—the actual debt in 2003 was $6,760,000,000, and you project the debt in 2004—in 8 months' time, now—next year, it is going up, in 2004, which is the fiscal year—to $7,459,000,000. So you have an "actual" or "total" or "gross" deficit of $699 billion; isn't that correct?

Mr. HOLTZ-EAKIN. That is not the concept that was on page 1.

Senator HOLLINGS. I did not ask about the concept. What is the fact?

Mr. HOLTZ-EAKIN. The fact is that the total borrowing by the Federal Government from the economy will be $477 billion in 2004.

Senator HOLLINGS. I didn't ask about the borrowing. I asked about the deficit. You and I have to not run around with the percent of GDP. When I go to pay my bill on the house payment, or when I go to pay the car payment, or when I go to pay the washing machine bill, they do not ask me what is the percent of my GDP. They want the money. They want the money. And we have to talk sense, and we have to talk facts and not theory—in 10 years, in

50 years, what we did 10 years ago and all—because we only have 8 months. And that is the duty of this Committee is to propound a budget.

Within that, do you find the budget different than $699 billion?

Mr. HOLTZ-EAKIN. I do. If you count the dollars coming in and then count the dollars going out, the difference, which is what you would have to go to the bank—and in this case, the "bank" is the entire economy—that difference is $477 billion.

Senator HOLLINGS. Oh, you are borrowing from Social Security, and you know—according to the budget law—in fact, Mr. Chairman, we were here in the Budget Committee, and we got a vote 20-to-1 to make sure that the Greenspan Commission was carried out—namely, that Social Security be put off-budget in Section 13.301, signed by George Herbert Walker Bush, Sr., on November 5, 1990, by a vote of 98-to-2 in the U.S. Senate. President Bush signed that into law, Section 13.301 of the Budget Act, not to use Social Security. And here you are trying to deduct it, and trying to answer the question what is total and what is actual.

The total deficit or the actual deficit is $699 billion; isn't that correct?

Mr. HOLTZ-EAKIN. With all due respect, Senator, this document is meant to provide an accounting of the congressional actions. The exchange of payroll taxes and debt and Social Security Trust Fund is an intergovernmental transfer and would not be reflected in the total budget deficit, which shows the borrowing requirements by the Federal Government.

Senator HOLLINGS. Why do you say on page 19—let us all turn to page 19, and you will see down there, "The gross Federal debt"—why did you use that rationale or whatever—that is where the debt is going up from 6,760 to 7,459—I mean, it is going up $699 billion. That is all the dollars in and all the dollars out; isn't that the case?

Mr. HOLTZ-EAKIN. It is certainly our desire to inform the Congress of all the budgetary consequences of its actions, and certainly as the Federal Treasury issues securities to the Social Security Trust Fund——

Senator HOLLINGS. I am not asking how to issue and borrow. That is the whole thing. They are going to have to borrow. If they wanted to actually put the Government in the black, they would have to actually borrow $699 billion; isn't that correct?

Mr. HOLTZ-EAKIN. No, that is not correct.

Senator HOLLINGS. Well, how is it incorrect? If it goes from $6,760 trillion to $7,459 trillion—that is where I get the arithmetic $699 billion.

Mr. HOLTZ-EAKIN. The point at which the Social Security benefits are paid in the future will be the point at which the Federal Government will be required——

Senator HOLLINGS. You are talking about the future. I am talking about your listing on page 19, the gross Federal debt.

Mr. HOLTZ-EAKIN. That figure includes those securities issued not only to the public but also to the Social Security—the Social Security Trust Fund—— and other such Federal entities.

Senator HOLLINGS. That is right, and it should not include Social Security, because under 13.301—I can read 13.301 to you; I have it; I have the Greenspan Commission report, I have the Budget Act

right here, and we can read it to you so you will understand 13.301.

But Mr. Chairman, I am not trying to belabor the good witness here. I am trying to get us all to speak the truth in budgeting, and by gosh, it says here, as you can read it, that Social Security—"exclusion of Social Security from all budgets." This is the thing you are administering. This is the Budget Act, 13.301. "The congressional budget shall not include Social Security."

And when I ask you the difference between "total" and "gross," you run around and try to talk about the borrowing and borrowing. The actual deficit is $699 billion, not $477 billion.

You have only given us on page 1 the 68 percent, not the 100 percent total, and that is the trouble. We around here are talking 10 years, and if we do not have to account for $222 billion of the deficit, then we can say, oh, well, let us have another tax cut.

If the American people understand that we are going in the hole, in the red, according to your projection, $700 billion by September 30, within 8 months, this year, I would not want to go home; they would run me back up here.

Chairman NICKLES. Senator Hollings, thank you very much. You only ran about 12 minutes, and that is all right. You are entitled to do that since you have been on this Committee for 30 years.

I will ask the rest of my colleagues if they could keep their comments or questions limited closer to 5 or 6 minutes so we will be able to get to everybody at a decent time.

Senator HOLLINGS. Thank you very much, Mr. Chairman.

Chairman NICKLES. I also want to say that you have raised the distinction between gross debt and debt held by the public for the last 20 years that I can remember and have done that very consistently. I almost look forward to your speech, because I know it is coming.

Senator SESSIONS.

Senator SESSIONS. Thank you, Mr. Chairman.

Mr. Holtz-Eakin, this projection includes no dynamic scoring—that debate we have had that by reducing taxes, it increases the economy—your projections do not have any factor in them to show an increase in revenue that might arise from a reduction in taxes, do they?

Mr. HOLTZ-EAKIN. That is not quite right. The baseline projections are done with an economic forecast that includes the impact of those policies that are currently in place, and indeed, one of the difficult issues that any analyst in this area faces is that, in particular, on the tax side, with the legislated sunsets of the tax cuts in 2001 and 2003, one has to make a judgment about how the private sector perceives those legislative sunsets.

If members of the private sector believe, for example, that all the tax cuts will be made permanent, they will act differently than they will if they believe that they will sunset on schedule.

What we have done in trying to guess what the private sector believes is simply to build an economic baseline that is consistent with the budgetary baseline, so we have constructed our economic forecast under the assumption that the private sector believes that these tax cuts will sunset as scheduled.

So, for example, if you will allow me, if you allow the partial expensing to expire at the end of this year, there are clear incentives for businesses to try to move their investment into 2004 as opposed to waiting until after the tax provision expires. We have built that into our forecast. It does not drive our forecast for 2004, but it contributes to more rapid investment in 2004, and there are myriad examples of that type. So the baseline forecast for the budget and the baseline forecast for the economy are a consistent pair.

Senator SESSIONS. Looking at your statement, the quote that you were given, I do not know if Senator Conrad's staff has that chart—maybe it is still there—but really, that chart was an inaccurate statement of the comment you made in the New York Times. As I read it, reading from the New York times article, it says: "Mr. Holtz-Eakin said the initial impact of the Bush tax cuts was positive because the cuts lowered marginal tax rates and gave people more incentive to work and produce."

To the extent that rates remain low, that will continue for as long as those rates remain low and incentive to work and produce, will they not?

Mr. HOLTZ-EAKIN. That is absolutely correct.

Senator SESSIONS. That incentive remains there constantly.

Then, you went on to say, to be accurate: "But to the extent that tax cuts lead to higher deficits"—you did not say this, because it is not in quotes—but it says, "But to the extent that tax cuts lead to higher deficits and greater government borrowing, he warned, they could have 'a cumulative corrosive effect on capital accumulation, on national saving and productivity.'"

So that was your statement in context.

Mr. HOLTZ-EAKIN. That is correct.

Senator SESSIONS. And then the New York Times went on to add in the next paragraph: "Economists prefer"—economists, not politicians—"to look at budget deficits in relation to the size of the overall economy rather than to the absolute dollar amounts."

So it is a legitimate economic consideration to consider the deficit we have as a percentage of the overall economy; isn't that correct?

Mr. HOLTZ-EAKIN. Indeed, I think it is appropriate. As I have mentioned in other places, if one goes to get a car loan or a mortgage, the first thing they ask you is, "What is your income?" They want to know what is your ability to repay, and it is appropriate to look at borrowing as a fraction of that ability.

Senator SESSIONS. So the President's commitment, which I think we can exceed, of reducing the debt as a percentage of GDP by one-half is a good step, I believe.

You noted that if we were to keep discretionary appropriations at the rate of inflation after 2004, we would save from the 2005–2014 timeframe $1 trillion plus. Is that how I interpret that chart that you have given us. "Policy alternative that reduce the deficit or increase surplus"—No. 1 that you list is "increase discretionary appropriations, excluding supplemental appropriations for 2004, by the rate of inflation after 2004."

Mr. HOLTZ-EAKIN. That is the impact of excluding the supplemental, not the impact of the growth rate that we assume; that just moves from a lower starting point.

Senator SESSIONS. All right—and keeping it at the rate of inflation.

Mr. HOLTZ-EAKIN. Keeping it at the rate of inflation.

Senator SESSIONS. So if we came in under the rate of inflation, that would be even more savings. So you are considering in your deficit numbers an $81 billion supplemental every year?

Mr. HOLTZ-EAKIN. It is actually an $87 billion, and it goes up with the rate of inflation. It is in all 10 years.

Senator SESSIONS. And that amounts to over $1 trillion, which is half of what you projected the deficit to be; is that not correct?

Mr. HOLTZ-EAKIN. That is correct.

Senator SESSIONS. Now, in this economy, it seems to me tax revenues seem to be more volatile than the GDP. If the GDP remains up, sometimes the tax revenues exceed the GDP growth, and if it drops, tax revenues drop below the GDP, faster than GDP drops. I think that is because we tax higher-income people significantly and because when people sell stocks after the stock market has dropped, they are taking losses, but when the stock market is up, they have to pay capital gains taxes on their profits.

Aren't those some of the things than make for volatility in revenue coming in to the Federal Government?

Mr. HOLTZ-EAKIN. Those are certainly factors that have contributed to it. We tax not just the flow of current income that is measured by GDP; we tax asset sales. Capital gains and capital losses affect tax receipts. It is also the case that not every income flow is even across the entire population, and shifts in the income distribution have impacts.

Senator SESSIONS. We took the hit with September 11, and airlines and hotels are in trouble, and these corporations, instead of paying corporate taxes, were having losses and were not paying taxes; is that correct?

Mr. HOLTZ-EAKIN. That is correct.

Senator SESSIONS. Some of the executives who make big salaries were not getting bonuses, which they pay very large income tax on, perhaps, because their companies did not show a profit that year. That makes some of the volatility occur, does it not?

Mr. HOLTZ-EAKIN. Those are pieces that are in what we refer to as our "technicals." They sound economic, but given the way we divide things, those are part of the technical revisions we have experienced in the past and going forward.

Senator SESSIONS. And I guess my question—and I know the Chairman is worried about how optimistic we ought to be—but if growth holds in the stock market at a steady, modest rate, and if GDP holds at the rates you are projecting, isn't it likely that profits will begin to increase, that people will begin to sell more assets that now have gained in value, so they are beginning to pay more capital gains taxes instead of offsetting income by taking capital gains losses to the extent they can, and that we might show a more volatile increase in revenue than you have projected?

Mr. HOLTZ-EAKIN. It is certainly the case that we have built exactly those phenomena into our baseline forecast—increasing capital gains taxes, increasing profitability by the business sector, and tax receipts to go with that. It is also the case that there is a lot of the forecast that is simply unknowable, and we have tried to

document the degree to which that kind of uncertainty can affect budgetary outcomes. It is in an appendix to our report, and you can see that as you move further out in time, as you go out to 2009, there is a wide range of possible impacts on the bottom line budget deficit that come from economic and technical uncertainty—exactly the factors you have discussed.

Senator SESSIONS. Mr. Chairman, I would offer this New York Times article and ask that Senator Conrad, to the extent to which his chart may be in error, correct that.

Chairman NICKLES. Thank you, Senator Sessions.

Senator SESSIONS. There is—is that The Washington Post? OK.

Chairman NICKLES. Thank you very much.

Senator Stabenow.

Senator SESSIONS. Mr. Chairman, let me just correct that; it is unfair to Senator Conrad. I was looking at the New York Times, and he had The Washington Post article, which does appear to be—I do not have any information on that, so he may be correct on that.

Chairman NICKLES. Well, I am sure The Washington Post is always as accurate as the New York Times is.

Senator SARBANES. Can we get that in writing?

Chairman NICKLES. No, no. Certainly that is off the record. Cut that off the record.

Senator SARBANES. Can we print out the record on that comment?

Chairman NICKLES. No.

Senator Stabenow.

Senator STABENOW. Thank you, Mr. Chairman.

First, I want to congratulate you on your last year chairing the Committee. While we do not always agree on policy issues or votes, I have very much appreciated your graciousness and fairness with the Committee and look forward to a process where we can openly debate all the issues and very critical policy differences that are before us.

When we look at these numbers—I was looking at the total that is being projected this year, for 2004, on the deficit, and depending on whether $477 billion, or if we exclude Social Security, as we all say we want to do, and remove that from the numbers, $631 billion, what I find extremely interesting is that when we look at domestic spending, non-defense domestic spending, we see that if we were to eliminate every penny of spending this year for education, innovation, non-Medicare health programs, environmental protection, and all the other things that are domestic spending including homeland security, if we were to eliminate it—$445 billion, according to your numbers—we could not wipe out our debt this year.

I think that is very important, Mr. Chairman, to put in context for us. Just as you, Mr. Chairman, and Senator Conrad agreed that 92 percent of the increase in spending in the last number of years has been defense, homeland security, rebuilding New York and the Pentagon, other issues related to 9/11—92 percent—I think it is very important to put in context that if we did nothing in terms of the defense and domestic spending, if we did nothing but defense and wiped out every penny of everything else the American people have asked us to invest in to promote education, innovation and

help drive the economy, we would not eliminate this year's debt. I think that is pretty astounding, actually.

When I came to the Committee, we were debating 3 years ago what to do about the largest surpluses in the history of the country. We are now talking about what to do about the largest deficits in the history of the country, and we can debate whether deficits matter—I believe that deficits matter. I believe that anyone looking at this in the public believes that deficits matter. And if we go back and look at comments that we all have made over the last many years, I believe that at many, many different points in debates, we have all acknowledged that deficits matter.

I think that what I would like to do is take my few moments and talk about the economy and what is happening in terms of jobs. There are lots of things I would love to ask you, and I certainly have comments about Medicare, and I will save those, Mr. Chairman, for another time in terms of what really happened under that bill and what will happen in the future.

But when I look at it from Michigan's standpoint, even though we see many of the numbers going up in terms of the stock market and what is happening, positive indicators happening, that is not being translated in terms of jobs in Michigan and where the rubber meets the road. When we look at the fact that we have seen about 1,000 jobs, I believe, created in the last month or so, I certainly question the numbers in terms of being able to see this economy turn around. But I would like to have you speak for just a moment about the difference between the macroeconomic statistics and what is happening in manufacturing in places like Michigan.

We have an unemployment rate of 7.2 percent this year. We have people who have been employed all their lives and have invested in education, have done all the things that we have asked them to do, losing their jobs right and left. And literally every day, I could show you headlines in the paper right now of jobs that are not coming back.

This gets to a whole range of policy issues that we need to address, and I will just mention one situation that occurred in the last couple of weeks that has been so shocking to people in Michigan—a plant in a small town, Greenville, Michigan. Nine thousand people live there, and Electrolux, which builds refrigerators, announced 2,700 jobs going to Mexico, not because they could not make a profit—they say they make a profit in the United States—but they could make a bigger profit if they paid people $2.50 an hour and no health care.

So we have a lot of challenges, and we are not seeing the jobs being created even though we are focused on high-tech manufacturing and focusing on increasing skills and so on.

I wonder if you could speak to what you have seen in manufacturing versus the larger macroeconomic numbers as it relates to employment.

Mr. HOLTZ-EAKIN. I would be happy to. There are a variety of factors that have influenced the manufacturing employment picture, and if we back up to the long-term trends, the most pronounced feature of the manufacturing sector is that it has managed to maintain growth rates and total production that are comparable to the economy as a whole. So it is not shrinking compared to our

economy in production, but it has been shrinking in terms of total employment on a steady basis for quite a while. The gap is filled by the very rapid productivity gains in manufacturing, and it is a reflection of the fact that in the face of the ability of manufacturers to innovate and produce their goods in a more productive fashion. Even when price declines are a result of that, consumers do not choose to continue buying as much in manufacturing goods as they used to; they tend to shift the mix of their purchases toward services and other items.

So we have seen a migration of employment from the manufacturing to the nonmanufacturing sector. It is a long-term trend. It has been in the data, and it is augmented by a statistical phenomenon, which is that many jobs that used to be classified as manufacturing are now essentially outsourced by manufacturers. They hire janitorial services, and the employee is still in the same facility but employed outside the manufacturing sector. That has been a piece of what has gone on as well.

A third has been a recession. No question—manufacturing is typically highly cyclical. Recessions hurt manufacturing more than some other sectors of the economy, and in this recession, it has been quite pronounced. We have seen that happen. And even more so than in other recessions, there has been a difference in the demand for manufacturing, and it comes from the sharp decline of business investment in this recession, really much more than a typical recession. That decline in business investment has hurt the demand for manufacturing goods, and to the extent that turns around, we would expect part of the manufacturing problems to be diminished to some extent.

And in the international sector, we have seen a decline in not only the demand for traded investment goods, which is a big part of our exports, but also manufactured consumer goods.

So one of the really striking features of the performance over this business cycle, the recession and recovery, has been that we have imported sort of a typical pattern of manufactured goods, but we have exported way below what you would expect at this point in a recovery. That has to do with weak foreign demand for these products and the status of the dollar. We have seen the dollar weaken somewhat, and, other things equal, that might help, but certainly weak foreign economic performance has been a big part of it. The U.S. has been one of the few engines of growth internationally. To the extent that foreign demand turns around, that also should contribute.

Then, finally, there is the mixture of locations of production, both domestically and internationally. We have just seen a growth in trade, and this has raised the usual issues in the impact of dislocations from international trade. On the whole, international trade betters all parties, but there are particular workers who typically bear the brunt of the adjustment, and that becomes an issue for policy concern.

So it has been a wide array of things that have all impinged on manufacturing employment, especially through this recession and recovery.

Senator STABENOW. Mr. Chairman, just in conclusion, I will say that manufacturing has been a backbone of the middle class in

America, and I would agree with you that what we are seeing is fewer exports—what we are doing is exporting the jobs. The plants are going to China as opposed to the product going to China. I believe that there are a number of things, including addressing currency manipulation, smarter trade policies, more incentives to remain in the United States and create those jobs, and that that is very much a part of any sustained, long-term recovery for us, because of the importance of manufacturing to the economy of the country.

Thank you.

Chairman NICKLES. Senator Stabenow, thank you very much.

Senator Allard?

Senator ALLARD. Thank you, Mr. Chairman.

I would like to followup a little bit on Senator Hollings' question, because I think he muddied the waters, and I would like to help clarify those waters and clear them up if I might.

I guess the best thing to do is think of this in terms of as though you were if you were a business. If you have a profit and loss statement on a business, you want to take the total expenses, you want to take the total revenue coming into the business, and you come up with your net, whether it is a loss or a gain, and that is what your figure reflects; it is total cost and total revenue. Is that correct?

Mr. HOLTZ-EAKIN. That is right.

Senator ALLARD. But if I transfer money from the sales department in my business to employee benefits in my business, it does not affect the bottom line, but as a manager, I may want to know that that is happening, because I want to know which areas are producing and which ones are showing a profit—just like we have here in the Federal Government. As managers, I think we need to be very much aware that Social Security contributes to that net figure. Whether we want to ignore that figure or not, the Social Security is part of the total.

Now, to take a transfer from Social Security to the general fund as managers, it is kind of good policy for us as Members of Congress to know that, because eventually, it is going to have an impact on the general fund unless we do something about it.

So I appreciate your figures. I think they truly reflect what is happening this year as far as the bottom line is concerned. I think that is important. I think it is in line with what we would expect from a legitimate cost and profit statement that you would get from a company, and I do think it is 100 percent accurate, and I just want to thank you for making that point to the Committee.

Also, I do not know whether you had an opportunity to look at the chart called "Source of Change in Deficit Surplus Outlook Since March 2003." It has been put out by the Senate Budget Committee.

If you have not had a chance to look at that, I would like to have you look at it and send me a letter or something as to whether you agree with the figures that are in that or not, because I think it tells a definite story, and I would like to get those figures confirmed by your office if we might.

Mr. HOLTZ-EAKIN. I am happy to do that.

Senator ALLARD. Also, looking at non-defense discretionary spending, I agree that it is up at record high levels, whether we

look at it in nominal terms or just as a share of gross domestic product. My question is do you believe it is necessary to reduce Government consumption in order to attain a balanced budget?

Mr. HOLTZ-EAKIN. In the end, you can balance the budget as a matter of the math by either cutting what goes out or raising what goes in, and it will be a policy decision about which route the Congress will choose to go.

Senator ALLARD. But you would agree that from a practical matter, it is pretty hard for us to balance the budget without holding down spending.

Mr. HOLTZ-EAKIN. Certainly, if you look at our baseline, by historic standards, that is a fairly stringent spending path, 2.5 percent, and you see a diminishing profile of budget deficits over the course of the 10 years.

Senator ALLARD. Well, I look at this chart that was provided to the Committee, and since March of 2001, the new spending is 61 percent, tax cuts are 9 percent. It is hard to say that if we are going to get around to balancing the budget, we certainly have to show some—we have to be aware of the spending that is going on in this budget and the impact that it is having on the deficit, and I do not see how we could ignore the impact of spending on our deficits.

Mr. HOLTZ-EAKIN. I think it is certainly the case that the threshold decision is the decision to spend money by any enterprise, especially the Federal Government, and at that point, the issue becomes how it is financed. But having made the decision to spend it, it will have to be financed either by taxes or borrowing, and the issue of the deficit is a finance issue. The first issue is what do the Congress and the administration choose to do in the way of programs and for public policy purposes, necessarily so.

Senator ALLARD. Now I have a question related to marginal tax rates. Some have argued that the marginal tax rates should be raised to reduce the budget deficit—instead of looking at the spending side, they are looking at the revenue side. And I want you to look at this as an economist—would raising marginal tax rates likely reduce the labor supply?

Mr. HOLTZ-EAKIN. If one were to increase marginal tax rates, there would be clear disincentives to supply labor. And more broadly, the economics literature documents the distortion to effort, occupational choice, and a wide variety of aspects of labor supply.

Senator ALLARD. So by doing that, we would have an impact on jobs.

Mr. HOLTZ-EAKIN. You would certainly have an impact on the efficiency with which the economy operated, and that would be one of the costs of high marginal tax rates. A flexible economy like the U.S. economy will in the end find ways in the form of lower real wages or some other mechanism to employ people, but there is a cost associated with high marginal tax rates that is a distortion cost in the economy, not measured well by jobs.

Senator ALLARD. Mr. Chairman, I believe my time has expired. Thank you.

Chairman NICKLES. Senator Allard, thank you very much.

Senator Nelson?

Senator NELSON. Thank you, Mr. Chairman.

You know, back in 1979 when I went to the House, I had the privilege of going on the House Budget Committee, and over two decades later, as another freshman member of a legislative body on the Budget Committee again, this Committee is where the action is, but there is too much "Gotcha" politics, Mr. Chairman, in this Committee. It seems to be endemic to the nature of this Committee, because it was so back in the late seventies and the eighties, so that the budget does not become an economic document, it becomes a political document. So we have all of these various interpretations as to what is going to help each side's political interest, and it is hard to get focused on what the real truth is.

Let me just on that note ask a question here. Last year's budget, August 2003 forecast, had a 10-year projected surplus or deficit, and it came out right at $1.4 trillion. If you take those same years, 2004 to 2013, it is $2.4 trillion, so that is an increase of $1 trillion in the deficit over that decade.

Help us understand why we shot up $1 trillion in the deficit.

Mr. HOLTZ-EAKIN. It comes in three pieces. Piece No. 1 is about $680 billion as a result of new legislation: Medicare prescription drug legislation plus other appropriations.

The second piece is a combination of economic and technical factors, as the Chairman mentioned earlier. Within the economics, we have three effects—faster near-term growth and impacts of higher productivity that allow us to have greater economic prosperity. And then, especially in the out-years, we anticipate that higher health and other benefits costs will lower the fraction of compensation that shows up in taxable wages.

We also anticipate lower inflation, which has a modestly negative effect on the budget.

So given the good news in the near term and the bad news in the long term, the net effect on the economics is negative by, with the technicals, a total of about $300 billion. So that is where the trillion dollars comes from—legislative, about $700 billion; economics and technicals, about $300 billion.

Senator NELSON. OK. Now, when we ask questions for the average American on the street, and they are trying to understand what is happening to the economy, we see right now that the economy is going up, there has been this stimulative nature of the cash that has gone into circulation through additional spending, through some of the tax cuts and so forth, but on the basis of what you just said, with a huge deficit increase over the next 10 years by these figures over the decade, $2.4 trillion of additional deficit, at some point, just from a common sense standpoint, if you have to go out and borrow an additional $2.4 trillion over the decade, the demand for that additional money is going to cause the cost of that money to rise, which is the interest rate, and are we not going to see interest rates start to rise?

Mr. HOLTZ-EAKIN. As I mentioned earlier, we have built into our economic forecast the budgetary projections, so these are part and parcel of the same forecast. Built into our economic projections is a rise in interest rates—for example, short-term rates will rise over the next 2 years to something like 3 percent, and we will see the 10-year rates go up as well.

One would expect that to happen both as part of the cyclical recovery and as the Fed perhaps moves its policy instruments closer to neutral.

Senator NELSON. Well, when the interest rates rise, will we not see, then, a stalling of the recovery because interest rates being higher, particularly if they go much higher, aren't we going to see a replay of history, that we suddenly have the recovery stalled, and we start slipping back into recession?

Mr. HOLTZ-EAKIN. We certainly do not anticipate that. As I mentioned, we have a robust cyclical recovery; we think the other factors that influence in particular business investments, which are central to a sustained cyclical recovery, might outweigh any movement of real interest rates back toward their more historical alignments.

Senator NELSON. Well, I can just give you some country boy common sense predictions, and this country boy has gone out and talked to several noted economists in the country as well as chief economists of some of the major financial institutions in this country, and the near unanimous feeling among these economists is that we are going to see the economic stimulus through the end of this year, and then watch out when we get into 2005—it starts slowly going down, and then it starts accelerating toward the end of 2005 as the interest rates go higher because the deficit keeps going more and more up, and we have to borrow more and more, and suddenly you get into a vicious downward spiral that will cause the economy to slip into that recession.

I would like to have the optimistic outlook that you have, but when I have had that on the Budget Committee before, it did not happen that way.

So, Mr. Chairman, I wanted to bring you the thoughts of this country boy.

Chairman NICKLES. Well, Senator Nelson, thank you very much, and I do not know that I would characterize Dr. Holtz-Eakin's comments as being "optimistic." We have had a great, robust last couple of quarters, and yet the reestimate calculates an additional $700 billion of spending that Congress is responsible for, that most people voted for, and then he came up with some pessimism, or reestimates, technical adjustments and so on, that cost or added to the deficit projections of about $300 billion.

So I do not know that I would characterize his statement, but I will tell you that in talking to our colleagues, knowing of your interest in the space program and knowing that we have to make some cuts, there have been significant discussions of funding the space program adequate to get you to the moon, but not enough to get you back.

Senator NELSON. And that is the one you want to send me on; is that right?

Chairman NICKLES. That was the one that you were supposed to attend—just kidding.

Senator DOMENICI. You were asking about it.

Senator NELSON. Mr. Chairman, I would just say that the witness has said 2.4 trillion additional dollars of deficit over the next 10 years, and that is bound to have an effect dampening any kind of optimism, any kind of reenergizing of the economy.

Chairman NICKLES. Senator Nelson, thank you very much.

Next is Senator Domenici.

Senator DOMENICI. Thank you very much, Mr. Chairman, and first let me compliment you on your superb work and wish you well. I hope you can get a budget this year. We have not seen the President's yet, but I imagine it is going to be as difficult as last year or more so.

But to those who complain about the deficit, it is going to be pretty obvious they are going to be given an opportunity to put their mouths where their money is also, and also for those who look at the President, I have heard candidates running around the country saying, "We are looking at him, that is the guy who did it"—well, we are going to check on how many things they voted for that would have been more than the President. We can start with the proposition that the President does not spend any money and then see how much did Congress spend and then look at each candidate and see how much would you have spent more than the President—and of course, they are going to say none—but then we can look at the budget. I think we had about eight points of order that many Democrats voted for that was $50, $60 billion a year, wasn't it, since you have been Chairman?

Chairman NICKLES. A lot; there was a lot.

Senator DOMENICI. Yes.

First of all, let me say to you, Mr. Congressional Budget Office Director, that I hope you are enjoying your job.

Mr. HOLTZ-EAKIN. I am.

Senator DOMENICI. Good. It is pretty hard to tell, because you have gloomy eyes. Your eyes do not smile.

Mr. HOLTZ-EAKIN. My wife will be disappointed to learn this.

Senator DOMENICI. But there is nothing we can do about that. You know, mine smile too much.

In any event, I do want to tell you that you keep trying, and people keep wanting it to disappear—not that we love deficits, but if we are looking at it from the standpoint of how risky it is, we have had a couple times when the debt of the Nation was bigger than it is now in proportion to gross domestic product. I think I was here, and I do not think I was very happy, but I had to produce the budget that met the times.

Do you recall the years that it was higher? My staff gives me a number of 1993. Anyway, we do not have to waste a lot of time, but if you could find that—OK, I have it. Do you think these are correct if I read them into the record: In 1993, the highest ever, the percent of GDP was 49.5 percent; 1994 was 49.4 percent; and now, we have 2003, which is 36 percent. Is that correct?

Mr. HOLTZ-EAKIN. Those sound to be in the ballpark, but we can check them.

Senator DOMENICI. Well, when you worry about the U.S. Government and the debt's impact upon society, this is a pretty relevant fact, the relationship of the debt to the gross domestic product. It is not exclusively conclusive, but it is pretty important. And I want to repeat what you have said—we have had higher ones than this year—again, not that we like to run around and have them always, but that is the truth.

Second, I am impressed and confused about a couple of things, and maybe you have some answers, maybe you can tell us where to look. First, we have a terrific growth pattern in the immediate past. For a year and a half or so, if you look at the productivity, it is incredible. We had some growth quarters that looked like we were China. I just noticed that last year, their composite was 9.1 percent. Sometimes it is 9.8, sometimes 8.9, but 9.1. Well, we have had productivity growth in the area of 6 and 7 percent and GDP growth that exceeded 5, right, during this period of time.

Now, I have a very perplexing question. When you woke up yesterday morning, you did not have to ask your people what the reality was that there were more people employed in the United States that day than ever in history—not in proportion to, but just more Americans were at work.

Now, two things—how come we are not having more employment with this fantastic GDP growth and this rather enormous productivity growth—maybe the productivity growth has something to do with why there are fewer jobs—but nonetheless, we have those, and we have the highest number of jobs ever, and yet we are running around talking about the fact that we have lost jobs.

First, is it very relevant that we have lost jobs in light of what I am talking about? And second, is it very important that we have more workers than we have ever had in the past? And third, when and how are we going to have a big impact on employment, since we keep talking about this being a Hoover-type situation with no new jobs?

Before you answer, let me tell you that I now understand, just from the practical standpoint, this very, very phenomenal thing happening in America, that is, the almost enormous, proportionately, productivity growth. It is incredible, and people wonder how and why, and I think I know, I think I understand. When you look at everybody who uses a computer or a new electronic gadget, you ask how many people did it replace, and clearly, they are replacing people all over, and you are still getting more production.

Now, you cannot expect to tell Americans not to do that, right? I think you would destroy everybody if you said you cannot be efficient, you cannot rent a new IBM machine, you have to keep 20 people employed.

So, having listened to me carry on here, talk about jobs in the context that I have talked to you here about it.

Mr. HOLTZ-EAKIN. Thank you.

Let me begin with productivity and turn to jobs. Certainly, long-run productivity growth is central to increasing the standards of living in any society, so it is something that is a good thing and something that we should pursue as part of our economic policies.

The productivity performance in this recession and recovery has been quite remarkable by historical standards, and the most recent data are in fact really quite impressive as well.

The first thing to note is that productivity often shows some quite dramatic one-quarter increases coming out of a recession. It is a highly volatile series, and for that reason, it is important not to take any single quarter at face value as an indicator of things to come.

The second thing to note is that, as a matter of national statistics, these are data that are revised often. That is a second reason to be cautious in interpreting the most recent data and taking them at face value.

But, nevertheless, as I mentioned earlier, since 1995, there has been an increased rate of productivity growth in the United States that economists puzzled about and wondered if it was permanent, real, and what the durability of this acceleration in productivity would be.

The recession and recovery marked essentially a litmus test for that, and it has continued, and that is good news. However, we do not fully understand the roots of this. In the report, we lay out what are some of the most common hypotheses about this. Is it reflective merely of business caution in adding new workers, and as a result, you get more stuff going out but not more people coming in; and productivity is simply the division of those two things. Or is it the fact that in the late nineties, businesses purchased a lot of computers and other IT goods and really undertook a massive expansion and then just slowly adjusted to using those and that we are now seeing the productivity gains with a lag—some sort of adjustment period. Or, finally, is it the fact that the gains that used to be concentrated narrowly in faster chip times and things concentrated in computing and then shipped—sort of physically embodied in those—is now diffusing into business practice and the economy more widely?

There are lots of tantalizing pieces of evidence on all of those. There is no definitive case to be made and certainly in our view not enough statistical evidence to start picking a dramatically big difference for our productivity future. So we have acknowledged the history, raised our productivity level to some extent, but we have not really changed our growth rate.

Our productivity puzzle will be an ongoing area of investigation not only for us but for many people.

If one turns to employment——

Senator DOMENICI. Could I ask you, just because you do not know its roots, is it fair to say nonetheless it is good?

Mr. HOLTZ-EAKIN. Productivity growth is very good. If productivity growth occurred evenly in all sectors of the economy, employment would move evenly in all sectors of the economy, and people would buy that stuff. It is the fact that we do not have even productivity growth and even purchases of the output of that productivity growth, which causes us to have to shift the employment mix in the economy. And that is an ongoing trend; in this economy, it happens all the time.

Senator DOMENICI. But we have had many decades in America where we would have loved to have this kind of productivity increase; right?

Mr. HOLTZ-EAKIN. Certainly, beginning in the seventies and up to the mid-nineties, the productivity puzzle in that era was, "Where did it go? Why did we not have productivity growth?" Now we have a puzzle in the other direction.

On the employment front, I can say with I think complete honesty that we do not really understand the cyclical pattern of employment growth, and the labor market has been a bit puzzling.

People have pointed to the December payroll employment survey: up 1,000 jobs. The same caveats apply. You do not want to read too much into any single month's data. These are very noisy series. There is some tantalizing evidence that the seasonable adjustment to the December survey may have influenced it.

But more generally, there has been relatively slow growth in payroll employment in this recovery that we cannot fully explain. There has been a mismatch between the household survey that the Chairman mentioned and the payroll employment survey.

We have looked at the different stories that these two surveys tell. They often tell different stories. They are never as far apart as we are experiencing right now. They are about 600,000 jobs different since July. We can explain about 100,000 of that difference through different statistical samples and different coverage issues. The rest, we do not fully understand. We believe still that the payroll survey, which is larger and which we think is probably a better indicator of the status of the labor market on average, is one that we will continue to look at. But we do know that around turning points, it will miss startup businesses and things like that. So there is an element of truth to both of the surveys.

But in terms of when this economy will begin to generate 100,000, 150,000, 200,000 payroll jobs per month, a capacity that it is capable of doing, I do not have a firm answer to that, and I will not pretend to.

Senator DOMENICI. I just want to make one last observation and thank the Chairman for giving me time.

I was going to bring, Mr. Chairman, and article, and I apologize, but with your permission, can I put it in the record?

Chairman NICKLES. Certainly.

Senator DOMENICI. I was reading a recent article, no longer than 2 days old, wherein a gentleman in business said, "I have the answer as to why there are no more people being employed in America as we come through this enormous growth period." He said, "I am the answer."

Somebody said, "Who are you?"

He said, "I am a business, and I have three employees, and I do enough business where 15 years ago, I would have had to employ 15 people."

Then they went on with the questioning. He said, "Just last week, I needed a specialist for something. I did not hire him and put him on my payroll. I ran an ad. And there was a person more equipped than I could ever afford who said he would come and do the job for 1 month, that it would take him 1 month to do it. I paid him heavily. He got employed for 1 month, and my business is rocking along, and a $50,000-a-year person is not on my payroll." And he said, "I think there is a lot of that going on in the United States."

Now, I do not think that that is bad. I think you have to be able to do what the marketplace demands of you. But I might just ask you if you have come in contact with that as something of significance with some name that is affixed to it.

Mr. HOLTZ-EAKIN. There are a couple of parts to that story that ring true. The first is that if you indeed get output growth, if business is rocking along, eventually, you will require more labor from

some source to continue to do business. Will that come internally, adding jobs within the company, or will it be temporary help that you hire from outside the company either in the form of a temporary help agency—and that shows up in the data and is one of the things you look for as an indicator of an upturn in the labor market—or in the form of this gentleman who may be a consultant, essentially a self-employed individual, in which case it will not show up immediately in the data but subsequently would be caught by the payroll employment.

So those are issues in our trying to understand the labor market. I would say that what the CBO anticipates in its forecast and what most people would say is that you cannot continue to grow at the pace that we did in the third and likely did in the fourth and as fast as we expect in the future without eventually beginning to create jobs. I quite frankly would have thought we would have seen more by now, but we have not.

Senator DOMENICI. Thank you very much.

Thank you, Mr. Chairman.

Chairman NICKLES. Senator Domenici, thank you very much.

Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman.

I want to focus on the issue of health care costs. I think it is obvious that there are no costs in America going up like medical bills. That is true with respect to both the public and private sectors. Last week, the country saw that we are going to spend $1.6 trillion on health. If we divide the number of Americans into $1.6 trillion, it comes to something like $16,000 for a family of four.

So that obviously, we need the strongest possible set of cost containment tools, and I want to talk to you about the non-interference provision in the Medicare legislation specifically. I voted for the bill—I still have the welts on my back to show for it—and one of the reasons that I did is that it seemed to me it allowed more choices and more alternatives with respect to the delivery of health care in America, and that would be a plus for senior citizens. That would be an opportunity with more choices and more alternatives to serve as a force for cost restraint and competition and a tool to hold down the bills.

But what I want to ask you about is wouldn't the removal of the non-interference provision allow for Congress to move toward the kind of cost containment program that Members of Congress have? Wouldn't the removal of the non-interference provision allow the Congress to move to a Federal Employee Health Benefits-style approach, which so far seems to have been the best cost containment vehicle? And I want to know particularly in connection with your letter to the majority leader whether you examined that issue in particular.

Mr. HOLTZ-EAKIN. Well, the letter we wrote to the majority leader examined that language in the context of the Medicare bill as passed, and in our scoring of the Medicare legislation, we certainly looked at lots and lots of pieces of evidence, including the limited data that we could get out of the FEHB program.

But on the language in particular, what we looked for in the bill was both the ability and the incentive to control costs. Private entities who bear cost risk have an incentive to cut a good deal with

pharmaceutical companies, and if we give them the tools to manage their costs and pick formularies and choose preferred drugs, they will have the ability. And given the incentive and ability, it was our reading of the legislation that the ability of the Secretary to negotiate a better deal than the private plans that already had lots of incentive and lots of ability to negotiate that same deal would be negligible, and as a result, removing the language should not have big budgetary consequences.

Senator WYDEN. You see, what I think is flawed in that argument is that if you believe in private sector cost containment—and I do; that was one of the factors in my supporting the legislation—the reality is now that Medicare faces a statutory bar to cost containment that is not faced in the Federal Employee Health Benefits Plan that is available to Members of Congress. Any way you slice this, colleagues, that is where we are on a key cost containment issue. If you believe in the private sector, the fact is Medicare now has a statutory bar, a statutory restriction, that is not applicable when you are talking about cost containment for Members of Congress and their families.

So what I would like to ask you today is to go back and do some more analysis with respect to FEHBP, because I do not quarrel with the idea that the private sector is of value—that is not at issue here. What is at issue is if you believe in the private sector, why should there be any statutory restrictions in terms of what you can do in terms of tough, hard-nosed bargaining, and any way you slice it now, we have restrictions in terms of what Medicare can do that is not faced when you are talking about negotiating for Members of Congress and their families.

Is that something that you would be willing to do, to look further at the FEHBP-style model and particularly whether removing the statutory restriction would allow Congress to move more aggressively toward a model that is used to protect our families?

Mr. HOLTZ-EAKIN. I would certainly be happy to go back and look at that. I will not pretend to be intimately familiar with all the details——

Senator WYDEN. I understand.

Mr. HOLTZ-EAKIN [continuing]. But my recollection was that access to data, hard data, on what happened in FEHBP was one of the limitations. We can look into that for you.

Senator WYDEN. I think what has happened in particular is that there was such a rush with respect to this legislation on the bargaining power issue that not enough time was spent, so you had a set of very powerful interests who said, look we will just put this in there and say that everything is going to go to the private sector, and then it is going to come out hunky-dory. That seems to me to be overly simplistic.

I will stipulate to the kind of argument that you are making as being of real value. There is no question to me that the private sector choices—because we have seen it in my home town—can be useful. But it also seems to me that if you believe in the private sector, you should not have the restraints. And the reality today is that when it comes to containing costs for senior citizens under Medicare, there are legal prohibitions that do not apply to what is done with respect to private sector cost containment for Members

of Congress, and I do not think that is right. You have always been very gracious to me, and when you say you will look at something, you are always fair and responsive, and I would like to see that as soon as possible, because I think that is going to be an issue that we are going to be dealing with on the floor of the U.S. Senate probably within a matter of weeks.

Mr. Chairman, thank you.

Chairman NICKLES. Senator Wyden, thank you very much.

I touched on this in my opening remarks. Let me just ask a related question—and I apologize to Dr. Holtz-Eakin who also has to testify in the House, and I was trying to get him out of here by 12. But if Congress mandated that the Government interfere in the negotiations, do you think there would be any savings?

Mr. HOLTZ-EAKIN. If you put a provision and language into the bill as passed which said the Secretary "should" or "must" negotiate, we think there is the potential for savings on some drugs, presumably the nonpreferred drugs, where the pharmaceutical company is really aggressively trying to take its preferred drugs, give the best deal on those, and get them into the prescription drug plans. On the others, we think there might be the potential for some saving. But given bottom lines, to the extent that you move down the prices on one drug, you probably move up the prices on the preferred drugs, and on balance, you could raise costs. Certainly, we would have to look at the details of any particular legislation and look at any other models of this kind of thing in practice, but in our thinking about the language, that is the kind of issue that arises.

Senator WYDEN. Mr. Chairman, if I could just very briefly, I want it understood that I am not talking about mandating some kind of cumbersome interference plan. With respect to the FEHBP plan, there is no language on this point. Now it is essentially discretionary, and that is what is wrong about the current law. We are not giving Medicare the discretion to go to bat for seniors the way we are giving our health plan the discretion to go to bat for us.

That is what is wrong, and that is what I am going to try to change.

Chairman NICKLES. I understand. We do not need to debate this now, but I think your letter stated that if we removed that language, you do not think there would be any appreciable savings.

Mr. HOLTZ-EAKIN. That is right.

Chairman NICKLES. I appreciate that.

Dr. Holtz-Eakin, I am going to have to run.

Just for the information and for the record, our next hearing will be next Tuesday, when we will have the Director of OMB. They will present their budget on Monday, and we will have their hearing on Tuesday.

I will leave it to Senator Conrad.

Thank you very much, Dr. Holtz-Eakin, for your appearance before the Committee today.

Mr. HOLTZ-EAKIN. Thank you.

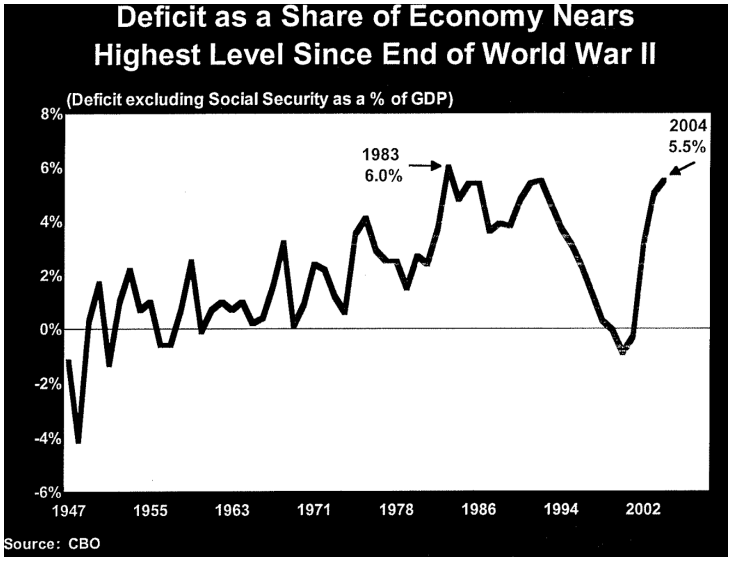
Senator CONRAD. I will be very brief.

I just wanted to indicate that our former Chairman was talking about deficits as a percentage of gross domestic product and was

talking about these as being smaller than they have been in the past.

I have a different view, and it is expressed in this chart that looks at deficits as a percentage of GDP, if you take out Social Security, you get a different picture. The last time we had deficits as a percentage of GDP that were anywhere close to this was in 1983. There, we had a deficit that was 6 percent of GDP, but there was a fundamental difference. There was almost no Social Security surplus at that time.

Now the Social Security surplus is $160 billion, or very close to it. And if you take out the Social Security surplus and look on an operating basis, our deficits as a percentage of GDP are the biggest they have been since World War II with the exception of 1983.



So I just want to provide that alternative view.

One other thing——

Mr. HOLTZ-EAKIN. If I may, I think you and I concur on those facts.

Senator CONRAD. Excuse me?

Mr. HOLTZ-EAKIN. I think you and I concur on those facts. I think Senator Domenici was talking about debt as opposed to deficit. We can check.

Senator CONRAD. I have heard many describe deficits as relatively small as a percentage of our GDP. I think that historically, that is not the case when properly viewed.

Senator Domenici also mentioned what he thinks is happening in the work force, and the front page of the business section in today's Washington Post has the story he was just telling of the gentleman who says he is running a small business, he has only three full-time employees, and when he wants to hire somebody—when he needs a computer programmer, or a speech writer, or a web designer—he just puts the project out to bid on the internet. And Senator Domenici was describing that he just had a problem with

a computer program he needed done, he put it on the internet, and he paid $118 to a gentleman in the Ukraine to write his computer program. He said it would have cost $1,000 to employ somebody here.

I think Senator Domenici is onto something in terms of productivity growth. You can see it in construction as well. We are able to put up a Class A building now in a year. It used to take sometimes 3 years. And what is happening with computer-assisted design, all of the computer ordering—it is a productivity gain that is occurring in terms of more efficiency.

Again, thank you, Director, for being here today.

Mr. HOLTZ-EAKIN. Thank you.

Senator CONRAD. The hearing is adjourned.

[Whereupon, at 12:17 p.m., the Committee was adjourned.]

STATEMENT FOR SENATOR BUNNING
SENATE COMMITTEE ON THE BUDGET
CBO'S BUDGET AND ECONOMIC OUTLOOK
January 27, 2004

THANK YOU, MR. CHAIRMAN.

I WAS CONCERNED, AS I'M SURE WERE MOST MEMBERS OF THIS COMMITTEE, TO READ THE NEW C.B.O. ESTIMATES OF A $477 BILLION BUDGET DEFICIT FOR FISCAL 2004. THIS NUMBER BRINGS INTO STARK REALITY THE MAGNITUDE OF THE JOB BEFORE US IN THIS COMMITTEE AND IN THIS CONGRESS.

CERTAINLY, WE NEED TO SEE SPENDING REIGNED IN. I WAS PLEASED WITH RECENT STATEMENTS FROM THE ADMINISTRATION REGARDING THE PRESIDENT'S CONTINUED COMMITMENT TO CONTROL SPENDING. WE, AS A COUNTRY, HAVE FACED DIFFICULT CHALLENGES OVER THE PAST TWO YEARS AND, AS THE PRESIDENT POINTED OUT IN HIS RECENT STATE OF THE UNION ADDRESS, WE CONTINUE TO FACE THEM. PROTECTING OUR CITIZENS DOES NOT COME CHEAP, BUT IT MUST BE OUR HIGHEST PRIORITY.

HOWEVER, WE MUST BE DISCIPLINED IN ALL AREAS OF THE BUDGET WE ARE ABOUT TO PRODUCE IN THIS COMMITTEE. WE MUST MAKE DIFFICULT DECISIONS AND WE MUST LEAD THE SENATE IN STICKING TO THEM.

ONE PIECE OF GOOD NEWS CONTAINED IN THIS REPORT IS AN INCREASE IN THE CONGRESSIONAL BUDGET OFFICE'S PROJECTIONS REGARDING REAL G.D.P. GROWTH. THIS TIME LAST YEAR, C.B.O. WAS ESTIMATING REAL G.D.P. GROWTH IN THIS CALENDAR YEAR AT 3.6%.

THE REPORT RELEASED YESTERDAY SET THIS PROJECTION AT 4.8%. I SHARE THIS OPTIMISM ABOUT OUR ECONOMY AND I HOPE AND EXPECT THAT IT WILL BE PROVEN CORRECT. I HAVE BEEN PLEASED WITH THE GROWTH WE HAVE SEEN IN RECENT MONTHS – IT IS A GREAT START.

I STRONGLY BELIEVE THAT THE DECISIONS MADE BY THIS COMMITTEE AND THIS CONGRESS WHICH HAVE ALLOWED AMERICAN WORKERS, FAMILIES, AND ENTREPRENEURS TO KEEP MORE OF THE MONEY THEY EARN HAS PLAYED - AND WILL CONTINUE TO PLAY - AN IMPORTANT ROLE IN PROMOTING THAT ECONOMIC GROWTH.

I THANK DR. HOLTZ-EAKIN FOR THE HARD WORK AND DEDICATION OF HIS OFFICE AND FOR HIS WILLINGNESS TO APPEAR BEFORE US TODAY TO EXPLAIN THE MOST RECENT ANALYSIS IN DETAIL.

THANK YOU.

Statement by Senator Russ Feingold
Senate Committee on the Budget
January 27, 2004

First let me note that this will be the last budget cycle in which our colleague Senator Nickles will chair this committee, as he has announced his retirement from the Senate. I have very much enjoyed serving with him for the past eleven years. He is a devoted public servant, and he will be missed in this committee, and in the Senate as a whole.

Today we will hear CBO's latest report on the budget and the economy. It should come as no surprise that the budget bottom line is bad, and getting worse by the hour. CBO now projects a unified budget deficit of $477 billion, $629 billion without using the Social Security surpluses to mask the problems with the rest of government. This is the largest deficit in history, a dubious achievement.

Mr. Chairman, there is no mystery about the causes of this dramatic deterioration. When I was first elected to the Senate, our unified budget deficit was $290 billion, and we saw deficits of comparable size projected for years to come. Thanks in great part to the deficit reduction package enacted in 1993, and to the budget rules that were in place at that time and that remained in effect until 2001, we not only eliminated the deficit, but we actually began to pay down the massive federal debt that was run up during the 1980s and early 1990s. In January of 2001, CBO was projecting significant budget surpluses that could have been used to reduce the debt burden facing our children and grandchildren.

But as we know, rather than staying the course we set in 1993, Congress and the White House instead embarked on fiscal policies that not only squandered all of the hard-earned progress we had made, but also ended up mortgaging the fiscal future of coming generations. In exchange for fiscally irresponsible, unbalanced tax cuts today, Congress and the White House saddled our children and grandchildren with a mountain of debt. The 10-year $5 trillion projected surplus has now become a 10-year $5 trillion projected deficit, if one assumes that recent tax cuts are extended and that the Alternative Minimum Tax is reformed – $7 trillion if one does not count Social Security. And of course we should exclude Social Security surpluses, because we are relying on those surpluses to pay for the retirement benefits of the Baby Boom generation.

What is even more startling, Mr. Chairman is that this dramatic turnaround happened in the blink of a budgetary eye.

We have to stop running these debilitating deficits. They cause the government to use the surpluses of the Social Security Trust Fund for other government purposes, rather than to pay down the debt and help our nation prepare for the coming retirement of the Baby

Boom generation. We have to stop running deficits because every dollar that we add to the federal debt is another dollar that we are forcing our children to pay back in higher taxes or fewer government benefits. When the government in this generation chooses to spend on current consumption and to accumulate debt for our children's generation to pay, it does nothing less than rob our children of their own choices. We make our choices to spend on our wants, but we saddle them with debts that they must pay from their tax dollars and their hard work.

Mr. Chairman, this kind of budgeting is reckless. We absolutely must restore fiscal discipline, and central to that will be reimposing the budget rules that helped us eliminate the budget deficits of the early 1990s, and that eventually led to a balanced federal budget.

With this in mind, Mr. Chairman, I hope this committee will work to bring back a budget rule that was so essential in helping us balance the federal books, the PAYGO rule. Some may recall that I offered an amendment to last year's budget resolution to reinstate PAYGO. In fact, it was adopted in the Senate, and I thank our Chairman and the Ranking Member, Senator Conrad, for their help with that amendment last year. Unfortunately, the provision was dropped in conference, and we have little protection against further damage to the bottom line.

There are other budget process reforms that I support, but reinstating PAYGO should be our highest priority. Without tough budget rules to hold policy makers' feet to the fire, there is little hope that the White House and Congress will ever make the tough decisions needed to eliminate the deficit.

I thank the Chairman and Ranking Member for their past efforts in this area, and I look forward to working with them this year to bring back the budget discipline that served us so well during the 1990s.

THE PRESIDENT'S BUDGET PROPOSAL

THURSDAY, FEBRUARY 5, 2004

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:02 a.m., in room 210, Cannon House Office Building, Hon. Don Nickles (chairman of the committee) presiding.

Present: Senators Nickles, Domenici, Gregg, Allard, Burns, Enzi, Sessions, Crapo, Conrad, Murray, Byrd, Nelson, Stabenow, and Corzine.

Staff present: Hazen Marshall, majority staff director; and Jim Hearn, senior analyst for government finance and management.

For the minority: Mary Ann Naylor, staff director; and Jim Horney, deputy staff director.

OPENING STATMENT OF CHAIRMAN NICKLES

Chairman NICKLES. Good morning. The Committee on the Budget will come to order. First I want to acknowledge our friends from the House, Chairman Nussle and the entire Budget Committee of the House. They have been very cooperative, very supportive. As a matter of fact, when it was announced that the Senate office buildings would be closed, Chairman Nussle notified me immediately that he would be more than happy to cooperate and allow us to use not only the hearing room but also offices and space. They have been very generous, very cooperative, and I am very grateful that they have accommodated us in our hearing this morning.

For this morning's hearing, we have Director Bolten, Director of the Office of Management and Budget, to present testimony before the committee. We welcome him to this committee. We welcome him to his position that he has now had for, I guess, about half a year. He has got one of the most challenging jobs in Government to try to manage a budget of now $2.4 trillion. It is a job just to develop one and to propose it, and we look forward to hearing his testimony as well.

I welcome my colleagues that are with us this morning, and following my tradition, I will call upon the ranking member, my friend, Senator Conrad.

OPENING STATEMENT OF SENATOR CONRAD

Senator CONRAD. Thank you, Mr. Chairman.

I also want to thank our colleagues on the House Budget committee. Certainly the chairman and the ranking member, Congressman Spratt, they could not have been more gracious. They have

opened their space to us. They have allowed us to use their equipment. And it has been enormously helpful, and we very much appreciate their graciousness.

Mr. Chairman, I also want to welcome Director Bolten to the committee. This is a challenging time, certainly for you, for the administration, and for the Congress, as we address what I believe are deficits that are far too large and growing geometrically. Certainly as we look ahead past the 5-year window, I think we have to be most concerned about the direction, the fiscal direction of the country.

When I look at past statements by the administration, I remember very well in 2001 they told us we could have massive tax cuts and there would be no deficits, even with an economic downturn. And that proved to be wrong.

Then the next year, they told us that the deficits would be small and short term. That also proved to be wrong. The deficits have been large and long term.

Then in 2003, they told us that the deficits were small by historical standards. That, too, proved to be wrong. These deficits are record deficits.

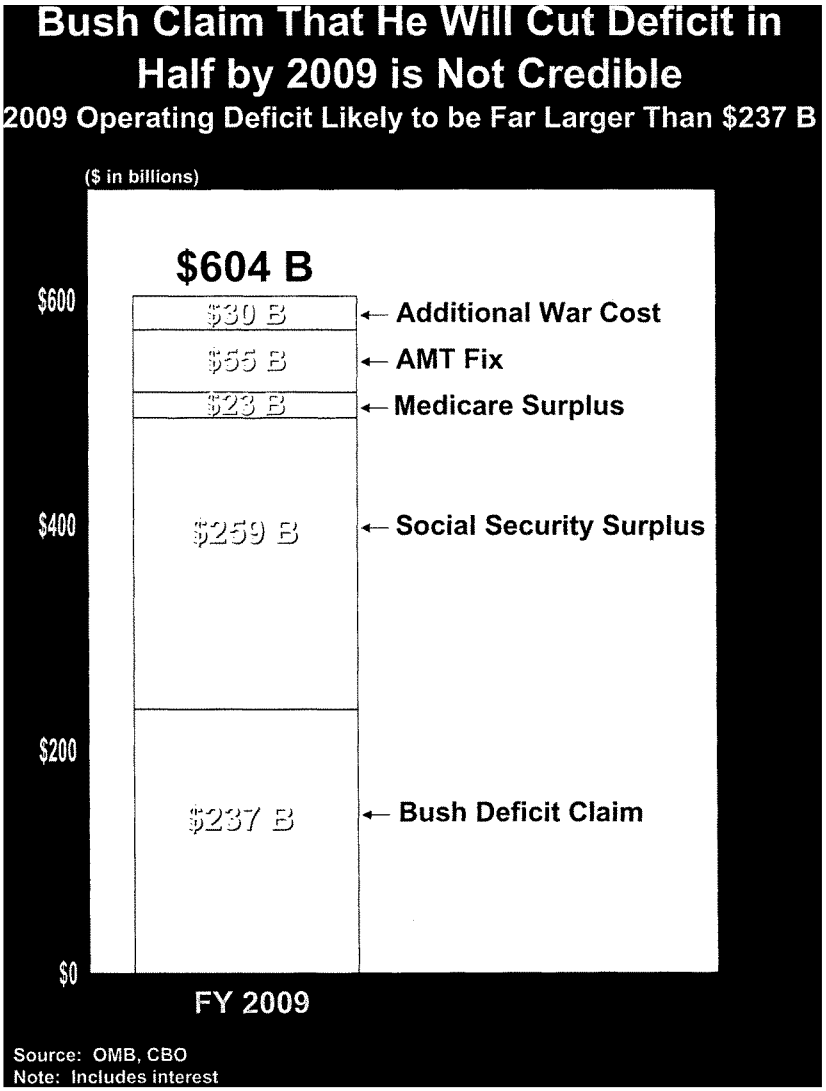
And now this year, we are being told that they are going to cut the deficit in half over the next 5 years. And I think we have to ask the question: Will that, too, be wrong?

Let me go to just a back-of-the-envelope analysis that tells me that will be wrong as well.

Bush Administration Claims on Deficit Have Been Consistently Wrong

2001	"[W]e can proceed with tax relief without fear of budget deficits…"	Wrong
2002	"[O]ur budget will run a deficit that will be small and short-term…"	Wrong
2003	"Our current deficit…is not large by historical standards and is manageable…"	Wrong
2004	"[T]he deficit will be cut in half over the next five years…"	Wrong Again?

The President says in the fifth year the deficit will be $237 billion, but he is not counting the $259 billion he is going to be taking of Social Security surplus funds, every dime of which has got to be paid back. He is not counting the $23 billion from the Medicare Trust Fund. He is not counting the $55 billion it would take to deal with the alternative minimum tax problem, which he is paying for for 1 year but not beyond. And he has no costs for the residual war cost, the war on terror, Afghanistan, Iraq, which the Congressional Budget Office says in that year will be another $30 billion. That is over $600 billion being added to the debt.


Bush Claim That He Will Cut Deficit in Half by 2009 is Not Credible
2009 Operating Deficit Likely to be Far Larger Than $237 B
($ in billions)
$604 B
$600
$400
$200
$0
$30 B
$55 B
$23 B
$259 B
$237 B
Additional War Cost
AMT Fix
Medicare Surplus
Social Security Surplus
Bush Deficit Claim
FY 2009
Source: OMB, CBO
Note: Includes interest

Just a reality check. I went to the President's budget document and looked at 2009, and what one sees is the President himself says he is going to add $633 billion to the debt in that year.

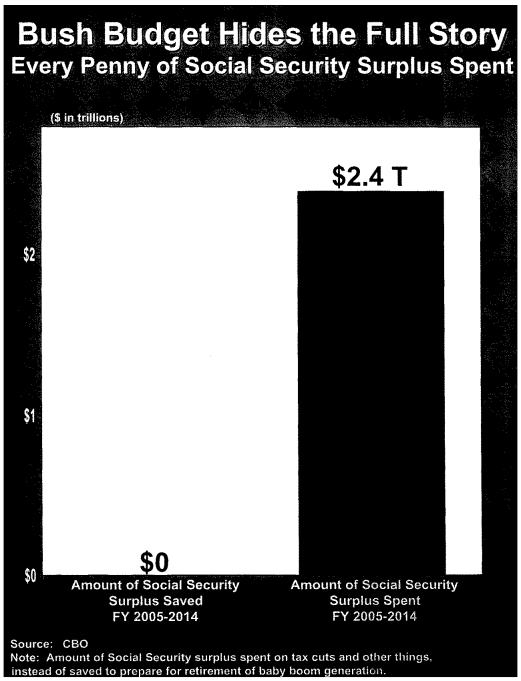
Gross Debt Increases by $633 Billion in FY 2009

Function	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
Debt Subject to Statutory Limitation, End of Year:							
Debt issued by Treasury	6,733	7,459	8,106	8,700	9,292	9,906	10,540
Adjustment for discount, premium and coverage	5	5	5	5	5	5	5
Total, debt subject to statutory limitation	6,738	7,464	8,111	8,705	9,297	9,911	10,545
Debt Outstanding, End of Year:							
Gross Federal debt:[6]							
Debt issued by Treasury	6,733	7,459	8,106	8,700	9,292	9,906	10,540
Debt issued by other agencies	27	27	26	26	26	25	24
Total, gross Federal debt	6,760	7,486	8,133	8,726	9,318	9,931	10,564
Held by:							
Debt held by Government accounts	2,846	3,066	3,341	3,652	3,985	4,342	4,720
Debt held by the public[7]	3,914	4,421	4,792	5,074	5,333	5,589	5,844
As a percent of GDP	36.1%	38.6%	39.8%	40.1%	40.2%	40.0%	39.8%

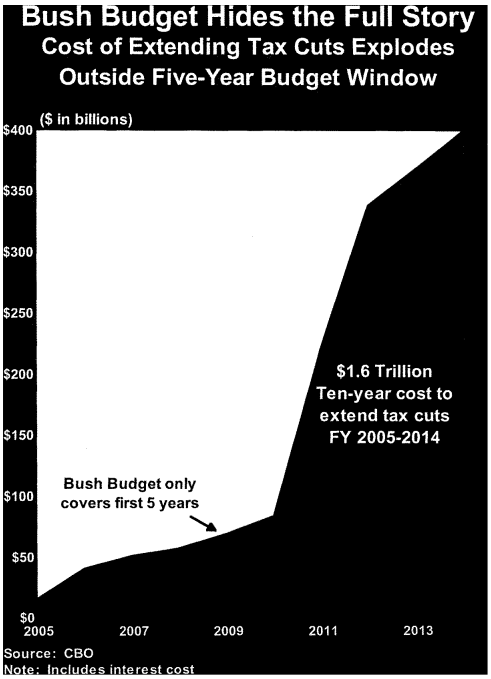
Source: President's Budget for FY 2005, Table S-17, p. 392.

So how is it that we have much larger accumulations of debt than the deficit picture that the President asserts would provide?

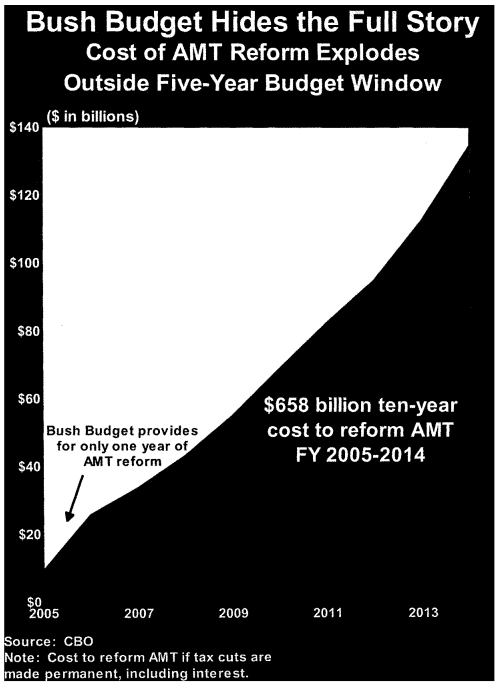
Well, first of all, he is taking all the Social Security Trust Fund surpluses over the next decade, $2.4 trillion, and not accounting for it—not accounting for it at least with respect to deficits.



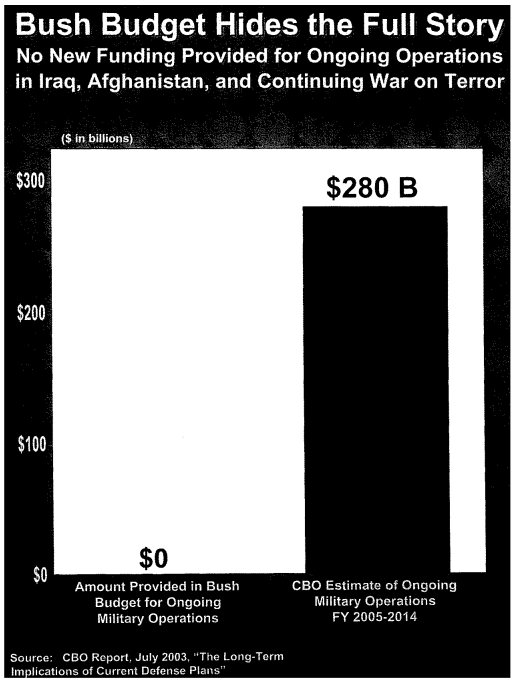
In addition, the tax cut the President is proposing explodes outside the 5-year budget window. He is only looking at 5 years, when we all know much of the effect of his additional tax cuts occur beyond the 5-year budget window. This is the cost of the tax cuts, including the associated interest cost.



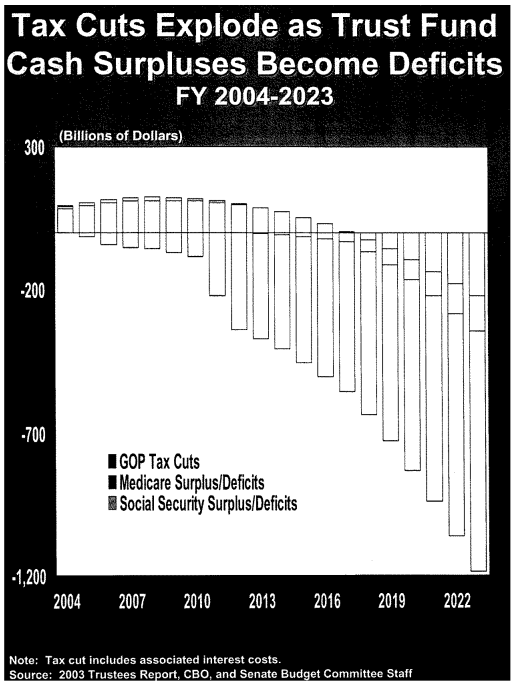
And the same is true of the alternative minimum tax that was the old millionaire's tax that now is going to be a middle-class tax because we have two or three million people affected by it today. It is going to be 40 million people by the end of the budget period, 40 million people and it costs $658 billion to fix. The President has counted 1 year of that cost, but does not have a dime beyond that time.



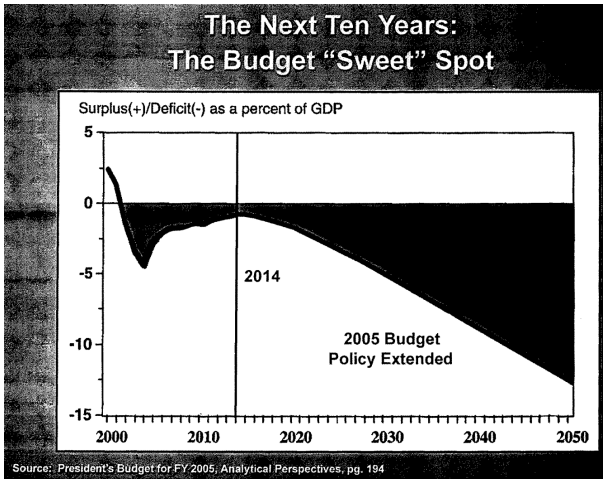
The same is true of war costs. The Congressional Budget Office says in the 10-year period, $280 billion of cost for the President's defense policies, war on terror, and yet the President has no money provided beyond September 30th of this year. They tell us we do not know what the cost will be, but we know the right answer is not zero.



The thing that most concerns me is the long-term trajectory because what we see is that right now we are in the good times, in effect, even though the deficits are at record levels, because we have these substantial trust fund surpluses. But look what happens when the trust funds—the green bar is Social Security, the blue is Medicare—when they go cash negative, at that very time the cost of the tax cuts explodes.



And I will just end with this chart that shows the President's own analysis of the long-term budget circumstance. This shows that the current situation, record deficits, is the good times; that when the baby boomers retire and the President's tax cuts go fully into effect, these deficits go right off the cliff. And so I think we have to alert the American people that we are on a course that is simply not sustainable, that fundamentally threatens the economic security of the country, and the biggest way it does is upward pressure on interest rates and the biggest way it does is people deciding they don't want to hold dollar-denominated assets.



And I would just conclude with an article that is in the Washington Post this morning saying, "Asian central bank consider alternatives to big dollar holdings." Already we have seen the dollar go down almost 30 percent against the euro in the last 18 months. I think we have to get very, very serious about the fiscal condition of the country.

THE WALL STREET JOURNAL.

© 2003 Dow Jones & Company. All Rights Reserved

THURSDAY, FEBRUARY 5, 2004

Asian Central Banks Consider Alternatives to Big Dollar Holdings

A number of Asian central banks, among the biggest investors in U.S. government debt, are looking at alternative targets for their vast dollar holdings.

South Korea, looking for better returns, plans to hand over as much as $20 billion of its foreign-exchange reserves, which total the equivalent of $157 billion, to private fund managers next year. Taiwan wants to put some of its $200 billion of reserves toward helping local companies and diversifying the economy. Thailand will use $7 billion of reserves to pay off the foreign debts of its government agencies and state enterprises.

By Phillip Day in Singapore and Hae Won Choi in Seoul

It isn't clear that Asian central banks will necessarily fund these plans by switching out of holdings of U.S. government debt. Asia's bigger central banks have estimated holdings totaling nearly $1 trillion of U.S. government bonds, including Treasurys, privately held government bonds and debt of government-sponsored agencies, such as mortgage buyer Fannie Mae (see related article on page A3).

Inflows from Asia into this U.S. debt have provided vital support for the U.S. financial system. They have helped to finance the budget deficit and made it easier for the Federal Reserve to boost the economy by holding down interest rates.

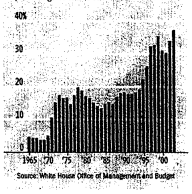
Foreign buying of debt is "critical—it's probably the biggest driver" of the Treasury market recently, says Michael Ryan, a strategist with UBS in New York.

The percentage of U.S. government debt owned by foreigners stood at 37.3% last year, compared with 33.9% in 2002 and less than 4.7% in 1965. Foreign central banks hold more than $800 billion in Treasurys—$1 of every $5 the U.S. government owes.

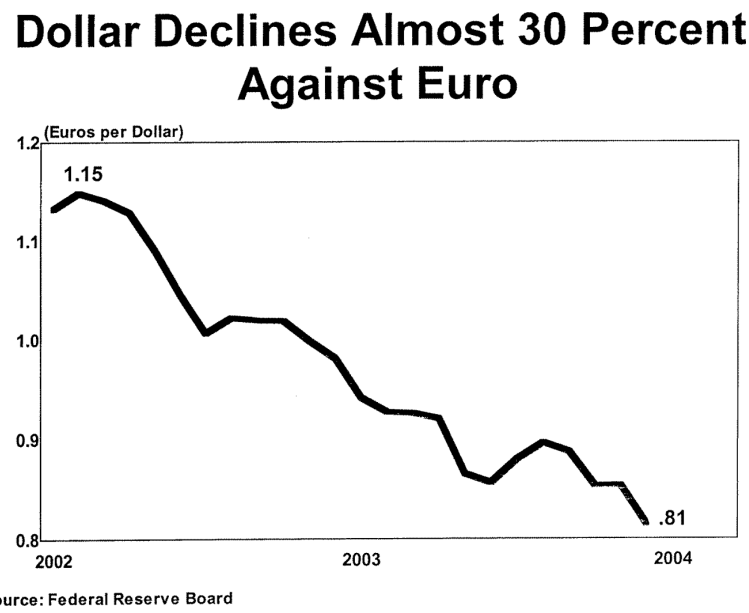
Asia's bigger central banks face a difficult task. They want to reduce dollar risk and shift reserves to better returns, but they have to trim dollar holdings without spooking the U.S. debt market or currency markets—and potentially fueling the dollar's downward momentum. That in turn would undercut another goal of Asian governments: to slow the rise of their currencies against the dollar, which makes their exports more expensive and

Bigger Slice

Foreign holdings of U.S. federal debt as a percentage of total debt



Source: White House Office of Management and Budget



Thank you.

Chairman NICKLES. Senator Conrad, thank you very much.

I would just make a couple of comments, and then we will recognize Director Bolten. A couple of comments.

One, we had a big challenge last year to pass last year's budget. It was not easy. Last year we were facing still the end, I guess, of a very soft economy. The stock market was still very, very weak. And we were fighting a war. Our budget we passed last year funded both of those. We did pass a growth package, and the growth package worked. The stock market is up substantially. We did fund the war.

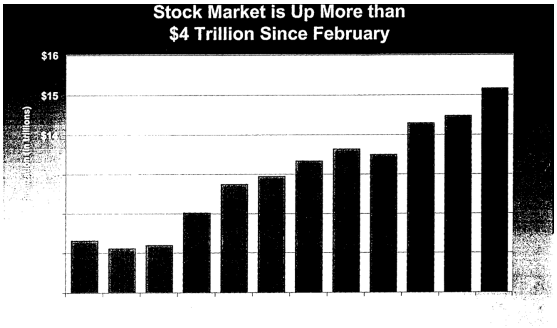
If you look at the chart, it shows that actually the economy started declining in the year 2000. Some people want to say, well, it was the Bush recession. But if you actually notice, it started declining substantially in the year 2000. The Nasdaq declined by 50 percent in the year 2000. And we had a very soft economy.

insert chart

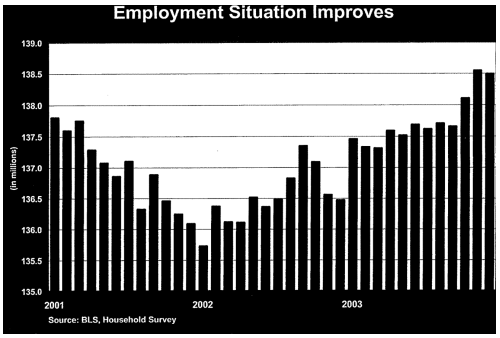
So we needed to do some things that would change it. The stimulus package that we passed—and I might mention that the Democrats had a stimulus package and we had a stimulus package, and ours was supported by a bipartisan majority. It became law, and it did work.

If you look at the next chart, the stock market has grown by over $4 trillion since last February. We did cut the tax on dividends in half. Maybe some people want to double the tax on dividends again, but we made the tax on dividends 15 percent. We made the tax on cap gains at 15 percent, and I think both greatly helped our economy, as evidenced by the significant appreciation we have seen in the stock market. I think the Dow Jones is up 25 percent,

Nasdaq up 50 percent. That is a big change, and I think in large part because of the changes that we made and that we proposed.



If you look at the next chart, there was a significant appreciation in jobs. You keep hearing about the jobs. The household survey shows that we are at an all-time high in employment. There is a difference between the household survey and the wage survey, and I do not need to debate that. But it shows, at least if you look at this trend, the employment situation has improved rather substantially.



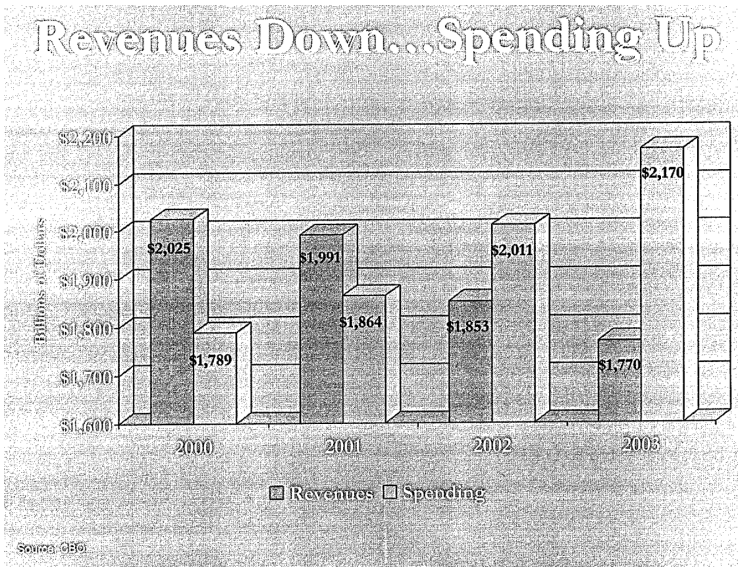
But I do not disagree with Senator Conrad. I think the challenges are very great before us. We are spending a lot more than we are taking in, and the deficits are way too high. And I will tell my friend and colleague Senator Conrad, I will work with him to get them down. I will work with anybody, Democrat or Republican, to reduce these deficits. I think they are way too high.

If you look at the next chart, it kind of shows just the history of where we are. The green on the chart shows the revenues, and you can revenues have actually declined. That has never happened before. We had 3 years in a row really where revenues did not grow. Actually, they declined.

If you look at the history, Senator Byrd, revenues over history in the United States almost always had some growth. But we actually have had a very significant reduction, not because of the tax cut, mostly because of the recession. The tax cut had some play in it, but the recession was the biggest reason why you had such a significant drop from over $2 trillion to about $1.78 trillion. I no-

tice, Senator, from the figures estimated by both CBO and OMB, very little revenue growth between 2003 and 2004. I hope the 2004 revenues are underestimated, and my guess is they are. I will just say that. We will find out 10 months from now, but I think they underestimated the amount of revenue that we are going to receive in 2004. I am not sure about your 2005 number, but we will talk about that.

But you notice in the red line, expenditures have gone up every single year. So we had a reduction in revenues, mostly because of the recession, somewhat because of the tax cut, but we had an increase in the red line that is outlays.



Most of the outlay growth, if you look at the next chart, you will see is kind of divided up between all other spending, domestic discretionary spending. DOD is the red line, defense. You will notice the last couple years, if you add the war, the war being the big delta, we had supplementals of $79 and $87 billion in 2003 and 2004. That is that top delta that shows a big increase of spending because we had to fight the war. The yellow lines are new spending. That is homeland security. So that is where most of the new money went.

So I just make mention of those facts, and the fact that we have a big challenge. We are spending more than we are taking in. We have to close that gap. And it will not be easy, and it probably will not be done unless we all work together to make it happen.

We have to have a budget. The administration has proposed a budget. We will work to pass a budget this year. It was not easy last year. It will not be easy this year. But I think it would be irresponsible of Congress if we do not pass a budget.

And so I applaud the administration. They have given us a challenge, and they said they think we should reduce the deficit by half in 5 years. I believe strongly that we should do that. I hope that

we can accelerate that. I hope that we can cut the deficit in half—did I say balance the budget or cut it in half? The administration wants us to cut the deficit in half in 5 years. I hope we can meet or exceed that level. I hope we can do it 2 or 3 years. I cannot stand the idea of having deficits at the $400 and $500 billion level. It bothers me daily. And I am very serious about that.

So I hope we can aggressively try and get our deficit, whether you are talking about GDP or you are talking about dollar-wise, get it to a much smaller, more sustainable figure, at the $200 billion level in the next year or so. And I will work aggressively to do that. And that may mean taking on some popular programs, like a highway bill that my colleague from Oklahoma is in the process of passing, and others. I want that highway bill to be paid for, and presently it is not paid for satisfactorily, and certainly not entirely.

I want to thank my friend, Senator Conrad, because he was of great assistance in our markup in the Finance Committee on that bill on Monday.

So we have many, many big challenges before us. We look forward to the administration presenting their budget to us. And just for the information of our colleagues, we were scheduled to have Secretary Snow testify yesterday and could not because of the loss of the hearing room in Dirksen. We are trying to reschedule him for as soon as possible. I was hoping that we would be able to get Secretary Snow Tuesday or Wednesday. We have not confirmed that yet, but we will notify members as soon as we can have Secretary Snow scheduled.

We have Secretary Thompson scheduled for next Thursday, and that will be in the Senate. And then we have a couple of others lined up, and we will notify all members as soon as possible on that.

We do expect to work through the entire budget process in the next 2 months, and so we have a lot of work to do, and we will have hearings basically throughout this month, and then the month of March we will begin committee markup, floor markup, and conference.

I told Senator Byrd I wanted to talk to him about it. I do want to tell all members I would like to improve the process that we consider the budget on the floor. I have been embarrassed with our vote marathons, vote-a-thons, whatever you want to call them. It is not a good way to legislate, and I think we all recognize that. Maybe we can see if we cannot together, collectively, bipartisanly, improve the procedure on the floor, and, frankly, add more respect and dignity to the Senate in consideration of a budget of the magnitude somewhere in the range of $2.4 trillion. We need to do a better job in managing the floor in that effort. So I am going to work with our colleagues and see if we cannot come up with some other improvements, and I appreciate very much Senator Conrad's willingness to consider some changes that might be an improvement, not just this year but, frankly, in future years.

And, with that, Director Bolten, we will recognize you for your comments. Welcome to the Budget Committee.

STATEMENT OF JOSHUA B. BOLTEN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. BOLTEN. Thank you, Mr. Chairman, and thank you, Senator Conrad and other distinguished members of the committee. It is a privilege to have the opportunity to appear before you this morning.

The 2005 budget that was transmitted earlier this week continues to support the President's three overriding national priorities: winning the war on terror, protecting the homeland, and strengthening the economy. The President is committed to spending what is necessary to provide for our security and restraining spending elsewhere.

Since September 11, 2001, as you have emphasized, Mr. Chairman, more than three-quarters of the increase in the Federal Government's discretionary spending has been directly related to our response to the attacks, enhanced homeland security, and the war on terror. The President's 2005 budget continues this spending trend. That means significant increases in essential funding for our security programs, combined with a dramatic reduction in the growth of discretionary spending unrelated to security. With your support in enacting this budget into law, we will be well on the path to cutting the deficit in half over the next 5 years.

If I could have the first chart up, please.

Mr. Chairman, at OMB we have found it useful to try to divide the discretionary budget into three categories, similar to the chart that you just showed. On the left is defense, which is basically the Defense Department. In the center is homeland security, which is not congruent with the Department of Homeland Security; about two-thirds of that Department spending we characterize as homeland security spending. But there are a number of other elements from other departments that are included within that category, particularly from Health and Human Services, the Department of Justice, some from the Department of Agriculture, and others. And then on the right is everything else, which we label non-defense, non-homeland spending.

The President's—yes?

Chairman NICKLES. Excuse me. Does that include all the supplementals? That includes all spending?

Mr. BOLTEN. No, it does not. We have another chart that includes supplementals, but this one is just base discretionary spending.

The yellow bars represent the President's proposals for 2005. What that reflects is, on the left, an increase in defense spending by 7 percent to support our men and women in uniform and transform our military; in the center, an increase in homeland security spending by nearly 10 percent to strengthen our capability to prevent future attacks; and on the far right, holding the rest of discretionary spending to half-of-1-percent growth, well below the rate of inflation, while continuing to increase funding for key priorities such as the President's No Child Left Behind education reforms.

The President's budget is built on the sensible premise that Government spending should grow no faster than the average increase in average American family incomes, which is approximately 4 percent. This budget, the 2005 budget, proposes to hold the growth in

total discretionary spending to 3.9 percent overall and, again, to reduce the growth in non-defense, non-homeland security spending to half of 1 percent, below the rate of inflation.

Mr. Chairman, in the last budget year of the previous administration, 2001—that is reflected in the green bars on this chart—discretionary spending unrelated to defense or homeland security soared by 15 percent. With the adoption of the President's first budget in 2002, that growth rate was reduced to 6 percent, then 5 percent the following year, then 4 percent for the current fiscal year that we are now in, fiscal year 2004; and as I have just emphasized, down below 1 percent in the President's proposal for 2005.

The President's budget builds on the pro-growth economic policies that have laid the foundation for the economic recovery now under way and for sustained growth and job creation in the years ahead.

The tax cuts that you and the Congress enacted have been critical to strengthening the economy and to creating jobs. Perhaps the best timed in American history, these tax cuts deserve much credit for today's brightening economic picture, which includes nine consecutive quarters of positive growth, the highest quarterly growth in 20 years in the third quarter of last year at 8.2 percent, ongoing extraordinary productivity growth, continued strength in housing starts and retail sales, and encouraging signs of renewed business investment. These indicators suggest that job growth, which typically lags recovery, should continue to strengthen in the months ahead.

Mr. Chairman, the President will not be satisfied, however, until every American who wants a job can find a job. So this budget supports the President's six-point plan for economic and jobs growth, including making permanent the tax relief that has fueled our economic recovery.

The sustained growth that this budget supports will be good news for our budget picture as well. As the economy improves, Treasury revenues will as well.

Like America itself, the Federal budget has faced extraordinary challenges in recent years: a stock market collapse that began in early 2000; a recession that was fully under way in early 2001; revelation of corporate scandals, years in the making; and, of course, the September 11th attacks and the ensuing war on terror.

With Treasury receipts only beginning to reflect a recovering economy and major ongoing expenditures in Iraq, Afghanistan, and elsewhere in the war on terror, we still face a projected $521 billion deficit for the 2004 fiscal year. That size deficit at 4.5 percent of GDP is not historically out of range. Deficits have been this large or larger in 6 of the last 25 years, including a peak of 6 percent in 1983.

Under the circumstances that created it, today's deficit is certainly understandable, but that deficit is also undesirable and unwelcome. And with enactment of this budget, we will bring it down.

With continuation of the President's economic growth policies and sound spending restraint reflected in the budget I have just outlined, our projections show the deficit will be cut by more than half over the next 5 years. This dramatic reduction begins in the

fiscal year of this budget, 2005, for which we are projecting a deficit of $364 billion, roughly 3 percent of GDP. The rapid deficit reductions continue in subsequent years, with our projections showing the deficit falling to 1.6 percent of GDP by 2009. This is not only well below half its current 4.5-percent level; it is also well below the 2.2-percent average deficit during the last 40 years. And you will see on that chart a black line across the middle of the chart. That reflects the 2.2-percent, 40-year historical average deficit for the Federal Government. It is also roughly a line that reflects cutting our current deficit in half.

This deficit reduction is the combined effect of economic growth and spending restraint. As the economy recovers, tax receipts as a percent of GDP will rise to historic levels by the end of the budget window, while spending restraint keeps outlays flat or slightly declining as a share of GDP.

The spending restraint reflected in this budget is not automatic, so we are also proposing new statutory budget enforcement mechanisms, establishing in law limits on both discretionary and mandatory spending, and requiring that any increases in spending be paid for by spending offsets.

We plan to transmit legislation to the Congress that has three elements: one, reinstate the caps on discretionary spending for 5 years through 2009; two, a pay-as-you-go requirement limited to new mandatory spending—any proposed increase in mandatory spending would have to be offset by a reduction in mandatory spending, tax increases could not be used as an offset, and PAYGO would not apply to tax legislation. Three, measure the long-term unfunded obligations of major entitlement programs and include a 60-vote hurdle in the Senate for legislation that would expand these obligations.

I look forward to working with this committee to gain enactment of these proposals to restrain spending.

Finally, the President is keeping this administration focused on what the American people care most about: results. The measure of the Government's success is not how much we spend but, rather, how much we accomplish. This budget includes a scorecard that measures the progress agencies are making in achieving results so that the Government continues to be accountable to the taxpayers.

Since President Bush took office, our Nation has confronted a cascading set of challenges. The President and Congress responded on all fronts, with tax relief to get the economy going, the largest reorganization of the Federal Government in 50 years to create a new Department of Homeland Security, and the largest increases in the defense budget since the Reagan administration.

The President's 2005 budget builds on this record of accomplishment. With renewed economic growth and the Congress' cooperation in restraining spending, and focusing it on our most critical priorities, we can accomplish the great goals the President has set for the country while dramatically improving our budget situation.

Mr. Chairman, I look forward to taking your questions.

[The prepared statement of Mr. Bolten follows:]

Testimony of OMB Director Joshua B. Bolten
President's FY 2005 Budget Request

Committee on the Budget
United States Senate
February 5, 2004

Chairman Nickles, Ranking Member Conrad, and distinguished members of the Committee, the President's 2005 Budget, which was transmitted to the Congress on Monday, continues to support and advance three overriding national priorities: winning the war on terror, protecting the homeland, and strengthening the economy.

The President is committed to spending what is necessary to provide for our security – and restraining spending elsewhere. Since September 11, 2001, more than three-quarters of the increase in the Federal Government's discretionary spending has been directly related to our response to the attacks, enhanced homeland security, and the War on Terror. The President's 2005 Budget continues this spending trend: significant increases in essential funding for our security programs, combined with a dramatic reduction in the growth of discretionary spending unrelated to security. With Congress' help in enacting the budget we transmitted this week, we will be well on the path to cutting the deficit in half within five years.

The President's Budget:

- Increases defense spending by 7 percent to support our men and women in uniform and transform our military to ensure America has the best trained and best equipped armed forces in the world;
- Increases homeland security spending by nearly 10 percent to strengthen capabilities created to prevent future attacks; and
- Holds the rest of discretionary spending to half of one percent growth - less than half the rate of inflation - while continuing to increase funding for key priorities such as the President's No Child Left Behind education reforms.

The President's Budget is built on the sensible premise that Government spending should grow no faster than the average increase in American family incomes of approximately four percent. This Budget proposes to hold the growth in total discretionary spending to 3.9 percent and, again, to reduce the growth in non-defense, non-homeland security spending to half of one percent, below the rate of inflation. In the last budget year of the previous administration (2001), discretionary spending unrelated to defense or homeland security soared by 15 percent. With the adoption of President Bush's first budget (2002), that growth rate was reduced to six percent; then five percent the following year; and four percent for the current fiscal year.

The President's Budget builds on the pro-growth economic policies that have laid the foundation for the economic recovery now underway, and for sustained economic growth and job creation in the years ahead.

The tax cuts Congress passed and were signed into law have been critical to achieving the President's priority of strengthening the economy and creating jobs. Perhaps the best timed

in American history, these tax cuts deserve much credit for today's brightening economic picture, which includes:

- Nine consecutive quarters of positive growth through the end of 2003;
- The highest quarterly growth in 20 years – an 8.2 percent annual rate in the third quarter of 2003; and the highest growth for any six-month period in 20 years as well;
- Extraordinary productivity growth;
- Continued strength in housing starts and retail sales; and
- Encouraging signs of renewed business investment.

These indicators suggest that job growth, which typically lags recovery, should continue to strengthen in the months ahead.

The President will not be satisfied however until every American who wants a job can find a job. So this Budget supports the President's six-point plan for economic and jobs growth, including making permanent the tax relief that has fueled our economic recovery.

The sustained growth that this Budget supports will be good news for our budget picture as well: As the economy improves, Treasury revenues will as well.

Like America itself, the Federal budget has faced extraordinary challenges in recent years: a stock market collapse that began in early 2000; a recession that was fully underway in early 2001; revelation of corporate scandals years in the making; and of course, the September 11th attacks and ensuing War on Terror.

With Treasury receipts only beginning to reflect a recovering economy – and major ongoing expenditures in Iraq, Afghanistan, and elsewhere in the War on Terror – we still face a projected $521 billion dollar deficit for the 2004 fiscal year. That size deficit, at 4.5% of GDP, is not historically out of range. Deficits have been this large or larger in six of the last 25 years, including a peak of 6 percent in 1983.

Under the circumstances that created it, today's deficit is certainly understandable. But that deficit is also undesirable and unwelcome, and with Congress' help, we will bring it down. With continuation of the President's economic growth policies and sound spending restraint as reflected in the Budget we are releasing today, our projections show the deficit will be cut by more than half over the next five years.

This dramatic reduction begins in the fiscal year of this Budget, 2005, for which we are projecting a deficit of $364 billion, roughly 3.0 % of GDP. The rapid deficit reductions continue in subsequent years, with our projections showing the deficit falling to 1.6 percent of GDP by 2009. This is not only well below half its current 4.5 percent level, it is also well below the 2.2 percent average deficit during the last 40 years.

This deficit reduction is the combined effect of economic growth and spending restraint. As the economy recovers, tax receipts as a percentage of GDP rise to historical levels by the end of the budget window, while spending restraint keeps outlays flat or slightly declining as a share of GDP.

The spending restraint reflected in this Budget is not automatic. So we are also proposing new statutory budget enforcement mechanisms, establishing in law limits on both discretionary and mandatory spending, and requiring that any increases in spending be paid for by spending offsets. We plan to transmit legislation to the Congress that has three elements:

- Reinstate caps on discretionary spending for five years through 2009.
- A pay-as-you-go requirement limited to new mandatory spending. Any proposed increase in mandatory spending would have to be offset by a reduction in mandatory spending. Tax increases could not be used as an offset and pay-go would not apply to tax legislation.
- Measure the long-term unfunded obligations of major entitlement programs and propose a 60 vote hurdle in the Senate for legislation that would expand these obligations.

I look forward to working with this Committee to gain enactment of these proposals to restrain spending.

Finally, the President is keeping his Administration focused on what the American people care about – results. The measure of government's success is not how much we spend, but rather how much we accomplish. This Budget includes a scorecard that measures the progress agencies are making in achieving results, so that the government continues to be accountable to the taxpayers.

Since President Bush took office, our Nation has confronted a cascading set of challenges. The President and Congress responded on all fronts, with tax relief to get the economy going, the largest reorganization of the Federal Government in 50 years to create a new Department of Homeland Security, and the largest increases in the defense budget since the Reagan Administration, to wage and win the War on Terror. The President's 2005 Budget builds on this record of accomplishment. With renewed economic growth and the Congress' cooperation in restraining spending and focusing it on our most critical priorities, we can accomplish the great goals the President has set for the country, while dramatically improving our budget situation.

Chairman NICKLES. Director Bolten, thank you very much. I have a lot of questions, but I also have a lot of colleagues, and I want to recognize them.

I am going to ask all of our colleagues that they try and keep their questions and remarks in the order of 5, 6, 7 minutes. That would be appreciated, and I think by others.

I will withhold many of my questions until the second round. I think I will still be here. I doubt that others will be. I will ask you one question, if you could help explain the difference in scoring be-

tween CBO and OMB or CMS on the cost of the prescription drug benefit. When we passed a budget last year, we set up a budget that said we would spent up to $400 billion over the next 10 years to strengthen, enhance, and improve Medicare, including prescription drugs. The bill that we passed was scored by CBO to be at $395 billion. Under your budget submission, CMS, HHS, OMB, your actuaries have determined that it was in excess of $520 billion.

Could you give us a brief explanation of the differences between the scoring between CBO and CMS?

Mr. BOLTEN. Mr. Chairman, there is a substantial difference between the actuaries. CBO, at the time the bill was being considered and enacted, scored the cost at $395 billion. The estimate that the HHS actuaries put out, I believe at the end of December, was $534 billion. So a substantial difference there.

The reasons for the difference are highly technical. I am not sure I am the best person to explain it, but I know that Secretary Thompson has had an opportunity to address the issue in some detail, and I know that the actuaries are working together to try to resolve their differences.

The CBO and HHS actuaries have had differences for some time about fundamental assumptions related to the Medicare bill. Those include how quickly the prescription drug costs would likely come down because of volume buying. They include different assumptions about level of participation rates. They include different assumptions about the level of participation by private plans in the program. All of this in an area that is inherently hard to estimate, but made especially difficult in this case because of the novelty of so many of the programs involved.

The important part of this is that I think this is an honest disagreement between experts, both of whom in my eyes have a great deal of credibility. We in the administration are under some constraint to carry the HHS estimate in our budgets, which we have done. So we are reflecting and carrying in our budget the higher estimate. But I know the actuaries are working together to try to figure out how to close their differences.

At the time you adopted the legislation, that you considered the legislation, what was relevant, as it always is with legislation, was and is the CBO score. My expectation is that as we submit our budget, CBO will in the ordinary course of things rescore our budget. And I expect that they will reflect their original score, because I understand that Director Holtz-Eakin as recently as this week has reaffirmed their intention to stay with their $395 billion score.

Chairman NICKLES. Thank you very much.

Senator Conrad.

Senator CONRAD. Director Bolten, when did you know that there was a difference, a substantial, dramatic difference, between the estimates of the cost of the prescription drug bill between CMS and your agency?

Mr. BOLTEN. I think all of those who were involved in the Medicare discussions were aware that there were differences between the assumptions of the CBO and the HHS actuaries. My understanding is that that was true all the way through the Medicare considerations.

Senator CONRAD. And did you ever feel that you had an obligation to tell Members of Congress that you thought the bill was going to cost much more?

Mr. BOLTEN. I wasn't directly engaged with the Members of Congress on the bill, but I know that Secretary Thompson, who was, did discuss with members some differences in the assumptions. But within the administration, we were also aware on this legislation, as in all legislation, that what counts as the legislation is being considered is the CBO score.

Senator CONRAD. Well, when you say you were not engaged with members, you were engaged with me. You came up here and told me that you thought additional steps needed to be taken to rein in spending, but you never once said to me that you had a belief that the cost was going to be far in excess of what was before the Congress.

Mr. BOLTEN. Senator, yes, I did. I did engage with you and several other members on the long-term outlook here. And you will recall that our conversation was about our interest in creating a unified trust fund, which I think would most accurately reflect the overall cost. But on the details of the bill, I was not engaged with the members, but I do not think that is what is really relevant here. What is relevant here is that at the time that you all were considering the bill, it was the CBO score that counted, and that is what everybody was operating on.

Senator CONRAD. Yes, but I would say this to you: I think you had an obligation, if you believed that the cost was going to be far in excess of what CBO was telling us, to say so. I will not go further with it. I just tell you I am personally disappointed that somebody in the administration did not send up a very clear signal that, in their judgment, this bill was going to cost a third again as much as what we were told at the time.

You keep saying you are going to cut the deficit in half 5 years from now. The only way you are going to cut the deficit in half 5 years from now is just not to count things.

Let me ask you this: When you say you are going to cut the deficit in half, you say it is going to be $237 billion. Are you counting the $259 billion you are going to take from Social Security in that year that you have to pay back? Is that in that?

Mr. BOLTEN. Senator, this administration, as all previous administrations, at least in recent decades, and CBO, looks at the deficit picture on a unified basis. So what counts for deficit purposes is the unified budget deficit or surplus, as the case may be——

Senator CONRAD. But isn't this going to add—isn't that $259 billion going to add to the debt of the United States? The money that is being taken from Social Security in 2009 you have to pay back, don't you?

Mr. BOLTEN. Sure. It is a Government obligation. But what——

Senator CONRAD. And that adds to the debt.

Mr. BOLTEN. It does not—it adds to the overall debt of the Government, but it does not add to the debt held by the public.

Senator CONRAD. Not the debt held by the public, but it adds to the gross debt of the United States, and it has got to be paid back.

Now, let me just say why I am concerned about this, because back in the 1980's there was virtually no Social Security surplus

to be concerned about. In 1983, the last time as a percentage of GDP we had a deficit as big as this one, there was virtually no Social Security surplus.

In this year alone, your estimates are the Social Security surplus is going to be $259 billion, and you are taking it all. You are not taking it all just for that year. You are taking it all for the next decade. That is $2.4 trillion—$2.4 trillion—and you are not letting the American people understand all that has got to be paid back.

But it does not end there. The same thing is true with Medicare. The alternative minimum tax, which you are paying for for 1 year, has a cost in 2009 of $55 billion. It is nowhere. You have, in addition to that, no calculation of residual war costs. CBO tells us it is going to be $30 billion that year. You add all that up, that is over $600 billion of added debt when you are telling the people it is going to be a deficit of $237 billion.

I think that is misleading to people, and all of this right before the baby boomers retire.

Mr. BOLTEN. If you can hold the chart up for just 1 second?

Senator CONRAD. Yes.

Mr. BOLTEN. Senator, we disagree—not about the problem with Social Security—I share very much your concern about the long-term unfunded liability in Social Security. But in terms of correctly describing what our deficit situation is, I think the right way to look at it is on a unified basis, because it is what the Government needs to borrow today from the private sector or tomorrow from the private sector that is relevant in the concern you expressed at the end of your remarks, which was: Is private capital being crowded out? What is going on with interest rates?

Right now we do not see the deficits we are running today putting pressure on interest rates, but I think you are right to be concerned about it. But the right way to look at it is what does the Government need to borrow today or tomorrow in order to meet that obligation.

Let me move on to the other elements. On the Medicare surplus——

Senator CONRAD. Let me just respond to that for a moment. I tell you, I think we have a fundamentally different circumstance than we faced in the 1980's because the baby boomers are about to retire. And the hard reality is debt held by the public is a different metric than the gross debt of the United States. The gross debt of the United States matters a lot more when the baby boomers are about to retire. And it is why, if you look back at the 1980's, there was virtually no Social Security surplus. Now there are huge Social Security revenues coming in, growing dramatically—it produces a $150 billion Social Security surplus this year. It is going to be $250 billion by your calculation in just 5 years. And you are not counting it as part of the deficit, when, in fact, it has all got to be paid back. It is adding to the debt. And what we have here is a gross debt that is spinning totally out of control at the worst possible time.

Mr. BOLTEN. I do want to emphasize that I completely share your concern about the long-term unfunded liability of Social Security, which begins to bite within the next 10 or 15 years very badly, when Social Security itself will start taking in less money than it is putting out. So I do not want to minimize concern about Social

Security. I do want to say we have a disagreement about the right way to characterize deficits today.

Looking at some of the other elements on your chart, I think to suggest that there is a Medicare surplus does not tell the actual story, that Medicare is divided into two parts, part of which has a trust fund, which is in surplus, but the other half of Medicare is running a large cash deficit.

Senator CONRAD. That is true, but we have made a decision around here, made it long ago, that we are going to fund Medicare in different ways. Some of it was by a premium. Some was by a general fund transfer. We do have a trust fund and it is in surplus, and it is being taken and used for other things. And the point is it has got to be paid back.

That is the fundamental problem I have with telling people the deficit is going to be cut in half, because the hard reality is that the debt in 2009 is not going to be increased by $230 billion. The debt, according to your own calculation, if you go to your own budget documents, the debt is going to be increased by $633 billion in 2009. I think the American people need to know that.

My time is up.

Chairman NICKLES. Senator Conrad, thank you. I am very interested in this subject, and you and I have a little difference of philosophy, and maybe we can hash this out.

Senator Conrad and I have basically decided to do a hearing on long-term cost implications of some of the Federal programs, which will certainly include Social Security and Medicare, but also other pension liabilities and long-term liabilities. And I may want to have a portion of that or maybe a separate hearing devoted to trust funds and what I would say is the false assumption of trust funds, but that would let you know where I am coming from. And maybe we could really hash this out. I would enjoy doing that. I think it would be a good, educational, intellectual exercise. But we will save that for another day.

We go by order of appearance, and I might ask my colleagues, Senator Domenici is here. Senator Allard, would you mind deferring to the former chairman, since he has only been chairman of this committee or ranking member for 25 years or something. But we are asking all of our colleagues to try and keep their comments to 5, 6, 7 minutes. That would be appreciated.

Senator Domenici? And thank you, Senator Allard.

Senator DOMENICI. I will try to be brief.

There is one item of kind of a parochial nature that bothers me, and parochial only in the sense that the subcommittee that I chair has to pay for this. That has to do with Yucca Mountain, Mr. Director. There is something very difficult about what your budget is doing on Yucca Mountain.

First of all, you propose that there be a Yucca Mountain fee. There has always been a fee accumulating for that. We use it even when we are not making any headway, but the President proposes $749 million as a legislative proposal related to Yucca Mountain that would change mandatory receipts related to the nuclear waste to discretionary receipts. Is that correct so far?

Mr. BOLTEN. I believe it is, Senator.

Senator DOMENICI. OK. In the budget request, the revenue from this change is assumed up front, and it is the means to maintain the schedule of 2010 opening of Yucca.

Now, I do not know that Yucca is going to be opened by 2010, so I do not want to act like I am agreeing with that date. But you all are and everybody else is telling the world we are.

Now, what happens if this legislative proposal is not enacted? Will we still stay on a path that assumes a 2010 opening?

Mr. BOLTEN. My expectation, Senator, is that unless we are able to find some other way to make sure that the funding for this project is adequate that it would cause a delay in the 2010 date.

Senator DOMENICI. Well, it would seem to me that is the right answer, but also I would like you to know that very few proposals for a user fee of this size gets enacted around here. And when you have something as controversial as Yucca, whose schedule has been all over, to come along and say, well, now is the time to ask for $750 million as a new fee, there are going to be a lot of people complaining because they have been putting up a fee, Mr. Chairman, for a long time. And you have been asking me, "Where is the fee?" And I say, "It is sitting out there." And then you say to me, "No, it isn't sitting out there. You are using it." Right? "Except you are not using it for Yucca."

Well, now, I personally want everybody to know that I will do what I can on Yucca, but I cannot keep it on schedule with $750 million left out that we assume we are going to get when I do not know how we are going to get it.

Mr. BOLTEN. Senator, one comment. I am advised that the fees we are talking about are not new fees. It is a shifting of fees from the mandatory over to the discretionary side. I realize that that still involves some difficult legislative machinations, but——

Senator DOMENICI. Yes, sir. But, you see, I already told you that, and I thought you were not getting it. But, you know, I already made that statement about the discretionary, this change. I note your marvelous assistant just whispered it in your ear.

Mr. BOLTEN. Senator, you are both far more astute about this than I am, sir.

Senator DOMENICI. You are right. He is pretty good, too. He worked for us for 20 years.

Let me talk about the defense environmental management, if I could. The fiscal year 2005 requests $350 million to be made available only to the extent that legal uncertainty concerning certain reprocessing is satisfactorily resolved pending litigation or by new legislation. What does that mean?

Mr. BOLTEN. I am not familiar with that, Senator.

Senator DOMENICI. Well, it is a bunch of money. I do not know that you have to be, but somebody has to be. Do you want to ask somebody to tell us—

Mr. BOLTEN. Can we give you the answers for the record?

Senator DOMENICI. Absolutely. Thank you very much.

The rest of that is: When do you intend to obligate that $350 million? And we will wait for that answer, too.

Mr. BOLTEN. We will provide that for the record, Senator.

Senator DOMENICI. Thank you very much.

Corps of Engineers. Everybody around here knows, and probably Senator Byrd knows the best, that every year Presidents submit budgets on the Corps of Engineers that ask for projects and then do not pay for them, or cut the projects so much knowing full well that you cannot live with them.

Now, I do not accuse you of it. You are too new. But you are following in the footpaths, it would seem, of those that came before you.

The Corps of Engineers fiscal year 2005 request, if enacted as is, underfunds the Corps so much that I question whether it could be effectively carried out and that it could do its mandated work. The fiscal year 2005 budget documents relating to the Corps state a concern about the growing construction backlog.

Can you explain how if we cut the construction budget by $300 million we are reducing the current construction backlog for 2005? Would you like to answer that for the record, too?

Mr. BOLTEN. I might, but I would just say, Senator, that when we have gone in and looked at that budget, what we have tried to do is focus on the priority projects, those already under way. I think the Corps does a pretty good job of trying to figure out exactly where the resources ought to be allocated. We have tried to continue doing that in this budget.

Senator DOMENICI. OK. I have three more Corps questions. I will submit them. But let me say to the Senators, there is no series of projects that the Senators want more than the Corps of Engineers. If anybody served on that subcommittee, it gets the biggest list, short of maybe Interior, which you chaired, Senator Byrd. We get lists of requests for Corps, and if I look at your numbers, it is—you know, you have submitted to us an impossibility. We cannot do what you have suggested here because the Senate Members and House Members will not let us.

Now, on a very big issue, I would like you to talk with us a minute. It seems to me the American economy is changing or something has happened that we have not yet put our finger on. The easy attack on this administration is that two million jobs have been lost, and I see a candidate saying, "Wait until I get President Bush, I will point right in his forehead and say, 'That is what you have done, lost two million jobs.'"

Well, Mr. Bolten, it seems to me that with the fiscal facts, everything is right on course for this to be a very strong economy. Normally a strong economy means more jobs. Is that not right?

Mr. BOLTEN. Yes, sir.

Senator DOMENICI. What has happened? Why do we have all these good acts on the economy? We have a few things that are strange, and that is this enormous, enormous increase in productivity, consistent and so high that 15 years ago if you had told Alan Greenspan we are going to have it that big, you know, he would have said it is impossible. A couple other things have happened. Do you have your version on behalf of this President as to why all the growth and other positive things and so few new jobs as they are talking about?

Mr. BOLTEN. Well, a couple of points. First of all, I think the macroeconomic policy has been very well designed to address the recessionary situation that the President encountered when he en-

tered office. There has been an accommodative monetary policy from the Fed, and on the fiscal side, you all have done exactly the right thing in enacting what may be the best timed tax cuts in American history.

CEA estimates that those tax cuts are responsible for two million more jobs. The Council of Economic Advisers, the professional economists within the White House, estimate that between 2001 and 2003, there were two million more jobs in the economy as a result of the tax cuts than there otherwise would have been.

Now, job growth has been too slow, and it has been, as you know, a great concern of the President. One of the reasons is routine, and that is that job growth typically lags recovery, and it takes some time, once the recovery is under way, for job growth to come back. But a huge factor is the one you mentioned, which is that productivity growth has been unprecedented, far beyond anything that any of the economists projected, which is good news for the economy overall. It means we are going to remain competitive. It means that we are going to have higher real wage rates. But it also means in the short run, when you are coming out of a recovery, that there aren't as many jobs created because high productivity means you are creating more products with fewer people.

We expect that the trend of low job growth is now moving to sustained job growth. We need to see what the numbers will be going forward, but I know that our economists are very optimistic that we will see strong job growth in the years ahead.

Chairman NICKLES. Senator Domenici, thank you very much.

I am going to urge our colleagues, we have a tool that we did not have in the Senate, and there is a little clock up there to give us a little guidance.

Senator Murray.

Senator MURRAY. Mr. Chairman, thank you very much, and I appreciate the accommodation of the House in being here. I would ask, Mr. Chairman, since many of our offices are not open and we are going to have difficulty getting things to you, if we could hold the record open of this committee hearing to submit our questions once our staffs get back int our office to be able to do that.

Chairman NICKLES. Certainly. That is an excellent suggestion. Thank you.

Senator MURRAY. Thank you, Mr. Chairman.

I just have to say that I am really concerned about the budget that has been presented to us by the President. I go home every weekend to Washington State. We have had the first or second highest unemployment since September 11th. We are now fourth highest, you know, so that feels a little better. But it is not good, and what people in my State are really worried about is health care, the cost of health care. They are concerned about jobs. They are concerned about an investment in transportation. They are especially concerned about security. And what I see in this budget, which is a statement of priorities, is a real lack of investment in those, and I want to get to that in just a second.

But I just got your opening statement this morning and listened to you give it, and I was kind of befuddled by what you were presenting to us because, as Senator Conrad has pointed out, you are telling us all that the deficit will be reduced by half, and you are

sending over legislation to kind of make that happen. You talked about reinstating caps, the pay-as-you-go requirements, but you are saying tax increases, pay-as-you-go would not apply.

Well, I do not understand how that works when the tax cuts take money out of the budget. And I know what you are going to go to is that, well, they will create jobs. But what I think we have seen and part of what Senator Domenici was talking about is that the jobs are not being created here. Many of the corporations who are taking advantage of tax cuts are having jobs go overseas, and we are not seeing people here, as you predict, create a better revenue forecast in the future by increasing taxes because they are not being paid here.

Now, I am a supporter of trade agreements, but I think we have to ask the question: If tax cuts are put in place permanently and the jobs are not created here, how are we ever going to get to a deficit that is cut in half that is being promised by this budget and by the White House?

Mr. BOLTEN. Senator, first, the tax cuts that we are talking about and the ones we are proposing be made permanent in the Code are not corporate tax cuts. These are individual taxes that we are talking about.

Senator MURRAY. But I would assume that you are saying that these people will invest back in this economy. That is not what we are seeing.

Mr. BOLTEN. They will invest, and in particular with respect to the top rates, many of the small businesses of America, Subchapter S corporations, pay their taxes through the top income tax rates. And these are not people typically who are sending their jobs overseas. These are people who are investing, buying plant and equipment here in America. They are the real engines of job growth.

Senator MURRAY. I think we are all very concerned that where we are seeing job growth is not here in this country, and I do not want to get into an agreement on that. Just an observation that we are not going to cut the deficit in half if we continue to give tax cuts out. We see no job growth here, and it is a dynamic that we are going to have to deal with as a country.

But let me ask you a specific question, because it is one I am deeply concerned about. You said one of the priorities of this budget was protecting the homeland. I do not think any of us disagrees with that. I think all of us realize that this last week three Senate office buildings were shut down because of a small bit of ricin. I would let all of you know that if one container comes into any one of our seaports in this country, we now understand the dramatic impact to this economy if those seaports were to be shut down and the products that could not get to stores in the middle of the country, let alone the jobs that are lost immediately on our ports, and, of course, the lives that would be involved in that.

I was really disappointed to see that this administration identified $1.7 billion for Coast Guard port, waterway, and coastal security activities, including $100 million for the implementation of the Maritime Transportation Security Act as a port security initiative.

First of all, Mr. Chairman, I want to point out that the Coast Guard commandant testified last September that it would take approximately $7.3 billion over 10 years to implement the Maritime

Transportation Security Act, including $1.5 billion for the first year. So this program is woefully underfunded, and that $1.7 billion figure represents 90 percent of the administration's proposed port security budget, and about half of the Coast Guard's discretionary budget for its traditional missions of port, waterway, coastal security.

The Coast Guard is doing an excellent job. Any of us who live on coastal States will tell you that. But they are stretched to the max. They are working overtime, long hours, and I do not think this budget offers any relief.

I want to know how this administration expects the Coast Guard, which is already stretched thin, to accomplish its traditional missions, including fisheries enforcement, search and rescue, all of those, take on 90 percent of the homeland security duties, and implement MTSA with only 7 percent—that is $100 million of the $1.5 billion—of what the commandant has told us they need.

Mr. BOLTEN. Senator, we have the Coast Guard very substantially funded. I agree completely. They have taken on a great burden. They do a terrific job. The Coast Guard funding over the course of this administration has been dramatically increased. We are proposing in this budget——

Senator MURRAY. At the behest of Congress, I would add, not——

Mr. BOLTEN. Yes, with the cooperation of Congress. I think we agree that that is an area that has needed a great deal of strengthening in this country. The overall budget for the Coast Guard in our 2005 submission increased by 9 percent in total. The port security program you referred to, I think we have baked into our figures full over the course of the 10-year period. But we need to focus our money where we think we can do the most good most quickly.

Senator MURRAY. Well, I would just disagree with the priorities, and I would say eliminating Operation Safe Commerce, which is a project that is ongoing in our largest ports right now to determine what is the best way to provide port security, eliminating that and underfunding this is going to cost us in the future. And it makes it very hard to believe that homeland security is one of the primary missions of this budget.

Thank you, Mr. Chairman.

Chairman NICKLES. Senator Murray, thank you very much.

Senator Allard.

Senator ALLARD. Thank you, Mr. Chairman. I would have to disagree with my colleague from Washington in that what I am seeing now is that we are starting to have some job growth. But I would also point out, in visiting with economists, it seems as though there has been a loss of manufacturing jobs for almost two decades. Whether we have gone through periods of recession or unprecedented growth like we did in the 1990's, the trend has been a loss of manufacturing jobs in this country.

It has brought up a discussion among a number of colleagues that I have been visiting with as to just how significant is the household survey as compared to, I guess, we call it the payroll survey, where we do the—where most of the figures are coming out of, historically I think it has been out of the payroll survey. What we have noticed recently, there has been a huge increase in household survey that reflects small business jobs. And I have talked to

a number of individuals, a number of economists and people sort of in the various industries. They seem to think that with the recession that we had, people were given bonuses to leave their jobs voluntarily, and they took this money and set up their own businesses. Many of them were home businesses, the household. They operated a computer and they had a good printer, and they ran a business right out of their home.

Do you have any explanation for the discrepancy in the household figures as opposed to the payroll figures?

Mr. BOLTEN. Senator, for a truly expert answer, I will ask the Chairman of the Council of Economic Advisers to give you something for the record. But I think the difference is exactly the one you identified, and that is that the payroll survey tends to go around and get the big businesses and survey their employment. The household survey actually asks individuals who is doing what, and that is the one that reflects much more accurately small businesses, and as has been typical in many recoveries, the real robust growth in the economy, and the real job creation comes from the small businesses.

Senator SESSIONS. Thank you, Mr. Chairman. I think it is critical that we take firm and decisive steps to demonstrate our commitment as a Congress to contain the growth in spending. The American people expect that. The financial community is watching us, and I think the world community is watching us.

We can sustain the deficits we had this year. I was glad to see that it came in, what, $50 billion below one of the estimates as late as June because of the growth in the economy, and it does appear to me that income to the Government from tax revenues is more volatile than the economy itself. It tends to go up faster and drop faster than the economy itself. But one of the things we have not talked about generally is the discretionary and entitlement accounts. We have focused mostly on discretionary.

Mr. Bolten, what percentage of our expenditures in this unified budget from which you are drawing the deficit number, what percentage of that is discretionary and what percentage is entitlement programs?

Mr. BOLTEN. It is about a one-third/two-thirds relationship, and then the interest is the rest of the budget.

Senator SESSIONS. So two-thirds of the expenditures other than interest would be entitlement programs, Social Security, Medicare and those expenditure items?

Mr. BOLTEN. I think it is a little bit less than two-thirds, yes.

Senator SESSIONS. And we do not appropriate that money as we have set that system up, but every single American who reaches a certain age or has certain income levels become entitled automatically to the check or the benefit from the Government regardless of the state of the government's budget and income; is that correct?

Mr. BOLTEN. That is true.

Senator SESSIONS. Will the entitlement program growth exceed the growth projected by the President for the discretionary accounts this year?

Mr. BOLTEN. This year actually I think entitlement growth has been relatively restrained after a number of years of large growth,

but it is not a path we can expect to continue in the future. But if you look out into the future and if you look out farther beyond 10 years into the future, as Senator Conrad did with his charts, and I know a number of members are interested in, you see in the entitlement growth far outstripping not just the growth in the rest of the budget, but the growth in the economy which is what makes that situation particularly dangerous.

Senator SESSIONS. I think it is important. So the answer is on Social Security, we know it is time for us in this Congress to get serious about it. We do not need to wait till 2018 when the thing goes into deficit. We need to be thinking ahead now. I think the President has had the courage to discuss that openly, and I believe he will move forward, and I hope the Congress will meet him halfway instead of politicizing the issue.

Now, one matter we need to deal with—and I am glad the Chairman raised it—and that is the prescription drug cost estimates that we had. Chairman Nickles, to his credit, told us on the floor of the Senate and in Committee and privately, that the numbers were probably going to exceed the $400 billion. Nobody else particularly was saying that, but Chairman Nickles did warn us of it. I told the people of my State that I believe we needed a prescription drug plan, I believe and know that there are seniors in our State who literally, whose health is compromised because they cannot afford prescription drugs. And I thought and was certain we could do it for the amount we budgeted last year, $400 billion, and I ran for reelection and that is what I said. So I have to tell you, I am very disturbed and concerned that we now have another Government agency saying it is going to be $534 billion which is $134 billion more. That is $13 billion a year. I do not know where in this Government we can save $13 billion a year. And this is a program going from zero to 400 billion and now it is going up to there.

I will just say a couple of things. Do you know which number is correct, and do you have an opinion? Is it 400 or 534?

Mr. BOLTEN. I do not know, Senator. I think even people who are expert in this area have legitimate disagreements. I know that the CBO actuaries are very professional. The HHS actuaries are very professional. And they are working together to try to resolve their differences.

Senator SESSIONS. I do not think we know either, and I have been talking to a number of Senators about this, and others in trying to figure out what the truth is, and the truth is we do not know. The truth is we passed a bill that we said was a $400 billion bill and now we have an authoritative agency saying it is going to be $134 billion more than that. So I think before this thing gets implemented, before we go down this road, Mr. Chairman, we need to confront this question. I believe that is what the Congress was intending. I know I would not have voted for a $534 billion bill, and I know other Senators would not have voted that big a bill.

So my question to you is, would you be willing to support, and do you think the administration would support a plan to contain the growth of this new entitlement program to the 400 billion we contemplated from the beginning, and would not that be good public policy, so if Congress felt they needed to put more money in it to drive it up, they could make that decision, but that we ought to

have a budget that we enforce and we ought to have an expenditure plan that is consistent with what we expected when we passed the bill?

Mr. BOLTEN. Senator, I cannot give you an administration position off the top of my head on that. I can tell you that, the administration remains very interested in ensuring that costs be contained at the same time that we are providing these new and improved benefits through Medicare. So there will always be an interest in that.

And I would just come back to one point, which is that as we submit this budget, I expect it will be rescored by CBO, and my understanding is that they will stay with their $395 billion estimate. So as the budget is in front of you, it will be at the same cost for the Medicare program that you voted on.

Senator SESSIONS. I think that could be helpful to us, Mr. Chairman, as we confront the question of can we contain this cost to the amount we intended to. I believe we can do that. We do not know what it is going to be. In fact, you have indicated, I think, we do not know to the extent it could be more than $534 billion, and I just think we have a responsibility to see what we can do to make this program come in at the level we want it to. The idea that entitlement program is just a machine let loose and it runs amuck and can never be altered should not be our way of thinking.

Chairman NICKLES. Senator Sessions, thank you. I welcome any suggestions that you have. I might say that during the conference I tried with others to come up with different methods of containing the cost, and we came up with a reporting mechanism if spending exceeds a certain amount of GDP or something, but it was not anything satisfactory as far as this Senator is concerned.

Senator SESSIONS. I would just say that of all the conferees, you are by far the most committed to maintaining integrity in that figure, and perhaps the growing concern over the deficit in recent weeks might cause some of our colleagues to rethink where we are on this particular question. If we can come up with a good sound approach, and I believe we can, we need to do it.

Chairman NICKLES. I appreciate your suggestion, and the administration has made several recommendations as far as budgetary changes. Either they would be made as part of the budget resolution or they would be made as a separate bill as part of amending the Budget Act. I am certainly willing to consider recommendations from any member of the Committee, any member of the Senate. So if you have some suggestions you think that we should be considering, I am more than willing to work with Senator Conrad to see what we can do.

Senator SESSIONS. And I do intend to be working on that, Mr. Chairman.

Chairman NICKLES. I appreciate that.

Next, the Senator from Michigan, Senator Stabenow.

Senator STABENOW. Thank you, Mr. Chairman, Mr. Ranking Member, and welcome, Mr. Bolten.

I am looking forward to a broader discussion on Medicare myself. I will not spend a lot of time on it today, but just to say what I would really like to talk about is how this is not a good benefit for seniors, how it lacks in the highest possible prices for people under

Medicare, and in over 10 years will begin to unravel Medicare as we know it. So I hope we are not only talking about the numbers but it is really happening and what will be happening under this Medicare bill which I am deeply concerned about for the seniors of the country.

There is a lot in this budget bill. It is difficult to spend just a few moments talking about it, so, Mr. Chairman, I would like to talk in big picture numbers. As I said in the last meeting that we had, last hearing, I think it is very important to note that with all this sea of red ink, that if we were to eliminate every penny of non-defense discretionary domestic spending this year, every penny of $445 billion this year, that would not eliminate the deficit for this year of $521 billion; is that not correct?

Mr. BOLTEN. That is true, Senator.

Senator STABENOW. This is huge. So we can debate around the margins about whether or not we should have a half a percent increase in non-defense discretionary spending or a percent or 2 percent. But you could eliminate every penny and it would not equal the deficit for this 1 year. So obviously, there are broader issues that we need to address, Mr. Chairman, and I hope we will.

The other thing I think is important to put in perspective is of the 65 programs that we are talking about being eliminated, and I have some questions about those, they equal 5 billion which is what we spend a month in Iraq and Afghanistan. So we are talking about and trumpeting 65 programs that eliminate $5 billion, and we can debate whether they should be or not, and I am all for eliminating things that do not work and doing new things, but that is what—we are spending $5 billion a month in Iraq and Afghanistan, and this budget does not include the funding at this point for those important issues of Iraq and Afghanistan. So this budget is not complete, which is one of the big concerns as we look at all of this.

Is it true, when I look at what you are proposing to eliminate, we are looking at eliminating in education $1.412, basically a billion dollars in education, as I have it, education programs, and I assume these numbers are correct that we have received from you, $1.412 billion. And adding back $1 billion in Title I. So we are looking at overall there would be a cut there in terms of dollars to education. That concerns me.

The other thing, coming from a manufacturing State, right now, where our world is very different than the world, with all due respect, that you are describing in terms of jobs. We are losing jobs and we are losing them permanently, middle class family wage jobs, and we are desperately concerned about it. Everyone is agreed. The President has said, and Members of Congress obviously have said, we need to focus on education and innovation. We see programs being cut as it relates to technology, regional technology in education programs, as well as vocational education, as well as other kinds of tech prep education, those kinds of things. Then we see being proposed for cuts the Advanced Technology Program, which frankly, has been a wonderful partnership in Michigan between the universities, the big three auto makers, other manufacturers to increase our applied technologies in terms of research and being able to raise that level of innovation that we all

know that we need to compete. So I am very concerned about the choices being made here that will undercut our ability to in fact invest in education, innovation and jobs.

I would add just one other thing on jobs, and that is I would comment—I do not usually commend a program on television—but Lou Dobbs has been doing a wonderful ongoing series on exporting of American jobs, "Exporting of America" I believe is what he calls it, in which he really, I believe the other night got into the whole question of how we look at productivity now. Part of the reason that productivity numbers look as high as they are is because we are taking out of the equation the numbers of jobs that are being outsourced overseas so that the numbers change, and there is some very interesting things that I thought came forward in this program.

So I am more specking, Mr. Chairman, than I am asking questions, except to say I am very concerned about the choices being made here in terms of education innovation, the choices in terms of keeping us safe and the cuts in first responders and bioterrorism. And I would ask simply a question as we look at these things. We all understand that Social Security and Medicare is being included in the numbers that we see in terms of the deficit, correct?

Mr. BOLTEN. Correct.

Senator STABENOW. Unified budget. Would you also agree with a chart that our ranking member has showed us in the past regarding borrowing, the top 10 countries holding our national debt, China, Japan. By the way, China is where our jobs are going is one of the places, and then manipulating their currency which makes it worse. Japan, China, United Kingdom, Hong Kong, Germany, OPEC and so on. Would you agree with the fact that we are borrowing, that we are taking Social Security and Medicare money, and on top of that we are borrowing from other countries in order to take care of this debt at this time?

Mr. BOLTEN. Oh, it is certainly true that a fair amount of the U.S. debt is held overseas, yes, and that is one reason why it is especially important that we show ourselves to be fiscally responsible today because we need to be assuring not only our own markets but international markets as well.

Senator STABENOW. Absolutely. So when we look at this budget and the fact that you could eliminate all education funding and homeland security and technology innovation and law enforcement and everything, and not equal the deficit this year, and you look at the fact that we are taking all of Social Security and Medicare and borrowing from China and Japan, Mr. Chairman, what I find of great concern is that that money is not going back into paying our bills. For the most part, that has gone as a conscious choice to give tax cuts that you want to extend to people who are doing very, very well in our country. So we are taking money from Social Security and Medicare, borrowing from China and Japan and other countries, giving it to millionaires in our country, and then not being able to pay our debt on the war, not being able to invest in education innovation.

These are choices that are being made right now in this budget and in the past several budgets, and I disagree with those choices.

I believe that this budget is about values and priorities, and I do not believe that right now this budget reflects priorities. Thank you.

Mr. BOLTEN. Mr. Chairman, may I take a moment for a comment or would you like to move on?

Chairman NICKLES. Yes, go ahead.

Mr. BOLTEN. I agree completely with the Senator, that that is exactly what these budgets are about, setting priorities. I imagine we will have some substantial disagreements about where the priorities belong.

Let me make one point about the tax cuts that you raised because I think there is a misconception about the effect of those tax cuts. This chart shows basically who pays what in our income tax system. Right now, let us take the top 5 percent of income earners in this country. That is the second set of bars from the left. Without the tax cuts, that group, those people making more than $135,000 a year, pay 50 percent of the income tax in this country. As a result of the income tax cuts, that same group pays 53 percent of the income tax take in this country. The result of the tax cuts that you all enacted was to make the tax code more progressive rather than less.

I would also come back to the point that a substantial portion of the money that is labeled as going to the rich is for the small businesses of America, which are, as Senator Allard was pointing out, the job creators in this economy.

Can I mention a couple more things?

Chairman NICKLES. I have two additional Senators and I am trying to get this out pretty close to 12 o'clock.

Mr. BOLTEN. All right, sir. I will be glad to engage the Senator separately.

Senator STABENOW. Mr. Chairman, if I can just make one response with two points. First of all, income tax is not the only thing paid in this country.

Mr. BOLTEN. Absolutely.

Senator STABENOW. Everyone is paying payroll taxes.

Mr. BOLTEN. Yes.

Senator STABENOW. The majority of Americans are paying payroll taxes which is Social Security and Medicare that we are now using to help pay for these income tax cuts as well as other things.

But second, the majority of this income tax cut went to those at the very top of our income. Child credit, terrific; eliminating the marriage penalty, I care about that more now, the last year, than I did the year before.

[Laughter.]

Senator STABENOW. And I certainly appreciate what you are saying about small business, but we all know where the majority of this went, and in fact, if you would be willing to work with us, we could eliminate what happened to those at the very top who have not been asked to sacrifice during this time of war, and reinvest it back into helping our homeland security first responders keep us safe, and I think we could have some common ground.

Chairman NICKLES. Senator Stabenow, thank you very much.

The Senator from Idaho, Senator Crapo.

Senator CRAPO. Thank you very much, Mr. Chairman.

I want to first add my voice to those who are raising a high level of concern about the level of deficits that our country is facing now. There is a tremendous debate starting in this country about why we are facing these deficits, where the responsibility lies, and I am sure that given the fact that it is a Presidential election year and there is a battle for control of the Senate and the House, that there is going to be a tremendous amount of rhetoric about these deficits.

I want to commend you, Mr. Bolten, and the President for submitting a budget that focuses on trying to reduce the level of these deficits and get us on to a glide path back toward balance. My efforts in this Committee are probably going to be to help increase the pace at which we engage in those efforts, but I appreciate that this budget recognizes that need.

Second, and I want to use my time here, I want to commend you and the President for recognizing that procedure, as we adopt budgets, is critical.

Mr. Chairman, could you help me on my information here, Senator Nickles? Last year when we brought our 2004 budget resolution to the Senate floor, did we not consider something like 80 or 81 admendments and were not the vast majority of those efforts to increase the level of spending assumed by the resolution?

Chairman NICKLES. The Senator is correct. 81 amendments, most of those were to increase spending. I am trying to remember if there was one or two to cut spending, but most all those were significant increases, most of which were defeated.

Senator CRAPO. And when you say "most" we are talking like 95 to 100 percent almost of those 81 votes were votes to try to increase the spending level of the budget.

Chairman NICKLES. The Senator is correct.

Senator CRAPO. The reason I say that is—and I appreciate you pointing out that we were successful in all but one of them in defeating them. The reason we were successful in defeating them is we had some budget protection measures in place that required 60 votes to increase the budget rather than 50. If we had not had those budget protections in place, it is hard to imagine what the spending levels we would be dealing with today might have been.

The reason I go into that is because it is my understanding that in addition to the proposals for the actual numbers of this year's budget, that the administration is recommending a number of specific statutory budget process changes to help us control spending. I want to just go over a few of those to get those clarified.

The first is, I understand that you are proposing that we reinstate caps on discretionary spending for five full years; is that correct?

Mr. BOLTEN. That is correct, Senator.

Senator CRAPO. Second, I understand that you are proposing a pay-as-you-go requirement similar to that that we have used in the past for new mandatory spending, and that this proposal would require that any increases in mandatory spending would have to be offset by reductions in mandatory spending, and that tax increases could not be utilized for that offset; is that correct?

Mr. BOLTEN. Also correct, Senator.

Senator CRAPO. I know that earlier in the hearing there was some argument with that notion, namely the notion that tax in-

creases should not be allowed. I want to first of all weigh in on your side on that and ask you to explain it a little more, because it seems to me that there are two, at least two major objectives here that we want to achieve. One is we want to balance our budget, but the second is—and I think this is sort of an age-old battle that we have here in Washington—is that we want to try to restrain the growth of the Federal budget and the growth of the Federal Government. There are those who I think believe that we need to have a large all-powerful centralized economy controlled by the Federal Government. I am not in that group. There are others who believe that we ought to have the Federal Government performing those limited functions contemplated by the Constitution, and that we should try to do all we can while we are trying to maintain a balanced budget, to also obtain the second objective, which is a restrained growth of the Federal Government. I mean you can easily balance a budget. Just pass a tax increase. Every time you want to spend more money, tax more, keep the budget balanced and just watch the Government grow. But we want to control growth as well as achieve balance. I assume that that was the principle behind your proposal to not allow tax increases to be utilized as the mechanism. Am I correct?

Mr. BOLTEN. Yes, Senator, I think that is very well stated. In fact, it is better stated than I did in my last hearing, so I am going to go back to the transcript and borrow from that.

But there is one other point as well, and that is that the economists will tell us that a spending cut and a tax increase are not equal in their effect on the economy, that a spending cut will reduce deficits basically one for one, maybe even a little bit more with the interest expense added in. A tax increase poses the prospect of undermining the economy. There is at a minimum a small—though some economists believe a very large-feedback effect from keeping that money in the economy, keeping economic growth robust, which keeps Treasury revenues robust. Those are the elements that I think also mitigate very strongly in favor of biasing the rules in favor of keeping spending down, rather than just focusing on increasing taxes.

Senator CRAPO. Thank you. In fact, I think that analysis is very appropriate. I am going to add that to my explanations of this issue as we go forward.

I would also say just quickly with regard to this proposal, I wish it was applicable to mandatory and discretionary spending and not just increases. But I will leave that to some further battles that we have here in the Budget Committee.

One last quick question. Among a number of other procedural proposals you are making, one of them is to reinstitute the line-item veto. As we all know that was stricken by the court recently when we tried it last time. How are you proposing to do it differently now to avoid successful court challenges?

Mr. BOLTEN. Senator, I am not able to go into the legal detail with you now but I know our lawyers are confident that a renewed line item proposal could be crafted that would withstand Constitutional attack in the courts. We will be glad to give you that detailed legal analysis.

Senator CRAPO. If you could submit some further analysis on that I would be very interested in that.

I see my time is up. Thank you, Mr. Chairman.

Chairman NICKLES. Senator Crapo, thank you very much. Next our colleague from Florida, Senator Nelson.

Senator NELSON. Mr. Chairman, you are a biblical scholar and given the fact that Senator Byrd had made note of the magnificent biblical name of our witness, Joshua, and the fact that—by the way, what great name, Joshua Nehemiah, and I got Bill. Yet, it is interesting to note about the great leader that Joshua was when he led the people into the promised land and had one victory after another until deceit, deception and untruth entered the camp, and then he lost his first battle when he tried to take the city of Ai. And not until he exorcized the untruths did the favorable hand of the Lord turn back on him to continue his victories in the promised land.

Now I want to point out one little subtle change here. Would you all put back up that chart that you just had up there? This chart would lead us to believe that of the top 1 percent, 5 percent or 10 percent, they are paying the huge share of income taxes. That is what the chart basically says. Technically, that is correct. But that does not give the whole picture about where the burden is upon the American taxpayer, for we know that of the American taxpayer, three-quarters of them are paying more in payroll taxes than they are in income taxes. Is that not approximately true?

Mr. BOLTEN. I do not know the exact numbers but the general concept is right. There are a huge number of, especially lower and middle-income taxpayers for whom the tax burden is greatest through the payroll tax rather than the income tax.

Senator NELSON. So as we try to craft an economic document, and this is not particularly an economic document—it is a political document—we need to tell the whole story of where the tax burden is and how, if we are going to provide relief, who that relief is being provided to.

I would submit that this is a political document of a budget—and I do this respectfully—that would offer an additional tax cut for the people at the higher end of the income scale paid for by borrowing. And where do we borrow from? We borrow from the Social Security Trust Fund, and as others have pointed out here we borrow from—you think we borrow from individual American citizens but a good part of the borrowing comes from countries like China and Japan.

So we have a document in front of us that is increasing the deficits, and what I would like for you to educate me on is, with this kind of deficit now in excess of $500 billion dollars in 1 year, is it not the law of physics applied to economics that as you go out and try to accumulate and borrow more and more, and the competition gets greater for the available dollars, that the cost of that money goes up, which is the interest rate? Are we not going to see with this budget, if implemented, later on at the end of this year interest rates start to rise, and is that not going to cause the economy to stall and ultimately go off the cliff? I would love to have your comments on that.

Mr. BOLTEN. Senator, we have not seen it so far, that interest rates remain at historic low levels, but I think you, Senator Conrad

and Senator Nickles, are right to be concerned about that and that is why we want to have as restrained a budget as we possibly can, even in the short run. The number that the economists tell us is actually most relevant for what you are concerned about, that is putting upward pressure on interest rates, is the debt to GDP ratio. That is the total corpus of the debt that is being built up in this country.

You will see in our tables that we show that debt to GDP ratio has been rising. I believe with a great deal of credibility our budget will put us on the right path. In the President's Budget that number peaks in 2004 at around 4.5 percent of GDP. This is below the average of the last several decades. It then will begin to slowly to decline. I think you are right to focus on that question because we do need to be concerned about putting upward pressure on our interest rates. But I think if we pursue strong pro-growth economic policies and if we exercise responsible fiscal restraint, we will see that path of the debt to GDP ratio coming slowly back down, which is where it needs to be.

We have a disagreement about tax cuts. I think you are right to focus exactly there. In putting this chart up, I do not suggest that everybody in America's principal tax burden is income taxes. In fact you are absolutely right, it is not. But if the tax cuts that you all enacted are attacked as having made the tax code less progressive, I put this chart up to show that in fact the tax cuts have made the tax code more progressive. That does not mean we should ignore the burden that remains on lower and middle-income people. Those are the people we want to support and why it is especially important I think that this year you all extend the child credit, the marriage benefit relief, and the expansion of the 10 percent bracket.

But I think the actual picture of the tax cuts is well-reflected in this chart. I am comfortable not having undermined the beauty of my namesake's biblical name in that respect.

Let me make one other comment, and that is that the tax cuts as an explanation for how we got into this deficit picture I think are greatly exaggerated. I think the Chairman had it exactly right in the early charts he put up. The tax cuts have reduced somewhat our revenue in these last few years and will continue to reduce somewhat our revenue. But by far the reason for the big change in our deficit picture over the last few years has been flagging economic growth. The tax cuts deserve a lot of the credit for restoring that economic growth, and the Administration takes a strong view that this would be exactly the wrong time to contemplate raising those taxes back up again.

Senator NELSON. Mr. Chairman, I want to take the liberty of just adding another sentence or two. I am just a country boy from Florida, but I understand basic economics. That if you have a deficit that is created because there is more spending than there is coming in revenue, that if you are going to get that deficit eliminated and instead are going to get it to where the budget is in balance you either have to cut spending or you have to stop tax cuts before they go into effect, and therefore the effect of the revenue is higher, and that brings you more into balance.

Now where I think you have miscalculated, I would grant you that the tax cuts and the additional spending that has occurred in this past year with regard to the war have generated more dollars in the economy and we have seen the economy start to rise. Not with the effects of the jobs that we would like to see increased. However, I think at some point there comes the moment of truth. Not bringing that budget into balance and instead, with the huge deficits, more spending than you have coming in in revenue, that the chickens come home to roost by the interest rate suddenly surging upwards, the economy constricting and us starting to go off the economic cliff.

That is what I am afraid is going to happen starting early next year, and only compounded, as has been expressed by several Senators here, by the fact that this monstrosity that we enacted called a prescription drug benefit is now nowhere near the level of $400 billion. Indeed, is only going to go higher over time. You add that to the fact of the $5 billion a month to take care of the war, which I was one of the ones that support the war, and obviously now that we are there, despite the fact of the misinformation that we had, we have to be successful. You add all of that and the budget deficit is going absolutely out of control. That is where I think, respectfully I say to you, with a great biblical name, that I think your budget document is flawed.

Thank you, Mr. Chairman.

Chairman NICKLES. Thank you, Senator Nelson.

Senator CONRAD.

Senator CONRAD. Thank you, Mr. Chairman. Thank you again for holding this hearing. Thanks again to our House colleagues. Thank you, Director Bolten, for being here.

Let me just say in conclusion, I think you are a good and decent person. I think the budget that you have put before us is a total fiction. As I look ahead, you just leave out things that are critically important for the American people to know.

This is what I think is a closer approximation to the truth because this includes the long-term effect of the President's tax cuts that he advocates, this includes dealing with the alternative minimum tax problem which is supposed to be a millionaires' tax that is about to turn into a middle-class tax increase, and this deals with Social Security. When you do that and you look ahead what you see is the deficits are not going down. The additions to the debt are going up, up and away. And these are the good times. These are the good times before the full effect of the President's tax cuts take effect and before the full impact of the retirement of the baby boom generation takes effect.

So I believe this budget, and frankly your presentation, badly understates how serious the fiscal condition of the country is. In that way I think it is an enormous disservice to the American people. I am sad to say that but I believe that is the truth.

The biggest thing you have left out is you folks after promising—in fact we looked at the White House web site and the President has this statement on his web site. "We are going to keep the promise of Social Security and keep the Government from raiding the Social Security surplus." It is interesting, it is not prominently displayed on the web site, and well it should not be because you

are taking every penny of Social Security surplus, not just this year, not just next year, but every year for the next 10 years. Every penny of Social Security surplus, and throwing that into the pot to pay for tax cuts and other things. Those chickens are going to come home to roost because that money has got to be repaid.

How is it going to be repaid when the baby boomers start to retire, and the full effect of making the tax cuts permanent takes hold? We already have record deficits and the President's plan has increased the spending and cut the revenue. He is restraining the growth of spending in a small part of the Federal budget, but most of the budget is increasing. The overall budget is increasing. The spending is increasing and we have record deficits now and he says, increase the overall spending, cut the revenue.

It does not add up. We are honest. We know it does not add up. It does not come close to adding up. He has got us headed for the fiscal cliff. That is my belief.

I thank the Chairman again for his many courtesies, and I would say on the question of tax cuts and Social Security, the Center on Budget and Policy priorities has told us, you take the tax cuts for 75 years and the Social Security shortfall for 75 years, the tax cuts are three times as big as the Social Security shortfall over the 75-year period that the analysts examined. So we do need to get serious. Getting serious, I believe means, no more tax cuts unless they are paid for, and get real tough on the spending side as well. Unless we acknowledge the reality of our fiscal condition we will do neither and that is a huge mistake, because the faster we get on this problem the less draconian the solutions will have to be.

I again thank you, Mr. Director, for being here today.

Chairman NICKLES. Senator Conrad, thank you very much.

Director Bolten, we do appreciate your appearance before the Committee. I would just make a couple of comments.

My very good friend Senator Conrad mentioned the fact, in the budget you are using the Social Security surplus. I alluded to the fact I do not think there is a Social Security surplus because the difference or the surplus is basically used to pay for Medicare. People should note that. I also might note that all the Democratic budgets, ones produced by Democratic majorities, also used the Social Security surplus. So a little something there.

The AMT fix that is assumed in some of these charts is $500-some billion over 10 years. I certainly think we can fix the tax code and solve a lot of our AMT problems concurrently without that kind of expenditure. And on the assumption that all the tax cuts are all going to be extended permanently, I hope that is not the case. Some of the tax cuts were temporary, designed to stimulate the economy. They will not be extended, or at least it is not my intention to extend them.

Also, future extensions of tax cuts require an act of this or a future Congress. If somebody does not want to extend the tax cuts they can vote, they can change. And some of those will not happen for years, may not happen for years. So they have ample opportunity to be able to make that decision.

Of the current tax cuts, the biggest bulk of them do not expire until 2011. I want to underline my belief that certain of the tax cuts should be extended: for example, the individual marginal tax

rates and 15 percent rate on capital gains and dividends. I think if you increase those, as some people are advocating, you are going to send the stock market and the economy down significantly. I also think the same thing on individual rates. I hope you do not take the 25 percent rate and make it 28 again. I hope you do not take the 35 percent rate and make it 39.6 again. That would be a mistake in my opinion. But a future Congress is going to have to deal with those things.

And the war cost is not going to be any $87 billion for the next 10 years. Some people are making that assumption. CBO had to build that into their baseline. I think that over estimates baseline spending and deficits to the tune of about $1.1 trillion over the next 10 years. I hope it is a whole lot less than that. I hope that the figures are much, much, much, much less that. I cannot imagine spending that kind of money in Iraq for the next 10 years.

So I just make those editorial comments. I do not think things are quite as bleak as some. I do think the deficits are far too high, and it is very much my intention to work with members of the Committee and the Administration to more than meet the goal of the Administration to get the deficits in half, and I believe a lot quicker than in 5 years. That is my intention.

Director Bolten, thank you very much. I know several of our Committee members requested that you would answer questions for them, most of whom do not have access to their offices and to their staffs, so I appreciate their cooperation in meeting with us in the House. Again, I want to thank our colleagues, Chairman Nussle and Ranking Member Spratt for their hospitality and cooperation with us. They have been a big assistance to us and I appreciate that.

The Committee is adjourned.

[Whereupon, at 12:18 p.m., the Committee was adjourned.]

Statement by Senator Russ Feingold
February 5, 2004

Mr. Chairman, I thank Director Bolten for taking time to appear before the Budget Committee this morning to lay out the President's budget for the coming fiscal year. I look forward to reviewing his proposals in more detail, but let me note that without endorsing or faulting some of the specifics, I am greatly concerned at the overall direction this budget takes.

Compared with the fiscal position of the budget three years ago, this proposal represents roughly a $9 trillion drop in the 10-year bottom line of the federal government, moving from a projected 10-year unified budget surplus of more than $5 trillion, to a 10-year unified budget deficit, making reasonable assumptions, of about $4 trillion.

A $9 trillion drop, Mr. Chairman. You might wear out a thesaurus trying to describe just how astounding that is. Even accounting for the expected uncertainty involved in making any budget projections, a $9 trillion deterioration in the 10-year bottom line of the federal budget is, at the very least, eye-catching.

Let me note that as rough as 10-year projections are to begin with, this estimate is even rougher, because the Administration has not provided us with a 10-year budget. What they have provided is a 5-year budget.

Mr. Chairman, I know there are arguments on both sides of this particular issue. It is admittedly a bit arcane, and I don't doubt those who suggest that most people don't really care whether the President sends up a 5-year budget or a 10-year budget.

I mention it, though, because whatever the rationale might be for a 5-year plan, the biggest single proposal this Administration has made - making the recently enacted tax cuts permanent - occurs in great part after the 5-year plan it has submitted.

Mr. Chairman, according to the materials provided by the Administration, the President's budget will produce a unified budget deficit of over half a trillion dollars this year. If we exclude the Social Security trust fund surpluses, the deficit for this year rises to $675 billion, and of course we should exclude Social Security surpluses, because we are relying on those surpluses to pay for the retirement benefits of the Baby Boom generation.

Mr. Chairman, as bad as those figures are, I should note that, if anything, they understate the problem. As I understand it, the budget does not include funding for the expected ongoing costs of our operations in Iraq and Afghanistan. In fact, I have heard reports that

the Administration already has plans to ask for a $50 billion supplemental funding bill to fund these operations in FY 2005.

I also understand that this budget does not propose much needed permanent reform of the Alternative Minimum Tax. While it may contain a short one-year extension of some modest relief, the President does not budget for the long-term solution we very much need.

As I'm sure you know, Mr. Chairman, today roughly two and a half million taxpayers are subject to the Alternative Minimum Tax. Without some reform, and assuming the 2001 tax cuts are made permanent, in ten years the number of taxpayers subject to that tax will grow to 39 million. There is little doubt that we need to reform the Alternative Minimum Tax, but the President's budget does not include the resources to pay for long-term reform.

This budget does not pay for Alternative Minimum Tax reform, it does not pay for making the tax cuts permanent, and it reportedly does not pay for the ongoing operations in Iraq and Afghanistan. That task is left to others.

Mr. Chairman, I haven't been around here as long as you have, but I do know that it is extremely difficult to find the political will to reduce deficits. When it comes to spending money or cutting taxes, there are long lines of volunteers, but reducing deficits is another matter. That is tough work. And the work has been made even tougher by this budget.

Brief Statement
By Senator Mike Enzi

Thank you, Mr. Chairman.

I would also like to thank Director Bolten for testifying today. You have a tough job today, Mr. Bolten. You have to discuss a budget that's over 2000 pages long and covers everything from abandoned mine land restoration to First Responder funding to veterans' healthcare. Last year, I read the entire document. I'll do the same this year. I'll read it because the President's Budget Request provides a blueprint for our legislative and fiscal work in the Senate and the House.

While the Budget Request sitting before us includes information related to hundreds of programs and projects, we must not lose sight of the fact that it is only a guide for Congressional action. The Budget Committee will use it to craft a resolution that provides spending authority in certain areas, while the appropriators will use it to set line by line budget allocations. Let me repeat that the job of the Budget Committee is not to determine the level of funding for each and every government program. Our job is to determine what will benefit the overall fiscal health of the country now, next year and ten years down the road.

Wyoming is one of two states in the country with a surplus right now. The surplus didn't happen over night. It happened because we were and continue to be fiscally conservative in the state. When we have huge surpluses, we don't spend every nickel of it – we put it away for a rainy day. When we have declining revenues, we cut spending and find a way to balance our budget. Because the Wyoming economy is even more cyclical in nature than the US economy, we have to think ahead and recognize that a million here and a million there add up to real money over time.

That being said, I am interested in Mr. Bolten's testimony on how OMB put together this massive document and the long-term effects of the Administration's proposed tax and spending policies.

I am pleased to see that President Bush produced a budget that recognizes the realities of responsible budgeting – that dozens of new programs cannot be created year after year and sustained at a growing rate without cutting or reducing others. Since my days in the Wyoming Legislature, I have been a proponent of an amendment that would require legislators to eliminate or consolidate programs every time they create a new one. It appears as if President Bush has attempted to do just that in this request.

To my knowledge, the Administration has proposed eliminating at least 65 programs for a savings of $4.9 billion and major reductions in at least 63 others. While I have not had the opportunity to review each of these programs, I am curious as to how the Administration chose these specific programs for elimination or reduction? More specifically, what criteria does the OMB use to determine the effectiveness of programs?

Senate Budget Committee Hearing Qs and As

Department of Energy

Senator Domenici: In the budget request, the revenue from this change is assumed up front, and it is the means to maintain the schedule of 2010 opening of Yucca. Now, I do not want to act like I am agreeing with that date. But you all are and everybody else is telling the world we are. Now, what happens if this legislative proposal is not enacted? Will we stay on a path that assumes a 2010 opening?

Answer: The President's Budget proposes that a total of $880 million be appropriated in FY 2005 for the U.S. nuclear waste management program's Yucca Mountain nuclear waste repository, an increase of $303 million over the FY 2004 appropriation. The FY 2005 request, in addition to funding requested in future years, will enable the program to continue on schedule and begin to accept waste at the repository by 2010. To align current fees with their related expenditures and facilitate appropriation requests needed for the project to stay on schedule, the Budget includes a legislative proposal to reclassify as offsetting collections the annual receipts to the Nuclear Waste Fund, which total $749 million in FY 2005. The project can remain on schedule in FY 2005 if Congress appropriates the $880 million requested in the Budget. However, without enactment of the legislative proposal to reclassify the receipts and if Congress significantly underfunds the Administration's request it would be unlikely that the project could maintain the schedule of opening by 2010.

Senator Domenici: Let me talk about the defense environment management, if I could. The fiscal year 2005 Budget requests $350 million to be made available only to the extent that legal uncertainty concerning certain reprocessing is satisfactorily resolved pending litigation or by new legislation. What does that mean? When do you intend to obligate that $350 million?

Answer: The FY 2005 Budget reserves $350 million for cleanup activities associated with certain tank waste (waste incidental to reprocessing) at the Department of Energy's Idaho National Laboratory (ID), Savannah River (SC), and Hanford (WA) sites. There is currently ongoing litigation that has called into question certain cleanup activities that this money would fund. The Administration's view is that it does not make sense for funds to be made available to move forward on these cleanup activities unless the legal uncertainty is resolved satisfactorily by the successful conclusion of the litigation or by new legislation.

Senate Budget Committee Hearing Qs and As

Corps of Engineers

Senator Domenici: The Corps of Engineers fiscal year 2005 request, if enacted as is, underfunds the Corps so much that I question whether it could be effectively carried out and that it could do its mandated work.

Answer:

The Budget supports a robust program to reduce the construction backlog for the Army Corps of Engineers (Corps) civil works program, both in maintaining existing infrastructure and continuing construction of priority projects throughout the Nation. The proposed program level for the Corps is $4.2 billion. The net discretionary appropriation request of $4.0 billion does not include proposed direct financing of Corps hydropower operation and maintenance expenses, which we expect to result in the completion of a greater number of needed repairs and upgrades of these facilities than were completed in previous years. We have proposed a strong program for the Corps by establishing priorities among water resources projects based upon their net economic or environmental returns.

Senator Domenici: The fiscal year 2005 budget documents relating to the Corps state a concern about the growing construction backlog. Can you explain how if we cut the current construction budget by $300 million we are reducing the current construction backlog for 2005?

Answer:

The Budget focuses on completing those ongoing construction projects that are consistent with current policies and accelerating work on eight high-priority projects. We believe that narrowing the focus on funding and completing a smaller, more beneficial set of projects will bring higher net benefits to the Nation sooner. We need to be careful that we do not continually start new projects and subsequently stretch out the completion of existing ones. That is why the Budget proposes only three new starts of projects that have a very high benefit-to-cost ratio, and does not propose funding for lower-benefit projects and those outside the central Corps mission areas. For example, the enacted FY 2004 Corps appropriation includes $289 million ($334 million before accounting for savings and slippage) for projects that the Budget did not fund. The added projects divert resources from priority ongoing construction efforts, and increase the construction backlog, whereas the Budget's approach would, over time, enable the Corps to complete the most worthy projects more quickly.

Two Surveys of Employment

Senator Allard: Do you have any explanation for the discrepancy in the household figures as opposed to the payroll figures?

Answer:

Everyone who works is either employed by a firm or is self-employed. Therefore, to count the total number of workers, one could ask each person whether he or she is employed, or one could ask each firm how many workers it employs. The Bureau of Labor Statistics, the agency responsible for tracking employment, uses both approaches. When the BLS, through the Census Bureau, asks individuals about their employment status, the results are summarized in the *household survey* of employment. When the BLS asks firms, it produces the *establishment survey* of employment. The Bureau of Labor Statistics has stated that the establishment survey is generally the more reliable indicator of current trends in employment.

Though both surveys ask about employment, they have some important differences that can cause their results to diverge. For example, the establishment survey obtains data from about 160,000 businesses and government agencies that represent about 400,000 worksites and employ over 40 million workers. The sample covers about one-third of all non-farm payroll jobs in America. The household survey, in contrast, collects data from about 60,000 households, thereby directly covering fewer than 100,000 workers. The establishment survey's larger base of respondents means the calculated margin of error of its estimates is significantly smaller than that associated with the household survey estimates. In addition, the establishment survey is revised annually to match complete payroll records from the universe of establishments participating in state unemployment insurance programs, while the household survey is not.

Furthermore, definitional differences affect the scope of employment measured by the surveys. The establishment survey estimate represents the number of payroll jobs, or the number of jobs for which firms pay compensation, while the household survey estimate represents the number of employed persons. Because some people hold more than one job, the total number of payroll jobs can exceed the total number of employed persons. On the other hand, the household survey includes employees working in the agricultural sector, the unincorporated self-employed, unpaid family workers, workers in private households, and workers on unpaid leave from their jobs. The establishment survey excludes all of these categories because they are not reported on the non-farm business payrolls that provide the source data for the survey.

When the two survey estimates are adjusted for these identified differences, the **level** of employment estimated by the two surveys – that is, the number of jobs at any point in time – tends to be similar. The recent issue in question has been the difference in measured employment **change** for the recent past. While long-term trends in the two surveys are similar, over shorter periods of time their trends have sometimes diverged. This was the case over the period from late 2001 until late 2003, when the household survey showed employment growth and the payroll survey showed employment decline. In particular, the establishment survey reported a decline in employment of over 1 million from the end of the recession in November 2001 to August 2003, while the household survey reported an increase of over 1.4 million. In

every month in 2003, the establishment survey showed employment below the November 2001 level, while the household survey showed it above this level.

It has been speculated that one reason for the relative weakness of estimated establishment-based employment growth during the 2001-2003 period is that the survey potentially understates employment growth that comes from the formation of new firms. However, new survey methods put in place in the last few years have likely reduced that vulnerability, and evidence comparing the survey results to the complete count of employment generated by the unemployment insurance system (which is only available with a lag) suggests that this was not a problem during the period of divergence.

Another possible explanation is that the household survey results are overstated because of the way in which the survey results are extrapolated to represent the entire population. Specifically, information from the 2000 Census, together with estimates of how the population is changing over time, are used to determine how many actual U.S. households correspond to each household in the sample. If, for example, immigration has been unexpectedly low because of tighter border controls and the weaker labor market over the past few years, the estimated number of U.S. households corresponding to each household in the sample may be overstated. As a result, the estimates of total employment (and other aggregates based on the population estimates) from the household survey could be too high.

There are other measurement issues that also could have affected the two surveys over the period in question, but are either impossible or difficult to quantify. As examples, BLS knows that some independent contractors are improperly classified in the household survey as wage and salary workers. That limits BLS' ability to reconcile the two surveys fully, as the extent of this problem cannot be measured directly. Similarly, it is quite possible that the weak job market over the period caused some workers to lose payroll jobs and revert to less formal employment which, by definition, could only be picked up by the household survey. Moreover, research indicates that job-to-job turnover declined over the period. That would serve to reduce payroll employment (someone holding two jobs in the same pay period is counted twice in the establishment survey) relative to household employment (where the number of jobs doesn't affect the employment count). While this effect cannot be directly measured, researchers have tried to estimate it.

Both surveys contain valuable information about current economic developments, but, as with all economic statistics, the data from both surveys are imperfect. Still, a complete explanation of why these two surveys' results diverged over the period coming out of the recession is yet to be identified. The Bureau of Labor Statistics, as well as researchers at other institutions, continues to conduct research on the employment change discrepancy issue.

Line Item Veto

Senator Crapo: Among a number of other procedural proposals you are making, one of them is to reinstitute the line-item veto. As we all know that was stricken by the court recently when we tried it last time. How are you proposing to do it differently now to avoid successful court challenges?

Answer:
It has long been recognized that the President has had authority under statutes to decline to spend appropriated funds. However, this delegated authority was curtailed in 1974, when Congress passed the Impoundment Control Act. The Line Item Veto Act of 1996 attempted to return some of that authority, but did so in a manner that a 5-4 majority of the Supreme Court determined was impermissible because it granted the President the "unilateral power to change the text of duly enacted statutes." Clinton v. New York, 524 U.S. 417, 446 (1998).

In striking down the Line Item Veto Act of 1996, the Supreme Court emphasized that the specific mechanism employed by that Act – which gave the President the power to "cancel in whole" specific provisions of law – were the source of the constitutional difficulty. Because, in the Court's view, the 1996 Act allowed the President to permanently and irrevocably prevent an appropriation from having any "legal force or effect," it was tantamount to a unilateral repeal of an enacted statute. By contrast, the majority opinion acknowledged the historical practice whereby Congress has granted the President "wide discretion with respect to both the amounts to be spent and how the money would be allocated among different functions," *id.* (citing authorities). Further, as Justice Scalia noted in dissent in Clinton v. New York, "[h]ad the Line Item Veto Act authorized the President to 'decline to spend' any item of spending contained in the Balanced Budget Act of 1997, there is not the slightest doubt that the authorization would have been constitutional."

The President's proposal for a constitutional line item veto is based on the principle, recognized by both the majority and dissenting opinions in Clinton v. New York, that the President has historically had the power to defer or decline to spend appropriated funds. We believe this could be accomplished through legislation authorizing the President to decline to spend, or defer spending of, amounts appropriated for discretionary budget authority or items of new direct spending. Such deferrals or declinations could be allowed based on a finding by the President, under criteria established by Congress.

THE PRESIDENT'S FISCAL YEAR 2005 BUDGET PROPOSALS

THURSDAY, FEBRUARY 12, 2004

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:03 a.m., in room SD–608, Dirksen Senate Office Building, Hon. Don Nickles (chairman of the committee) presiding.

Present: Senators Nickles, Enzi, Ensign, Sessions, Conrad, Wyden, Byrd, Nelson, and Stabenow.

Staff present: Hazen Marshall, majority staff director; and Stacey Hughes, deputy staff and policy director, Don Dempsey, health policy director.

For the minority: Mary Ann Naylor, staff director; and Jim Esquea, analyst for income security and medicaid.

OPENING STATEMENT OF CHAIRMAN NICKLES

Chairman NICKLES. Good morning. I want to thank everybody for coming, and particularly, Secretary Thompson, we welcome you before this committee.

Everyone, I think, knows Secretary Thompson. Governor Thompson, who was Governor of the great State of Wisconsin for 14 years, has now served 3 years at Secretary of HHS, and he will make his budget presentation to us today.

I notice that your budget is 41 percent of the entire Federal budget. You have enormous responsibilities. I have had the pleasure of working with you both in your previous capacity as Governor and as one of the leading Governors on welfare reform. I compliment you for that monumental task and, frankly, very good success. Because of your leadership and the cooperation of Democrats and Republicans, we passed historic welfare reform. That needs to be reauthorized this year, so we might hear your comments on that.

Also, you have been a very active participant in enacting the Medicare changes, which include the prescription drug proposal. You were very active throughout the conference. I appreciate your leadership on that as well.

We have some big challenges, needless to say. With the scope of your Department being as broad, as large, as comprehensive, as extensive, and as important as it is, I value very much your leadership.

I might tell my colleagues, I mentioned this when Secretary Thompson was testifying before the Finance Committee, but I had

the pleasure of traveling with Secretary Thompson. He led a very large delegation, a very prestigious delegation throughout Africa to not only learn more, but also to assist in the worldwide battle on AIDS. And I compliment you for your leadership in that global fight.

I will recognize my friend and colleague, Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

Welcome, Mr. Secretary.

Secretary THOMPSON. Thank you, Senator.

OPENING STATEMENT SENATOR CONRAD

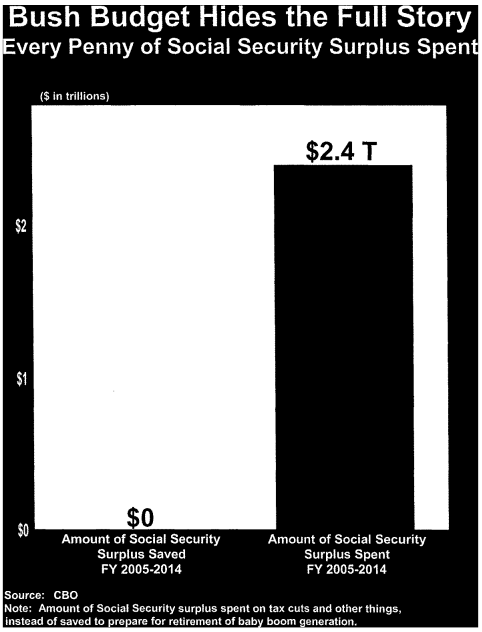
Senator CONRAD. Let me start by talking about the concerns I have about where we are headed with Social Security. I have similar concerns with respect to Medicare, but let me just put up something the President said when he was putting out his 2002 budget. He said that none of the Social Security surplus will be used to fund other spending initiatives or tax relief.

President Bush Promised to Protect Social Security

"None of the Social Security surplus will be used to fund other spending initiatives or tax relief."

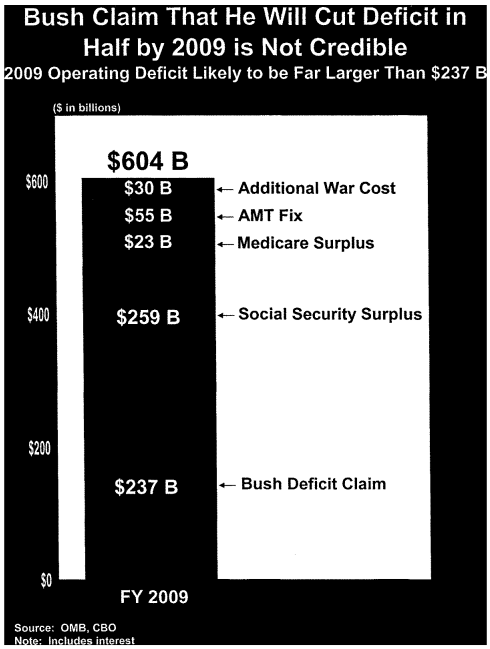
– Excerpt from President Bush's FY 2002 Budget
A Blueprint for New Beginnings

Let's go to the next chart. But that is not what is happening. Despite those words, which were the right words, instead what we see is the President's taking every penny of Social Security surplus to pay for other things, and not just for this year but every year for the next 10 years, $2.4 trillion of Social Security surplus funds. And they are really not surplus. They are surplus for the moment. They are needed for when the baby-boom generation retires. And the President is taking every dime over the next 10 years to pay for other things.



The President is also telling us, telling the American people that he is going to cut the deficit in half over the next 5 years. I wish that were so. But when I examine the President's plans, I see the only way he accomplishes cutting the deficit in half is he just leaves out things. He leaves out the fact that he is going to take in that fifth year $259 billion of Social Security money, every penny of which he has got to pay back, but he is not accounting for that when he claims he cuts the deficit in half. He says the deficit will be $237 billion in that fifth year. But in addition to that, he is taking $259 billion of Social Security money.

He also leaves out the money that he will be taking from the Medicare Trust Fund, $23 billion, also money he has got to pay back. He leaves out the $55 billion he would need in that fifth year to address the alternative minimum tax problem. He funds it in the first year, but the alternative minimum tax that was designed to be a millionaire's tax is turning into a middle-class tax increase. And 3 million people are affected now. By the end of this budget period, 40 million people will be affected. And yet the President provides no funding.



In addition, he provides no funding past September 30th for the war effort. The Congressional Budget Office says that in the fifth year the residual war cost is $30 billion. You add up all those things, and you don't have a deficit or an addition to the debt of $237 billion. You have an addition to the debt of over $600 billion, and right before the baby boomers retire.

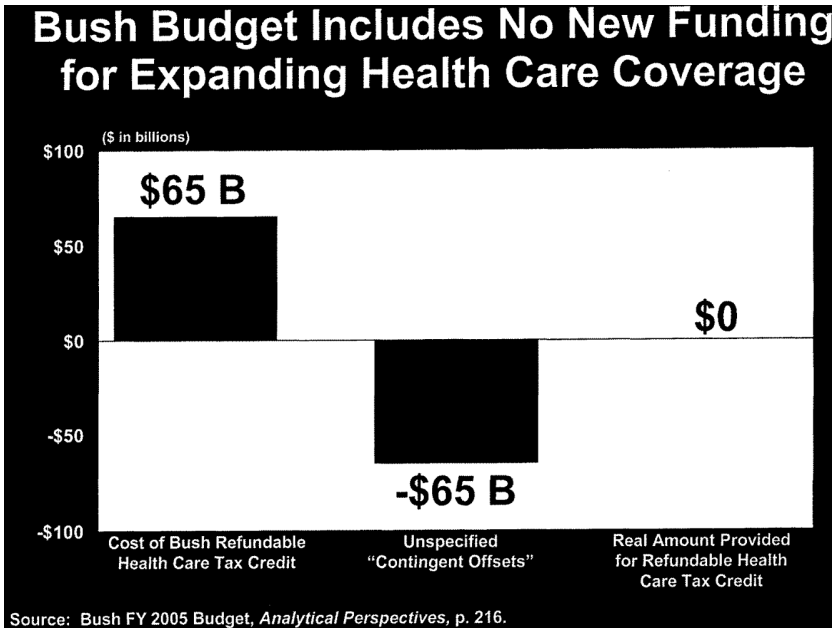
Now, that flows through to this budget as well. And what we have, Mr. Secretary, in the budget that the administration has submitted for your Department is the magic asterisk, the suggestion that there is going to be expansion of health care coverage, but there is no funding for it. It says from the President's Analytical Perspectives: "In the case of the President's proposed health care credit, the budget includes contingent offsets that would cover the estimated increases in mandatory spending that would result from this proposal. When the Congress moves legislation to implement the President's health care credit, the administration will work with the Congress to offset this additional spending."

Bush Budget Hides Cost of Health Care Tax Credit Proposal with "Contingent Offsets"

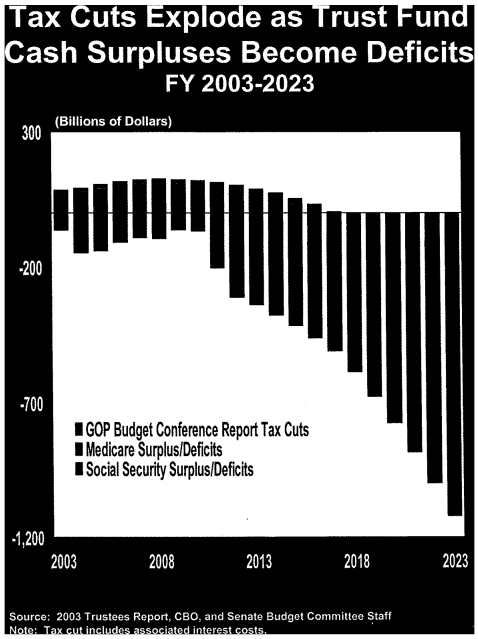
> **"In the case of the President's proposed health care credit, the Budget includes contingent offsets that would cover the estimated increases in mandatory spending that would result from this proposal. When the Congress moves legislation to implement the President's health care credit proposal, the Administration will work with the Congress to offset this additional spending."**
>
> **– Excerpt from President Bush's FY 2005 Budget *Analytical Perspectives,* p. 216.**

Now, Mr. Secretary, you were a Governor, a distinguished Governor, one with a very good reputation for being responsible fiscally. I doubt very much you ever submitted a budget that says you are going to do something and then says we will somehow come up with the money at the time that we move forward. That is not a budget.

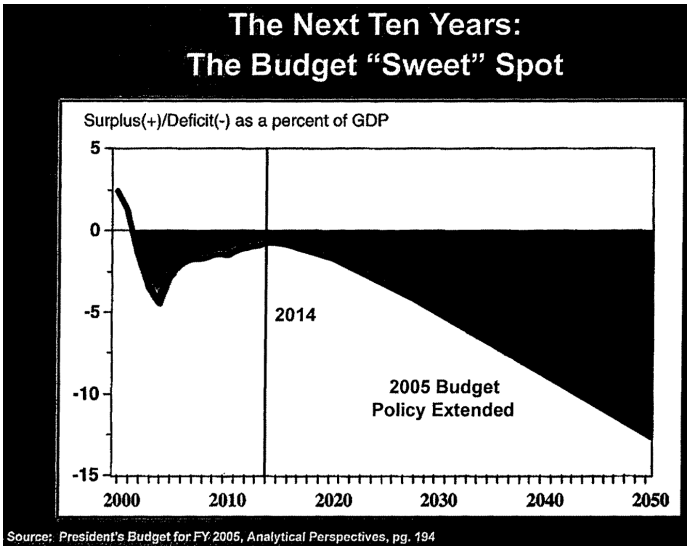
Let me just put up the next one. So what we have is the President advocating a $65 billion cost for a refundable health care tax credit, and he offsets it with nothing. It is just words. And so the real amount provided is zero. That is what is wrong with this whole budget. It is just filled with things where they are just left out. And so then the President says he is cutting the deficit in half. I am surprised he did not make the claim he is balancing the budget and just leave out some more things.



Let's go to the next one. The thing that really concerns me is where we are headed in the long term, because as this chart shows, the green parts of these bars are the Social Security Trust Fund, the blue is the Medicare Trust Fund, the red is the cost of the tax cut proposals by the President. And what we see is right now the trust funds are in substantial surplus, and they are offsetting much of the effect of the tax cuts. But as we go forward, when the trust funds turn cash negative, at that very time the tax cuts explode in cost, driving us right over the fiscal cliff.



And I would conclude with the next chart. This is from the President's own Analytical Perspectives. This is his long-term outlook for the deficit if his tax and spending proposals are adopted. And what it shows is we are in the good times now with the trust funds running substantial cash surpluses. But look what happens when the baby boomers retire and the President's tax cuts go fully into effect: deficits that are massive, unsustainable, and unprecedented. That cannot be the trajectory.



Let me just conclude by making one other point. I was very disturbed to see this campaign that is being run, some $20 million of advertising, which is really a propaganda effort. It is, I think, clearly a political effort to sell the Medicare plan. I voted for that plan, but I think it is totally inappropriate for public money to be spent in a propaganda campaign. That is not an educational campaign. I have read the words of the ads. That is not an educational campaign. It is a political campaign.

And I was even more stunned to learn that the firm who is conducting it is the same firm that is handling the President's re-election account. Now, that just cannot be.

If this isn't stopped—and I will ask the Secretary today to stop this campaign—I will offer legislation to make it illegal for public money to be used in a propaganda campaign about legislation. That is a totally inappropriate use of taxpayer money.

With that, Mr. Chairman, thank you.

Chairman NICKLES. Senator Conrad, thank you very much.

I want to make just a few comments, and then we will turn it over to the Secretary.

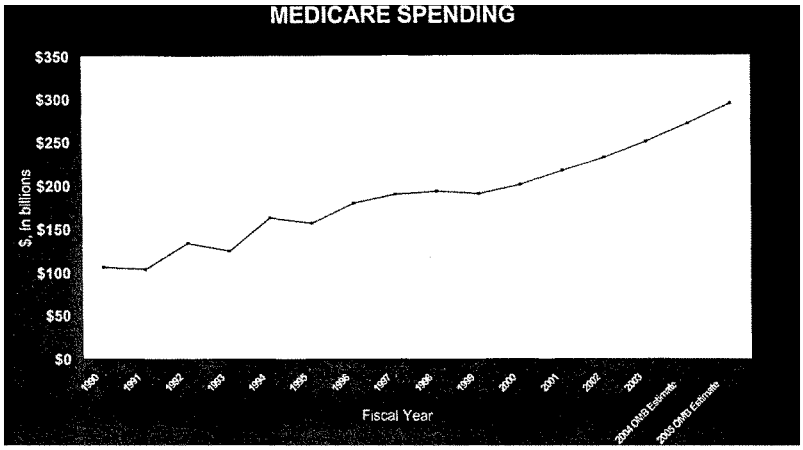
I share many of Senator Conrad's concerns about the long-term sustainability of paying for programs, particularly in Social Security and Medicare. Medicare spending is growing, and growing substantially, and it is going to grow faster now as a result of the legislation we passed last year.

I will also show a couple of charts, but I do have a difference of at least outcome. I am concerned about the long-term health of both, and I might just show a couple of those. That is a chart of Medicare spending. It basically shows that, you know, we were spending, Medicare in 1990, $105 billion, and today it is $271 billion. So that is 2.7 times as much in a period of 14 years. If you look at Medicaid, Medicaid spending, we were spending about $40

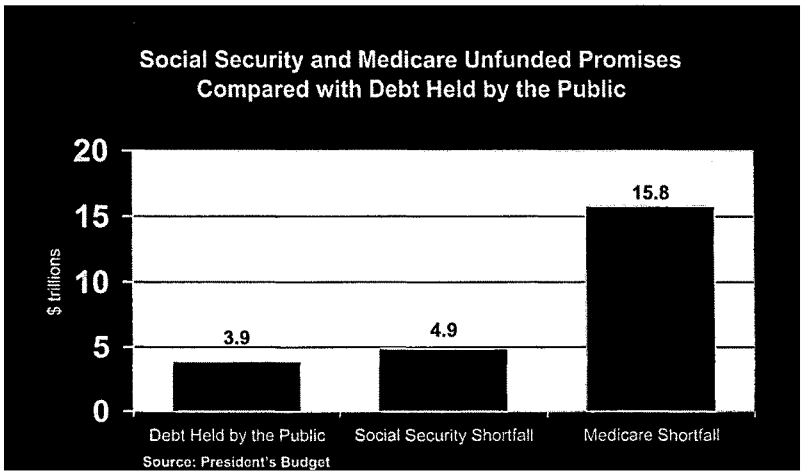
billion in 1990, and today we are spending $180 billion. That is about 4.5 times. An enormous increase in Medicaid.

The unfunded liabilities, if you look at the debt held by the public, it is $3.9 trillion; Social Security shortfall—and this is estimated over a 75-year period of time—is $4.9 trillion; and Medicare is $15.8 trillion. So the unfunded liabilities that we have projected in Medicare are three times as much as they are in Social Security. That is troubling.

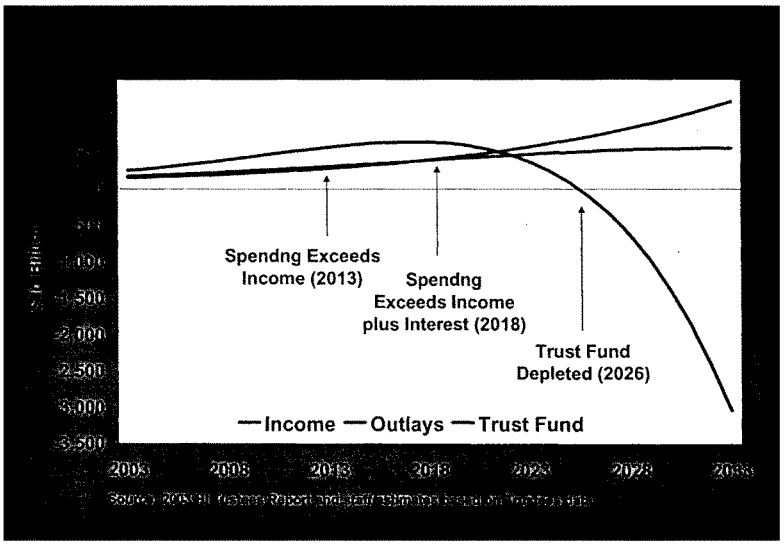
And, incidentally, for our colleagues, we plan on having a hearing where we are really going to get into this in depth. We are going to look at the long-term fiscal challenges that we face in this country and try and figure out if there are some things that can be done or should be done.



Medicare spending is growing and growing substantially. And it's going to grow faster now as a result of the legislation we passed last year. In 1990, we were spending $105 billion, and today it's $271 billion. So that's 2.7 times as much in a period of 14 years. (**Medicaid spending chart) If you look at Medicaid spending, we were spending about $40 billion in 1990. And today we're spending $180. That's about 4.5 times; so an enormous increase in Medicaid.

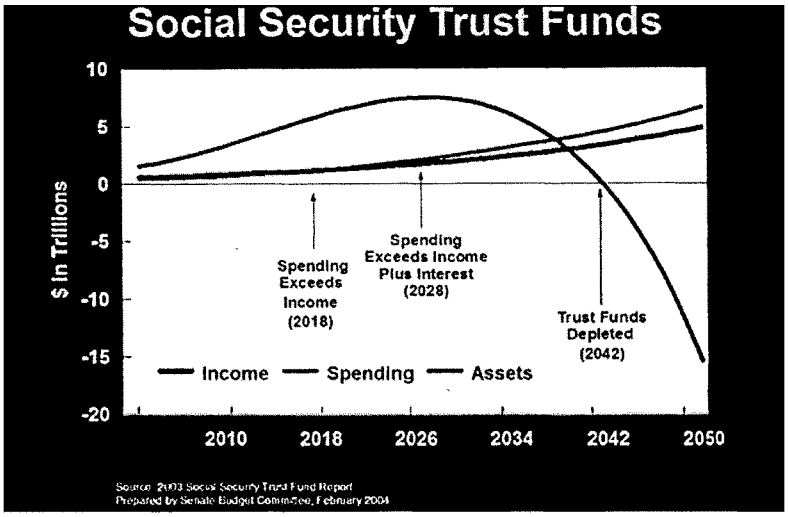


The unfunded liabilities, if you look at the debt held by the public, it's $3.9 trillion. The Social Security shortfall – and this is estimated over a 75-year period of time -- is $4.9 trillion. And Medicare is $15.8 trillion. So Medicare is three times – the unfunded liabilities that we have projected in Medicare are three times as much as they are in Social Security. That's troubling. And incidentally, for our colleagues, we plan on having a hearing that we're really going to get into this in depth. We're going to look at long-term fiscal challenges that we face in this country and try and figure out if there's some things that can be done or should be done.



Just a quick thing on the HI trust fund. That just -- the Medicare HI trust fund -- the trust funds, I think, are a little bogus. And I might talk about that. We're going to have one meeting just on trust funds. But it shows that we have big challenges in the future years. And the secretary is a trustee of that trust fund. So I mention that. Social Security has a chart that looks just like it.

Just a quick chart on the HI trust fund. The Medicaid HI trust fund—the trust funds I think are a little bogus, and I might talk about that. We are going to have one meeting just on trust funds. But it shows that we have big challenges in the future years. And the Secretary is one of the trustees of that trust fund. So I mention that. Social Security has a chart that looks just like it. But I have a difference of my opinion with my colleague, Senator Conrad, on are we raiding the Social Security Trust Funds. I might mention that almost every budget, including the Senator from North Dakota's budget, used Social Security Trust Fund. But people ignore the fact that we use Social Security Trust Funds to pay—or I will say we use Social Security Trust Fund to pay Medicare Part B. General revenue funds subsidize Medicare Part B three to one. Three to one. And I put together a chart—and I will give this to our colleagues so they can see it. All the money coming into Social Security and Medicare is paid for by a payroll tax, Senator Byrd, 15.3 percent of all payroll. And, actually, on Medicare it is 2.9 percent on all payroll. Of the 15.3, 12.4 is Social Security and limited to $87,000, in 2003, of income. And then Medicare is unlimited, 2.9 percent on all payroll.



But I have a difference of opinion with my colleague, Senator Conrad, in are we raiding Social Security trust funds? I might mention that almost every budget, including the senator from North Dakota's budget, used Social Security trust funds. But people ignore the fact that we use Social Security trust funds to pay-- I will say we use Social Security trust funds to pay Part B. General revenue funds subsidize Part B three to one, three to one. And I put together a chart, and I'll give it to our colleagues so they can see it.

SOCIAL SECURITY (OASDI) & MEDICARE (HI & SMI)
Cash Income Compared to Benefits in Billions
CBO March Baseline

FY 1993 to FY 2013	HI - Payroll taxes	HI - tax on SS benefits	SMI premiums	HI premiums	Part D premiums	OASDI payroll taxes	OASDI - Tax on SS benefits	[illegible]	HI benefits	SMI benefits	Part D benefits	OASDI benefits	[illegible]	[illegible]
1993	81	–	15	1	–	312	6	414	91	52	–	302	445	-31
1994	90	2	17	1	–	335	5	450	101	58	–	317	476	-27
1995	96	4	19	1	–	351	6	477	113	64	–	333	510	-33
1996	105	4	19	1	–	368	7	504	124	67	–	347	538	-35
1997	111	4	19	1	–	392	8	535	136	71	–	362	569	-35
1998	120	5	19	1	–	416	10	571	135	75	–	375	585	-14
1999	132	7	20	1	–	445	12	616	129	79	–	386	594	22
2000	136	9	21	1	–	481	12	659	128	87	–	408	623	36
2001	150	5	22	1	–	508	13	699	139	97	–	432	669	30
2002	149	11	24	2	–	515	14	715	145	107	–	454	706	9
2003	147	8	27	2	0	524	13	720	151	122	0	471	743	-23
2004	155	8	30	2	0	545	13	753	163	129	0	492	784	-31
2005	164	9	35	2	0	572	15	797	175	138	1	513	827	-30
2006	173	10	37	2	9	601	17	849	180	140	47	533	901	-52
2007	181	11	39	2	13	629	18	894	193	149	75	559	976	-82
2008	190	13	41	2	14	659	20	939	204	158	84	587	1033	-94
2009	199	14	44	2	16	690	22	987	217	170	92	618	1096	-109
2010	208	16	48	2	17	721	24	1037	230	182	101	653	1167	-130
2011	218	18	52	2	19	753	26	1090	246	199	111	690	1246	-156
2012	227	21	56	3	21	786	31	1145	257	210	123	732	1323	-178
2013	238	23	61	3	23	821	34	1201	276	230	137	776	1421	-220
2014	248	25	65	3	26	858	37	1261	295	248	153	827	1523	-262

Source: Senate Budget Committee

All the money coming into Social Security and Medicare is paid for by payroll tax, Senator Byrd, 15.3 percent of all payroll. And actually on Medicare, it's 2.9 percent on all payroll;15.3 of the Social Security. The 12.4 percent is limited to --what?-- $86,000 or whatever that level is. And then Medicare Is unlimited, 2.9 percent on all payroll. So this chart is busy. It's complicated. But it shows all of the money coming in from taxes, including the tax on Social Security and Medicare -- so the receipts coming into the fund, and the outlays coming out of the fund to pay Medicare and Social Security. And actually, the government, if you could say, is raiding Social Security, it's raiding Social Security to pay Part B premiums. And it will be raiding Social Security to pay Part D, to pay the prescription drug benefit. It actually shows that more money is going out for these two programs than coming in.

And so we're not raiding Social Security to pay for defense or to pay for non-defense. It's basically used to pay for Medicare. And the two combined, if you add all of the taxes combined in coming in -- and just give you one outlay year for '04, projector, or maybe I could use '03 because it would be actual -- I'll use '04 -- the total amount of money coming in is $753 billion. And the total amount of money going out is $784 billion, for basically a deficit of $31 billion.

So I just make that point. I think there's a lot of misunderstanding on trust funds. And maybe we can have a more thorough debate. That's not the purpose of the hearing today. Our purpose today is to welcome Secretary Thompson, since he has control or responsibility over 41 percent of the budget and a very significant growing part of the budget. I believe his proposal is for a 5.6 percent increase in his total domain. We look forward to hearing him present their budget to us. I might mention, Senator Byrd,

So this chart is busy, and I will give it to my collegues—this is not for people to read. It is complicated, but it shows all the money coming in from taxes, including the tax on Social Security and Medicare, so the receipts coming into the fund and the outlays coming out of the fund to pay Medicare and Social Security. And, actually, the Government, if you could say it is raiding Social Security, it is raiding Social Security to pay Medicare Part B premiums. And it will be raiding Social Security to pay Part B, and to pay the prescription drug benefits. It actually shows that more money is going out for these two programs than coming in. And so we are not raiding Social Security to pay for defense or to pay for non-defense. It is basically used to pay for Medicare.

The two combined, if you add all the taxes combined coming in—and I will just give you one outlay year for 2004, projected, or maybe I could use 2003 because it would be actual, but I will use 2004. Total amount of money coming in is $753 billion, and the total amount of money going out is $784 billion, for basically a deficit of $31 billion.

So I just make that point. I think there is a lot of misunderstanding on trust funds, and maybe we have a more thorough debate. That is not the purpose of the hearing today. Our purpose today is to welcome Secretary Thompson since he has control or responsibility over 41 percent of the budget and a very significantly growing part of the budget. I believe his proposal is for a 5.6-percent increase in his total domain. We look forward to hearing him present the budget to us.

I might mention, Senator Byrd, most all of Secretary Thompson's growth is in entitlement programs. Very little is on discretionary. Mr. Secretary and Senator Byrd, I would be very interested, since we only appropriate about one-third of the budget, I would be very interested in seeing if some of these programs that are already set on automatic pilot as entitlements, maybe they should be considered and scored and written as discretionary subject to appropriations. I used to be on the Appropriations Committee. I used to be very chagrined, feeling that we only had one-third of the budget under real control and the other two-thirds growing almost out of control.

This committee can work with the Finance Committee to control the two-thirds. But a lot of that control has been growing the programs, not controlling them. Maybe we will take a little different approach this year in light of the deficit challenges that we have. But there are a lot of programs in your domain, and maybe some of those should be subject to appropriation, instead of set up as entitlement.

I am happy to consider those, either as part of the budget resolution or as changes that we might want to make free-standing, either through budget and/or the appropriations process. We have members on both committees on this committee, and maybe with some cooperation we could make some adjustments.

Mr. Secretary, welcome to the committee.

STATEMENT OF HON. TOMMY G. THOMPSON, SECRETARY, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Secretary THOMPSON. Thank you, Mr. Chairman. It is an honor for me to appear in front of you and, Senator Conrad and the other distinguished members of this Budget Committee.

First, let me thank you, Senator Nickles, for going to Africa with me. I think it was one of those life-transforming trips. It was for me, and I think for most of the people on the trip, and I appreciate your participation.

I thank all of you for inviting me to discuss the President's fiscal year 2005 budget for the Department of Health and Human Services. In my first 3 years at the Department, we have made, I believe, tremendous progress in improving the health, the safety, and the independence of the American people. We continue to advance in providing health care to seniors and to lower-income Americans and improving the well-being of children and strengthening families and protecting the homeland. We are building a new public health infrastructure to give doctors and hospitals the tools they need to be able to respond to any public health emergency.

We have re-energized the fight against AIDS at home and abroad. We increased access to quality health care, especially for minorities, the uninsured, and the underinsured. And with your help, 2 months ago President Bush signed the most comprehensive improvements to Medicare since it was created nearly four decades ago.

To expand on our achievements, the President proposes $580 billion for HHS for fiscal year 2005, an increase of $32 billion, or 6 percent over fiscal year 2004. Our discretionary budget authority is $67 billion, an increase of $819 million, or 1.2 percent over fiscal year 2004, but an increase of 26 percent since 2001.

We look forward to working with this committee and Governors to improve and modernize Medicaid as well as SCHIP and by giving State governments flexibility to use consumer-directed services and to coordinate with free-market providers.

We propose promoting home and community-based care as an alternative to institutionalization for disabled Americans through the President's New Freedom Initiative which my Department worked on for several months. I look forward to working on a bipartisan basis to get this important legislation introduced, passed, and signed into law this year.

President Bush seeks to build on the success of the 1996 welfare reform law by reauthorizing the successful TANF program to help more welfare recipients achieve independence through work and be able to protect children and strengthen families. I hope that this Congress will take the next step in welfare reform and complete the TANF reauthorization. We can and we should accomplish this critical goal this year.

We are also working to protect our most vulnerable children. The Federal Government will spend nearly $5 billion this year for foster care. We would fund existing adoption bonuses as well as the new bonuses that Congress approved last year for older children, with $35 million for 2004 and $32 million for 2005, and to be able to support our commitment to helping families in crisis and to protecting children from abuse and neglect, President Bush has re-

quested full funding, $505 million, for the promotion of the Safe and Stable Families Program.

Working with Governors, we have made tremendous progress in providing millions of children with needed health coverage. I am delighted to announce today that about 5.3 million children who would not have had health coverage were enrolled in the State Children's Health Insurance Program at some point during 2003, a 9-percent increase from 2002. And over the past 3 years, we have approved Medicaid waivers and State plan amendments to allow the States to expand access to health coverage for more than 2.6 million people and to expand the range of benefits offered to 6.5 million other Americans.

And, of course, the new Medicare Modernization Act is a significant accomplishment for our Department. Adding these benefits and choices and educating seniors about them will be a significant challenge. You and your fellow lawmakers were right to follow the CBO score in making decisions, and when CBO scores the budget we submitted last week, it is going to be and we expect and anticipate that their estimate would reflect their original score of $395 billion, or close to that number.

As you know by now, in late December—December 24th, to be exact—our actuaries came out with a final score showing they believe the Medicare bill will cost $534 billion. I thought it might be helpful to break down the differences between the CBO projections and the HHS projections to explain why we differ by $139 billion. I have instructed our actuaries to make it a top priority to fully examine why their estimates differ from those set forth by the Congressional Budget Office and then to begin to work to reconcile those differences. That project is just beginning, but here is what we know so far.

A hundred billion dollars, all those in blue, are the difference for what we call the Title I or Title D of the Medicare Modernization Act, Chapter 1 of the Act. The first one is the eligibility. We learned from our actuaries because of the tremendous benefits for low-income Americans, which the total is about 11 million people—and you have talked about that in the conference committee, Senator Nickles. We believe that more low-income Americans will participate and will use the subsidies to a larger degree than what CBO says, and that accounts for $47 billion of difference.

The next one is higher participation, totaling $32 billion. This is for those individuals, 100 percent of the universe, all those that are eligible to participate in Part D. CBO believes that because 9 percent of those individuals do not participate in Part B, if they don't participate in Part B, more than likely they will not participate in Part D. So that reduces the universe down to 91 percent. Then they subtracted an additional 4 percent and saying only 87 percent, according to their calculations, will avail themselves of Part D, the drug benefit. Our actuaries——

Chairman NICKLES. You estimate what percent will participate?

Secretary THOMPSON. They believe 87 percent.

Chairman NICKLES. And you believe?

Secretary THOMPSON. We believe 94. Our universe is 100 percent. We believe that 5 percent are still actively employed and will be insured by their employers, and our actuaries believe it will be

94. The difference between 94 and 87 percent is a difference of $32 billion.

The next one is what we call the Medicaid savings and woodwork effect. We believe that is a difference of $18 billion. We believe that when people come and hear about the Part D, they are going to also find out that they are also eligible for additional Medicaid benefits, and they also will be using more of that, and, therefore, there is a difference of $18 billion.

The next one is $3 billion. That is in regards to what we call the stabilization fund. CBO does not believe it will be utilized, our actuaries do, and that's a difference of $3 billion. That is $100 billion of Part D. The second one is the plan. That is Chapter 2 of the Medicare Modernization Act. We believe that there will be 33 percent of the Medicare eligibles that will participate in the plan, and right now it is 11.8 percent. CBO believes that is going to go up to 14 percent, and only 14 percent. That difference is a huge difference, and that makes up $30 billion.

The other $7 billion is basically all differences in the other ten chapters in the Medicare Modernization due to some pluses and some minuses, but a total difference of $7 billion. That is the total of the $139 billion.

As you know, Mr. Chairman, seniors can begin enrolling in the drug discount card by June of this year. We will add transparency to the prescription drug market by making available the price of drugs under each card. Competition among the cards will drive down drug prices, probably very significantly, as people compare the prices that each card offers for the drugs they typically take. So a senior citizen, let's call her Mrs. Jones, can sit down with all of her prescriptions in front of her and call 1-800-Medicare. Our representatives will review with Mrs. Jones the discount cards in her area and tell her the exact price that she will pay for her prescriptions under each card. Mrs. Jones then can choose the card that will give her the best deal for the prescriptions that she is taking. If Mrs. Jones has a computer, she will be able to go to our website and get the exact same information.

We are also currently reviewing the new benefit proposals which were submitted by health plans. It appears that more than half of current enrollees that are currently on the health plans will see better benefits and that almost one-half will see reduced premiums or out-of-pocket savings. The average premium may decrease by as much as a third. The bottom line is that the extra payments are providing more to beneficiaries, just as was intended by the Medicare Modernization Act.

We look forward to working with Congress, the medical community, and all Americans as we implement the new Medicare law and carry out the initiatives that President Bush is proposing to build a healthier, safer, and stronger America.

Thank you very much, Mr. Chairman.

Chairman NICKLES. Secretary Thompson, thank you very much. I appreciate your going over the differences between CBO and CMS on the cost of that. Some people were aware that there was a significant difference. Others were not. Some were surprised. And so I was going to ask you to do that. I appreciate your doing that.

Let me ask you a couple of quick questions. You mentioned the drug card is a new benefit, passed under the bill. That is going to begin in June?

Secretary THOMPSON. That is correct.

Chairman NICKLES. That is going to be provided for by private companies; is that correct?

Secretary THOMPSON. That is correct.

Chairman NICKLES. Is there interest from private companies? What is this looking like? Is it going to happen?

Secretary THOMPSON. We were absolutely amazed. We thought there would probably be 40 to 50, possibly 60 applications. There are 106 applications. We have them, we are now reviewing them, and we will be making recommendations by March 23rd as to which ones of those we feel are going to meet the requirements set out by the law and also the requirements set out by CMS. And we will make those known. We will also start putting the information out so we can start enrolling in April and May, and we will also put on our website a comparison so that individuals across America will be able to really have the most up-to-date, accurate information, transparent information, on every drug that is being purchased. And this is going to help a senior pick the right card, and it should drive down the cost of drugs for seniors very much.

Chairman NICKLES. So all seniors will be able to enroll in May and June?

Secretary THOMPSON. That is correct. We want to kick it off on June 1st.

Chairman NICKLES. By June 1st, so they would be able to enroll April and May?

Secretary THOMPSON. We are going to start enrolling in May.

Chairman NICKLES. OK. And then——

Secretary THOMPSON. I am trying to push that up, though. We are moving very rapidly, and we are hoping to actually get it out sooner. But that is what our intention is right now.

Chairman NICKLES. Then will the various providers determine what kind of discount they will receive? And will all seniors receive the discount?

Secretary THOMPSON. All the companies will be negotiating with the pharmaceutical companies and will be putting those discounts out to a formulary, and those formularies will be made available to every senior in America. We will be putting it on our website, and our representatives will have the most up-to-date information. And you will be able to compare the cards in your area. So if you are taking Lipitor, and if you have 15 cards in your area, you will be able to determine which individual issuer of that card is going to give you the best price for Lipitor. And so as with competition, it is going to drive down the market and give the best market to the seniors.

Chairman NICKLES. And then low-income seniors have—the card also entitles them to a $600 benefit?

Secretary THOMPSON. We are already working on that. We are working with Treasury and Social Security. We are meshing together the computer systems from Treasury, from the Social Security Department, and CMS, plus all the States. All those individual States that have individuals on Medicaid, we have to take in and

go through all of those computer runs to find out who is eligible. Every senior that is under 135 percent of poverty is going to be able to get a credit of $600.

Chairman NICKLES. OK. Then one final thing. A large part of the difference in the estimates between your Department, CMS actuaries, and CBO is the value of the low-income drug benefit, which I stated unsuccessfully during negotiations, was too generous. But would you give just a brief description of that? Am I correct in saying the low-income benefit, this would be for people with—I want to say 36 percent of Medicare beneficiaries, but people less than 150 percent of poverty, and for those less than 100 percent of poverty, basically their copay is $1 and $3. Is that correct?

Secretary THOMPSON. That is the only out-of-pocket expense they have to pay. The deductible will be waived. The doughnut hole is going to be waived and the copays, except for the $1 for generics and $3 for brand prescription drugs. That is all those under 100 percent of poverty will have to pay. We believe that is going to be a subsidy of somewhere in the neighborhood of 95 percent to 97 percent of those individuals under 100 percent.

Those between 100 and 135 percent of poverty, the copay is the only thing they have to pay, and it will be $2 for generic drugs and $5 for brand prescription drugs. They will not have to pay a deductible, and they do not have the doughnut hole.

The third one is those between 135 percent and 150 percent of poverty will have to pay a $50 deductible, and they will pay approximately 85 percent of the balance. And that is going to be a subsidy of somewhere around 75 to 80 to 85 percent.

Chairman NICKLES. I am familiar with what you are saying when you say there is not a doughnut hole. But basically, for an audience——

Secretary THOMPSON. All those under 150 percent of poverty, there is no doughnut hole, no gap between 2,250 and 3,600 dollars, where those above 150 percent of poverty will have a gap in which they will have to pay 100 percent. All those below 150 percent of poverty, all that doughnut hole has been filled up completely.

Chairman NICKLES. OK. Still, to get out of Washington vernacular and Washington discussion, those below 150 percent of poverty—and that would be for a couple—would be, what, about $20,000, $19,000?

Secretary THOMPSON. It is approximately $22,000.

Chairman NICKLES. Wherever that is, that sounds a little high. But at that point——

Secretary THOMPSON. That is the last—it would be about $14,000, 150 percent of poverty.

Chairman NICKLES. I think it is pretty close to $19,000, is my guess. I was talking about couples, for two.

Secretary THOMPSON. It is $20,000 for a couple. It will be $20,000 for a couple in 2006, Senator.

Chairman NICKLES. So in the year 2006, for a couple that has less than——

Secretary THOMPSON. When it starts.

Chairman NICKLES. Oh, that is correct. I was looking at the 2003 level. I think you are correct. It would be $22,000 by the year 2006 when that is available. So for a couple with less income than that,

they are on Medicare, they are on Social Security, they will basically have a drug program that they don't even have to pay monthly premiums. For the most part, they would be paying their drug copay of maybe $2, $5, or $1 and $3. And that is all they pay with no limit.

Secretary THOMPSON. That is correct.

Chairman NICKLES. No limit.

Secretary THOMPSON. That is correct.

Chairman NICKLES. Not up just to the first $2,000, not up just to the first $5,000, but, frankly, no limit whatsoever. And that is a very generous benefit. You happen to score it higher than CBO does. I happen to guess that you are going to be more correct. I think utilization will go up substantially when people realize that is a very, very generous proposal.

Secretary THOMPSON. It is.

Chairman NICKLES. I am a little concerned maybe it is too generous, but I did not prevail. I tried but I did not prevail.

Senator Conrad.

Senator CONRAD. Mr. Chairman, could we put up this chart that you put up?

Chairman NICKLES. Yes. Don't take apart my chart.

Senator CONRAD. Well, I have to take apart your chart a little bit.

The chairman put up this chart, and the issue that I take with this chart is what it has done is it has lumped Medicare and Social Security together as though they are one program. They are not one program. They are two separate programs.

There is no question, if you look at Social Security alone, that Social Security surplus funds every year for the next 10 years are being taken to pay for other things, $2.4 trillion worth, something the President pledged not to do. And it is being done. And nobody here can say whether that money is going to pay for Medicare or tax cuts or parks or recreation or any other part of the Federal budget.

What we do know absolutely is every penny of Social Security Trust Fund surplus—and I want to make sure that people understand. When I use the word "surplus," it is not because it is more money than you need. It is more money than you need right now. But it is money we are going to need when the baby boomers retire, and they are going to start retiring in 2008. And this is right at the heart of what is wrong with the President's budget in my judgment.

The fact is Medicare has been funded in part by payroll taxes. This chart assumes it is all payroll taxes. Medicare has also been funded in part by general fund. That has been the way Medicare has been funded since its inception.

So I do not want to leave the impression that somehow Social Security money is being taken just to pay for Medicare. Nobody can tell you what the Social Security money is being used for, except we know it is not being used for paying down the debt or prepaying the liability. I think those would have been appropriate uses.

With respect to budgets that I have submitted, after the hole that has been dug, there is no way in the short term to write a budget that does not continue this practice. But I have submitted

budgets that would use at least $1.2 trillion less of Social Security funds for other purposes, and as much as $1.6 trillion left, depending on our defense needs.

So I do not want to leave the impression that Social Security money is not being taken for other purposes. It is, and it is going to be taken to the tune of $2.4 trillion. I think that is a profound mistake.

Mr. Secretary, I want to turn to this ad campaign because, I must say, I find it very troubling. I supported that bill. I thought it was the right thing to do. But I do not think it is the right thing to do to run an ad campaign extolling its virtues using taxpayer money to run, in effect, a political campaign. And I was especially disturbed to find out that the firm that has been hired is also doing work for the President's re-election campaign.

You know, I do not think taxpayer money should be used to promote a political agenda. I do not think taxpayer money ought to be used to, in essence, propagandize taxpayers about the merits of a program. I mean, I could not use and would not use my Senate budget to go out and run a campaign telling people about how good my voting record is. That would be illegal. And I believe it should be illegal for taxpayer funds to be used to sell a position on an issue. I just think that is totally inappropriate. I suspect it is illegal.

And I want to ask the Secretary: Do you intend to continue with this campaign? Or would you consider ending this campaign in respect to those who believe it is just inappropriate?

Secretary THOMPSON. Senator, let me correct some impressions that I think are erroneous.

First off, the Medicare bill requires me to do certain things. The conferees expect—and this is direct language out of the report. The conferees expect, in carrying out the annual dissemination of information requirements, that the Secretary will conduct a significant public information campaign to educate beneficiaries about the new Medicare drug benefit to ensure the broad dissemination of accurate and timely information.

Second, we put out an RFP in 2003 in order to find out—in 2003, in order to find the best person and the best group to do our ad programs for Medicare, in 2003, 2004, and that is what we did.

Senator CONRAD. Who is doing the ads?

Secretary THOMPSON. Ketchum Public Relations, since 2003, is still doing them. The chief executive of Ketchum Public Relations is Chuck Dolan, who is part of the team. They are the overall contractor, and Mr. Chuck Dolan is a financial supporter of John Kerry and is one of his biggest supporters. John Kerry. He is the chief—that is the chief person. They put together the subcontractors. The subcontractors are Campbell Ewald. They did the creative work. They are out of Detroit. They have done all of our ads since 2001. And Ketchum Public Relations, who won the RFP in 2003, kept them on. They do the creative work. National Media, which is the one you are talking about, are the subcontractors. They have been purchasing for CMS since 2001. Ketchum Public Relations kept National Media because they worked together.

Senator CONRAD. Is National Media doing the President's campaign or part of the President's campaign?

Secretary THOMPSON. I understand that they are, but they have been doing work at CMS since 2001, and they were retained by Ketchum Public Relations, who won the contract, and I am telling you that. And then they——

Senator CONRAD. But do you know how bad that looks, honestly? I mean, I am being very direct with you. I have great respect for you. I tell you, that really looks bad. And I think it more than looks bad. I think it is bad for a campaign to be run with taxpayer money to promote a program that has enormous political implications and to use as a major part of that campaign a firm that is helping to run the President's re-election campaign.

Secretary THOMPSON. If I could just finish. National Media is not doing the creative work. All they are doing is purchasing it. And they were hired by Ketchum Public Relations, and one of the chief individuals happens to be Chuck Dolan, who is a Democrat who is supporting John Kerry.

Senator CONRAD. Well, I am for taking the money away from both of them. I tell you——

Secretary THOMPSON. Some Republicans are saying that, you know, we are wrong for having Chuck Dolan do it, I am sure. But——

Senator CONRAD. Well, let me join them. I think you are wrong doing it at all. I think we ought to stop this. I think we ought to stop using public money, taxpayer money, to run what has all the earmarks of a political campaign. I have read the—and I have it here, the TV ad script. I must say, I saw this TV ad. I never knew about this campaign until I saw the television ad. And it reads like a political ad. It is just inappropriate to use public money to do that. And if you guys are not going to stop it, then I am going to introduce legislation to make it illegal to do it, because it is not right. It would not be right if a Democratic administration were doing it, and it is not right with this administration doing it.

Secretary THOMPSON. Senator, I would like to be able to respond. I do not want to argue with you. I understand your concerns. I am telling you, the law requires me to put out information. In 1996——

Senator CONRAD. Well, wait a minute. The law does not require to run——

Secretary THOMPSON. Well, let me finish——

Senator CONRAD. No, let me just say, the law does not require to run television spots that read like political spots. Now, the law does not require that.

Secretary THOMPSON. In 1996, the Democrat administration put out a 30-page bulletin——

Senator CONRAD. Did they run television ads that are television spots?

Secretary THOMPSON. They did not, but they——

Senator CONRAD. I tell you, I do not argue with putting out written material like that. That is fine. This has all the earmarks of a political campaign, and it is not right.

Secretary THOMPSON. Well, GAO, as I understand it, is going to review it, and if they say that it is political, it will be pulled immediately. Maybe for the GAO——

Senator CONRAD. I would not wait for somebody else to tell me it is political. I can see it is political——

Secretary THOMPSON. I do not think it is political.

Senator CONRAD. Well, I do, and I tell you something——

Secretary THOMPSON. That is a difference of opinion, Senator.

Senator CONRAD [continuing]. If you guys—well, I tell you, I have been in a lot of political campaigns, as have you——

Secretary THOMPSON. And so have I.

Senator CONRAD. This reads like a political spot.

Secretary THOMPSON. Well, I am sorry to tell you, I do not believe it is political at all, and that is a difference of opinion. I did not put it out. Creative people did on a contract basis. It was reviewed by a lot of different people. They came back, and we are obligated, I think, under the law to do as much information as possible.

Senator CONRAD. Well——

Secretary THOMPSON. And I am sorry that you feel that it is political. I do not believe it is.

Senator CONRAD. I not only——

Secretary THOMPSON. And I do not believe that Chuck Dolan would put out a political statement when he is in charge of the responsibility of putting out the ad.

Senator CONRAD. Well, he is under contract to do something.

Look, there is nothing in the law that requires you to run what are, in effect—look just like a political spot to me and have hired, whether it is a subcontractor or the contractor, people who are helping run the President's campaign.

Now, goodness, if that does not smack of inappropriate use of taxpayer money, I do not know what would.

Secretary THOMPSON. I am absolutely sorry that you feel that way. This was a contract that was put out in 2003, a long time before the election ever started, the one that——

Senator CONRAD. Well, but it is for the election period. We are in an election period right now, and these ads are running now, and these ads are equivalent to political ads in my judgment. And now it goes even further. The people who are helping do it are involved in the re-election campaign of the President. That is wrong. It is inappropriate and it ought to stop. And I am going to offer legislation to make it illegal to do so under whatever administration. I tell you, it would be wrong if a Democratic administration were doing it. It is wrong for this administration to be doing it.

Chairman NICKLES. Senator Conrad, thank you very much. The statute, just looking at it, doesn't say whether it should be TV or not. It just says, "The Secretary shall provide for activities under this subsection to broadly disseminate information to discount card eligible individuals and prospective individuals regarding enrollment."

I mention, one of the reasons why my opening comments on the card and the low-income benefit, one, because a lot of people are not aware of the fact this card is a benefit that is coming in a couple months. And so I want to get that information out. I was using the hearing to do it.

But this is a benefit that is going to be available to 40 million Americans, and a lot of them are not aware of it. And so we have

to get it out. This did not say what method, and obviously you are certainly entitled to your opinion. You are entitled to your right to offer amendments.

Next we have Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman, for having this hearing and, Mr. Secretary, for coming. I have had my curiosity piqued a little bit. Are you just using television for the ads or are the other media being used as well?

Secretary THOMPSON. We are sending out a mailer. We are putting out other information. We are putting it out in other languages so that we get to other communities that do not have English as the first language. And we have set up programs with the Aging Commission called SHIPs, and we are doubling the number of individuals in SHIPs, which two-thirds of those come from the Commission on Aging, which are going out and helping individuals in their own homes or in senior centers to pick the best card.

We are forming an organization with 28 different associations that have been over to meet with me that are going to be using their organizational strength, including AARP who was one of those, to get the information out to seniors all across America. So we are hitting this with a whole plethora of different groups, different ways to contact seniors to tell them about the Medicare changes as well as the new drug card that is coming.

Senator ENZI. So I anticipate then that the expenditures are approximately in proportion to where people get their information, and probably a large amount of seniors get theirs from television.

Secretary THOMPSON. That is true, and actually we are spending more on mailers than we are on television.

Senator ENZI. Thank you. I appreciate the job that is being done on that. I think that it is important for seniors to get information about what this program is. I know that there are a lot of misconceptions out there; probably many of them came from our debate.

Secretary THOMPSON. That is true.

Senator ENZI. And the debates where we argue about the 20 percent that we are never going to agree on, and there is some confusion out there, so I appreciate your taking some efforts on that.

Along those lines, I guess, on the new Medicare prescription drug law, there is $1 billion for spending to startup the administrative costs. And I was kind of curious. I assume—we have already talked a little bit about how those are being spent, what those are being spent for, but I am just as curious as to why that has been decided to be counted as discretionary spending instead of mandatory spending.

Secretary THOMPSON. It always has been the tradition that administrative costs have been on the discretionary side of the budget. The $1 billion is—we had requested more because we believe this is going to be a huge, monumental thing.

Our computers systems, I just would like to point this out. Some of our software is older than the technicians that are hired to maintain it. We have software that is running some of the Medicare program that is over 30 years old, and from your vast experience before you became a Senator, you know how difficult it is to

run a large company—and this is the largest insurance company in the world, 42 million subscribers—with 30-year-old software.

So we have to upgrade our computers. We also have to collaborate with the computers with Treasury, with the State Medicaid programs, and with Social Security in order to find out the low-income recipients.

We are also taking over the Medicaid program as far as drugs are concerned. It is a huge undertaking. And so we also have to get people, contractors and vendors, involved. And it is going to be a tremendous undertaking by the Department in order to implement all the provisions of the bill and make sure that it is up and running on January 1, 2006, for the drug portion. But before that, in 2005, we have to set up the programs for the free induction physical for those people that are coming in, which I think is maybe the most important part of the Medicare bill, as far as prevention is concerned and managing diseases. And then we have to have the card up and running by June 1st of this year.

A huge undertaking from my Department, and that is where the bulk of the $1 billion is going to go, for staffing, for computers, for contracting out, for getting all the computers to run successfully and be able to intermingle and have interoperability.

Senator ENZI. I appreciate that. Could you provide me with a breakdown of——

Secretary THOMPSON. Absolutely. But we have not——

Senator ENZI [continuing]. Anticipated and also the additional needs that you mentioned?

Secretary THOMPSON. Thank you very much. The computer system is really—when I came in, we had over 200 different computer systems in the Department. And now we are trying to get it down to one computer system.

Senator ENZI. I appreciate that. It sounds like you are doing some good management there.

Now, one other, what I hope will be a quick question. In rural places like Wyoming, the choices in health service providers are limited. On Indian reservations, the health service selection is even more limited, and they have to contract off the reservation sometimes in order to have, particularly for emergency purposes, health care for those on the reservation. And despite this common use of contract health services at both hospitals, IHS does not always adequately or evenly supply doctors in those areas. So it is my understanding the problem is both fiscal and administrative.

I am pleased that the HHS budget begins to address this fiscal problem, increasing the contract health services by $18 million. But I am wondering whether or not IHS plans to review the management policies of doctors to ensure that the Native Americans have equal access to quality care hospitals serving large populations.

Secretary THOMPSON. We are reviewing all of the Indian Health Service programs and projects, and one of the biggest problems we have is being able to get enough medical personnel to be able to go to areas that are hard to get individuals to go into. Indian reservations in some areas of the country have a real serious problem of getting the proper medical people there, and we are expanding the National Health Service Corps so that we can get more people,

use the service portion and get more doctors and nurses to go to Indian reservations throughout.

This is a high priority of the Indian Health Service, and especially a high priority of mine because I travel to a lot of Indian reservations, see the tremendous need. I go every year to Alaska and tour the Alaskan settlements up there, and I know the tremendous problem we have of getting proper medical treatment but, more importantly, proper medical personnel to these underserved area.

Senator ENZI. Thank you very much. My time is up.

Chairman NICKLES. Senator Enzi, thank you very much.

Senator Wyden.

Senator WYDEN. Mr. Chairman, just a clarification. These are 10-minute rounds?

Chairman NICKLES. I have asked people to try and limit it to 5 or 6 minutes, 7 minutes, but I have not been strict in enforcement.

Senator WYDEN. OK. Mr. Secretary, Senator Snowe and I have introduced the first bipartisan effort to try to address some of the concerns in the prescription drug bill. Our legislation, for example, does exactly what AARP has called for. You just invoked them. The Snowe-Wyden legislation makes sure that the Department has adequate authority to negotiate to try to get the best deal on prices for seniors, and addresses the reimportation issue.

I am not going to ask you to address the merits of this bill and to announce your position on it, but I would like your views on one key point. Given the fact that we have these two projections out there with respect to the cost of the bill, the CBO appraisal and your actuaries' appraisal, wouldn't it make sense to try to work immediately to get the maximum amount of cost containment that we can so as to not hit that $530 billion-plus level or possibly exceed it? In other words, I think there was a good case for the Snowe-Wyden bill a month ago, but I think there is an even better case today. So I would like your views on the question of: Wouldn't it make sense to work right now to try to push additional cost containment so as to not hit that $534 billion spending level?

Secretary THOMPSON. Without a doubt. I think every one of us, Democrats, Independents, Republicans, have to take a look at how we are going to be able to contain the expenditures. I was very impressed by both Senator Conrad's and Senator Nickles' charts. I happen to be a trustee of both Social Security and Medicare. I am very concerned about that, and I will work with you and Senator Snowe.

I also know that your proposal has something to do with discrimination in regards to pricing. I think this is something that we should look at, and I will be more than happy to work with you, as I have on many different occasions, Senator Wyden, in any way I possibly can to further the cost containments.

I appreciate your offer, and I will reciprocate whatever way possible that I can make it work.

Senator WYDEN. Well, that is very constructive, Mr. Secretary. I did not want to get you into the specific provisions of the bill, but to know that you are on record as being interested in trying to get additional cost containment so we do not hit that $534 billion level is helpful.

I would also like, just with respect to the policy aspects of it, for you to state your current position on the reimportation of medicines that are safe. As you know, there is considerable debate with respect to where FDA is on this now. I will tell you, as somebody who has tried to specialize in health over the years, I am very troubled by the evidence that indicates that FDA cannot find cases indicating problems with health and safety consequences with respect to reimportation, and at the same time we have thousands of cases out there of people who have suffered as a result of adverse reactions on medicines.

So could you tell us your current views with respect to reimportation? It is part of our legislation, but I am more interested in your policy position on it as of today?

Secretary THOMPSON. The law requires me to certify that the drugs coming in from another country are safe. This is a hurdle that I cannot meet because I cannot certify that they are safe, because by immediately certifying that drugs from other places that are not supervised or regulated by FDA are safe puts the Federal Government in complete financial responsibility for liability if they are not safe.

We had two actions that were taken by FDA, Senator Wyden. The first was in Miami and New York between July 29th and 31st in 2003, and in San Francisco and Carson, California, from August 5th to the 7th. During those 3-days, approximately 100 parcels per day that were suspected of containing drugs were pulled, and out of those, about 85 percent were found to be mislabeled, were counterfeit, and had other safety problems.

The second action was conducted in the same manner as the first in November in Buffalo, Dallas, Chicago, and Seattle. The first one had 1,153 imported products to examine; 1,019, or 88 percent, were unapproved prescription drugs. The remain 12 percent represented dietary supplements and other products. The drugs were from the following countries: Canada, India, Thailand, Philippines, and the remaining from other countries.

On the second stop, out of the 1,982 parcels, 1,728, or 85 percent, of unapproved drugs were found. So both of them were in the high 80's. Both actions were taken with interdiction of drugs coming in which were mislabeled. That doesn't mean that they were wrong. They were just mislabeled, mispackaged. Several were counterfeit. And, therefore, based upon that information, I cannot certify that drugs coming into America are safe.

Senator WYDEN. I just hope you will stay at this question, Mr. Secretary, because I have been in a number of hearings where the FDA literally cannot give any cases that document injury, and you juxtapose that by the thousands and thousands that have been injured that have been documented. I hope that you will stay at it.

A couple of other areas I do want to get into. As you and I have talked about before, the country is headed for a demographic tsunami. We have millions of baby boomers retiring, and the health care system is completely unprepared for this.

Secretary THOMPSON. It is.

Senator WYDEN. We are completely unprepared for what is coming in 2010 and 2011. Senator Hatch and I have been able to win passage of the Health Care That Works for All Americans Act, leg-

islation that would give us a chance to have a plan to get those people covered, to get everybody under the tent for the basic affordable health care services, and to do it in a responsible way, building on the kinds of things that we have done in Oregon and that Wisconsin and other States have done.

What is your position on that? Obviously, we are going to be trying to get the appropriation this year. Senator Byrd has been enormously helpful on this, and I am so glad that he is here. I would like to just have you state for the record your assessment of this bill that Senator Hatch and I have written that has been passed.

Secretary THOMPSON. My reaction is that anything we can do to move health policy and health insurance to forefront and get more people involved is a net plus. Your commission idea is a positive one. It is going to allow for a commission. The only question I had is all of the commissioners have to become employees of the Senate, and I am one of those that are designated. And it is going to be funded by the Senate Appropriations. I don't know. So I think there has got to be some interpretations done in order for me to qualify to be on the commission.

I think it is a giant step forward. I think that there are other ways that we can approach it. But anything we can do to get more people involved in talking about how we solve the health insurance problems in America, I am all for it.

Senator WYDEN. We will work with you on that. It is a per diem arrangement, Mr. Secretary, and, of course, we very much want your involvement in it. It just seems to me that we have tried the same thing now, literally going back to Harry Truman in 1941, in terms of trying to get everybody covered. You write these bills in Washington, D.C. The American people find them incomprehensible. The interest groups attack it, and it all falls apart. What Senator Hatch and I have done is essentially say let's go 180 degrees the other way. Let's get the American people involved early on in terms of some of the difficult kinds of choices and then force congressional action.

So we will work with you to make sure that it is clear on that point that you appropriately raise, that this is per diem for these kind of people, and it is not all——

Secretary THOMPSON. The idea, the concept is great. I think just the mechanics have to be worked out a little bit.

Senator WYDEN. I appreciate that. One last question, if I might, Mr. Secretary. As you know, Senator Smith and I have been very concerned about Oregon's TANF waiver, the Temporary Assistance to Needy Families, and we have a situation where States like ours are performing particularly well, and you have—and we have talked about it—often been a champion of this question of making sure that the States have the flexibility so that what you do in Oregon is not necessarily what you do in Tallahassee or what you do in the Bronx. And we would just like to—and I ask this on behalf of Senator Smith and myself, because we have both been very interested in it, what you can do to help us nail down that waiver and get the Oregon program protected.

Secretary THOMPSON. Let me respond, because we have worked very closely with Oregon, as you know. When the TANF bill expired, it took away my authority to grant any waivers in this area

whatsoever. So my waiver authority expired with the termination of the TANF law. So I have no authority to do that.

Second, we have examined—we have worked with Oregon, in fact, I think we worked with them this past week.

Third, we have examined Oregon's law. We think you have a good law. We want it to continue. We want it to have as much flexibility as possible. We are under the impression, in looking at it through our professionals, Senator Wyden, that Oregon has nothing to fear whatsoever, that Oregon's all-family participation rate, if the finance bill was passed, would be over 60 percent and would qualify, more than quality for all of the requirements under it, and TANF in Oregon, Oregon-style, would be able to continue, with or without the waiver.

Senator WYDEN. We will work with you on that, Mr. Secretary, and you will also be getting an effort from the State to deal with the Oregon Health Plan. As you know, because of our difficult economy, we are trying to figure out how to make the best use of those resources, and given the State budget situation, they are going to have to turn this around in sort of land-speed record time. And if Senator Smith and I could work with you on both the TANF waiver and the Oregon Health Plan——

Secretary THOMPSON. The door is always open for you, Senator Wyden.

Senator WYDEN. Next time we have a chance to visit and I have given you more time to prepare, we will talk more about the specifics of the Snowe-Wyden legislation on prescription drugs.

Secretary THOMPSON. Thank you.

Senator WYDEN. But both of the principles embodied in this—and we are two, as you know, who voted for the legislation—would allow you to keep in place the basic configuration of the legislation. Both policies have been endorsed by AARP. I am hopeful that we can win additional support for it in the administration, and given these projections that you lay out—we are going to need every cost containment tool that we can use. As of now, the fact is the Medicare program faces a statutory bar to going to bat for the beneficiaries that the Federal Employee Plan doesn't face when you are going to bat for Members of Congress. Just having come off the town hall meeting circuit at home, that just doesn't pass the smell test. And I want to work with you on that.

Secretary THOMPSON. Thank you.

Senator WYDEN. Thank you for your cooperation.

Secretary THOMPSON. Thank you very much, Senator Wyden.

Senator CONRAD [presiding]. Mr. Secretary, we have a vote on, just a few minutes left, so I am going to have to leave momentarily. We are trying to make it so that Senator Nickles can be back in time so the hearing can continue.

Secretary THOMPSON. Good.

Senator CONRAD. Let me just go back to what I was asking you about before. I have now been told that some 70 members of the House and Senate have written to you to ask that you suspend this Medicare campaign until the GAO determines whether or not it is an illegal use of taxpayer money. Would you be willing to suspend the campaign until GAO determines whether it is illegal?

Secretary THOMPSON. I will consider it, but I am not going to make a commitment at this point in time. I just heard about the individuals that have written to me. I would like to see what they have to say. I know your concerns. I differ with you, Senator Conrad, but as you know, I try to be bipartisan, I try to reach across. I will take your complaints, and I will go back to the office and review it again, and I will get back to you with a definite answer.

Senator CONRAD. I would appreciate that. And I say to you, I think it would be wrong if the other party were doing it. If my party were doing it, I think it would be wrong. I just think it is wrong. I think this way lies a lot of grief if we start going down this trail.

Let me turn to another issue, and that is in CBO's letter to us, Chairman Nickles and the Committee, with respect to the differences in the estimates, one of the major differences, $32 billion, is that CMS assumes higher participation in Medicare Advantage, 32 percent versus 9 percent in the CBO estimate in low density, low cost areas where payments to these plans would be much higher than the cost of traditional Medicare. The whole idea of Medicare Advantage is that it is going to save money. How can it be that your actuaries are telling us that these plans cost more than traditional Medicare?

Secretary THOMPSON. Because our actuaries and the proposal that we had advanced limited, Senator Conrad, the bids to the lowest three bidders.

Senator CONRAD. Say that again for me. You would have?

Secretary THOMPSON. We requested that the Medicare Advantage, the bidders, would be limited to the three lowest bids.

Senator CONRAD. OK.

Secretary THOMPSON. The conferees said no, and they said if we are going to go this way, it has to be expanded to anybody that wants to bid. By having the three lowest bids, you would force the marketplace to come in with the lowest bids. Our actuaries at that time projected they would be at 98 percent, but if you took——

Senator CONRAD. 98 percent?

Secretary THOMPSON. Of fee for service.

Senator CONRAD. So the cost of Medicare Advantage would be 98 percent of traditional fee for service?

Secretary THOMPSON. That is correct.

Senator CONRAD. OK.

Secretary THOMPSON. But when they took off the cap, our actuaries projected that that would go to 105 percent as an average.

Senator CONRAD. And the reason for that is, because, frankly, I think given the fact we have now had this dramatic change in the estimate from $400 billion of cost to $530 billion in just a few months, that we have to go back in and figure out how we can save some money here. Maybe this is one place we could save some money.

You had taken the position before that we ought to restrict access to the three lowest bidders. Is that the basic concept?

Secretary THOMPSON. That is correct.

Senator CONRAD. Does the lowest bidder always win or not?

Secretary THOMPSON. The three lowest bidders would always win.

Senator CONRAD. Under that scenario the three lowest bidders would win. And under this scenario somebody that is not among the three lowest bidders could win?

Secretary THOMPSON. Everybody will be eligible, anybody that bids.

Senator CONRAD. Anybody that bids can be in even if they are much higher than the three lowest bidders?

Secretary THOMPSON. That is correct, and that is why our actuaries say if anybody can be in, there is no reason to sharpen your pencil and be below.

Senator CONRAD. That is really—why did they do that?

Secretary THOMPSON. Well, that was an argument we made in the—I made the argument, so I lost, I lost——

Senator CONRAD. Can you tell us what the argument was on the other side for doing it the other way? I find it hard to understand what their rationale was.

Secretary THOMPSON. Senator Nickles I think was the only person in that conference——

Senator CONRAD. That agreed with you.

Secretary THOMPSON. That agreed with me.

Senator CONRAD. Do you think we should at least reopen the bill for the purpose of revisiting at least that item? Frankly, I think we have to revisit other items too. We went from $400 billion to $530 billion in 3 months.

Secretary THOMPSON. We want to get the bill up and running. We are fearful that opening it up is just going to delay the implementation of it. I understand your arguments, and I think they are sound, Senator Conrad. The argument on the other side, you asked what it was. They said that this is a competitive model. Let us allow competition to work. So let us let anybody that wants to bid, bid.

Senator CONRAD. But your actuaries say by not restricting it to the lowest bidders, just saying open sesame, everybody can participate, the marketplace will give us higher cost than traditional Medicare. That makes absolutely no sense.

Secretary THOMPSON. That is not the motive to keep the prices down.

Senator CONRAD. Certainly. Let me ask you on another issue if I can. This $65 billion that is in the President's budget, I know you were Governor of a State for a long time, Governor of Wisconsin. You had a very distinguished record there. You led reform of welfare. You were more fiscally responsible as a Governor. You are close to being a neighbor, so I have followed what you did there. I find it very troubling that the President's budget says we are going to have $65 billion for health care credit, but then provides no money for it. I do not think you budgeted that way when you were Governor.

Secretary THOMPSON. There are a lot of things, Senator, that I have found different in the Federal budgeting process than what we were able to do. I still find it somewhat hard to believe that you do not have amortization accounts, you do not have capital accounts.

Senator CONRAD. I will tell you, you know I come from a financial background, and I must say, when I first came here, and to this day, the way the Federal Government accounts for things makes no earthly sense, and I think it fundamentally misleads people.

Secretary THOMPSON. It does.

Senator CONRAD. And I think it even misleads our colleagues. That is why I think the Social Security reference I was making earlier is so important. We talk about surplus. There are no surpluses. We need that money when the baby-boomers retire. I think the misuse of language confuses people.

I am going to go vote.

Chairman NICKLES [presiding]. Senator Conrad, thank you very much for chairing. They are holding the vote for you, and I am sure they will.

Senator MURRAY.

Senator MURRAY. Mr. Chairman, thank you very much.

And thank you, Mr. Secretary, for being here today to talk about the HHS budget for this year. You oversee an agency that impacts all of us, and I know it has a tremendous impact on a lot of people across this country, so I appreciate the job you do.

I am concerned about a number of issues in the budget, some of the proposed cuts in CDC and the Community Access Program, which I think is really critical. I am concerned about the FDA, particularly in light of the mad cow disease that surfaced in my home State, and I want to ask you about that, and a number of things.

But before I do that, I do want to ask you, since you are here today, about a story that is out today that I find extremely troubling, and that is the announced efforts by Attorney General Ashcroft and the Department of Justice to subpoena private medical records of doctors and hospitals who are currently challenging the Federal Partial Birth Abortion Ban. It is reported in the New York Times today and a number of outlets that the Department of Justice is demanding that at least six hospitals in New York City, Philadelphia and elsewhere turn over hundreds of patient medical records on certain abortions that are performed there, and it does not appear that the Department of Justice has made any distinction between different procedures. They are simply demanding private medical records of women who have no idea that their identities would be turned over to Attorney General Ashcroft.

Mr. Secretary, I find this kind of intimidation very, very troubling, and I also believe that it is a clear violation of the intent of HIPAA, which you oversee in your division. I know there are some exceptions in HIPAA, but clearly, releasing private medical information to the Department of Justice about any reproductive health procedure just is not acceptable.

Has the Department of Justice asked for any opinion of your office since HHS was the lead agency on implementing and enforcing HIPAA standards, on this action?

Secretary THOMPSON. To the best of my knowledge, no. I was not contacted. This is the first time I have heard about it, Senator Murray.

Senator MURRAY. I find that troubling as well since it is your office that oversees the Health Information Privacy Act.

Secretary THOMPSON. That is correct.

Senator MURRAY. It would seem to me that it would be extremely important that they get an opinion from you. Since they have not, then I would ask you to give this Committee an opinion, and simply ask you the question: are women who seek abortions or reproductive health care denied protections under HIPAA, and can doctors be compelled to release this kind of information at the request of the administration?

Secretary THOMPSON. Why don't you send me these questions and I will get back to you. The Department of Justice could have contacted our General Counsel or could have contacted some of our legal staff. I do not know, but this is the first time this issue has come to my attention, Senator.

Senator MURRAY. I will give that to you in writing, but I think it is extremely critical that we get an answer from your agency as quickly as possible since you do oversee HIPAA. I, like many women, are very, very troubled that someone can go to a doctor and completely, unbeknownst to them, have their records subpoenaed by the Department of Justice over an action they have nothing to do with, and clearly, prying through medical records or second guessing doctors' advice to their patients is the kind of Government intrusion that many Americans are very, very troubled by. Since you oversee HIPAA, I would really request that you do it and do it expeditiously because I think the question needs to be answered.

If it is that the DOJ can go on a fishing expedition to hospitals and doctors and seek medical records, I think we have an obligation to make sure that the privacy acts that we have worked so hard on protect their rights. I certainly think any woman or anybody who has a daughter or anybody who may have sought health care protections or decisions that are very, very private and part of their own family and their own religious decisions, should not be worried that this Department of Justice can ask for their records. So I would ask that you expeditiously get a response back and tell us what HIPAA will allow under that.

I would hope, really, that DOJ take a quick second thought here and realizes they should have sought your opinion before going on this expedition as well.

Secretary THOMPSON. Thank you.

Senator MURRAY. Thank you. I will ask you also a question about the prescription drug bill, but I hope you can get that back to us because I am deeply troubled. I think many, many people are by that.

On the prescription drug bill, you are going to be tasked with determining different regions of the country, and as you know, under that bill, the country's going to be divided up into as many as 50 regions. PPOs will be offered within these regions, HMOs within the entire State, and the products that these PPOs and HMOs offer will really determine the kind of access that seniors will have to qualify affordable prescription drug coverage.

As we experienced in my home State and others with the Medicare Plus Choice program, senior can be facing a new Medicare program every year, and many seniors within a State do not have access to those choices. That was the experience we had under

Medicare Plus Choice. In fact, in Washington State we had two very different Medicare options for seniors, and every year there were changes to the plan. Some increased premiums, reduced coverage, limited coverage, or even closed for new enrollees.

So I am really concerned as we move forward on this that my State could be divided up into more than on region or even two regions with a fall-back region. That would mean that access to coverage would depend on where you lived for the first time in the history of Medicare and could force health care providers to compete for preferred provider status.

I would like to know from you what efforts you are going to undertake to ensure that stability within a State and with States will be there, and whether you know States like Washington, that are large and diverse, will see a number of different regions that could mean different choices for different seniors who live within the same State?

Secretary THOMPSON. As you can well imagine, we have not been able to get to that particular portion of the law because our attention had to go to the drug card first and to get that up and running. We are looking at all of the provisions.

I would like to point out that there is a tremendous, enthusiasm for the new Medicare Modernization Act. There are people that were on Medicare Plus Choice and are now coming back into it. You are going to see a lot more plans coming to the forefront. You are going to see a reduction in copays. You are going to see enhanced benefits, and you are going to see a lot more people in the market.

In regards to the State of Washington, I cannot imagine any scenario, just listening to you, Senator Murray, in which you would divide the State of Washington up into more than one region. I suppose it is possible, but I do not know any reason why you would do that. The law says we have to have a minimum of 10 regions up to a maximum of 50. We are looking at the potential of around 15, but in all of the regions that we have even speculated on, States are held together, and every State is held together in a region. I cannot imagine any way in which we would divide it up at this particular point in time unless it might be a huge city that would be overlapping into another region. But I cannot imagine that would take place in the State of Washington.

Senator MURRAY. As you know, we have regions like Portland, Oregon that is right across the border from a——

Secretary THOMPSON. Yes, but I would think that Washington and Oregon would probably be in the same region.

Senator MURRAY. We will be following this very carefully because——

Secretary THOMPSON. Listen, before we make final decisions—this is going to be a very controversial as to how the States are placed in the regions. I will be working with everybody on a bipartisan basis as long as I am Secretary.

Senator MURRAY. All right. Let me ask you quickly then about mad cow because I know you are working with FDA to address a lot of the issues of the gaps in safety, and FDA has moved forward on a number of initiatives to deal with this.

Secretary THOMPSON. Yes, we have.

Senator MURRAY. As a member of this Committee and the Health Committee, I am really concerned that FDA may need some kind of legislative authority to continue to move forward, and I wanted to ask you if you felt that that would be necessary, or is there anything more we should be doing to providing you the authority you need to provide the protections that are citizens are looking for?

Secretary THOMPSON. As you know, we have expanded our rules as it relates to the composition of feed. That is a big area that we have complete control over. We have strengthened the oversight. We are going to increase the number of inspections by a great deal, and we are also prohibiting the use of downer and dead cattle into human consumption products. So we are doing a lot.

We are continuing to address this. Les Crawford is the individual I have tasked to do this. He negotiated this week with the Canadians, and we are negotiating with the Japanese as far as opening up the market, and we are looking at scientific things. We want to base our decisions upon science. At this point in time we have not found a place where we cannot go statutorily, but if we do, I will be more than happy to sit down with you.

Senator MURRAY. You know that there are many of us who stand ready to work with you in case you do need that authority.

Secretary THOMPSON. This is very much a concern of mine being a beef grower myself.

Senator MURRAY. Mr. Secretary, I appreciate that. Let me just say, Mr. Secretary, we will get the question to you on whether or not women who seek reproductive health care protections are denied privacy under HIPAA. We will get that to you today. Can I ask you how long it will take your decision to come back to us?

Secretary THOMPSON. I would hope that my attorneys would be able to turn it around the beginning of next week.

Senator MURRAY. OK.

Chairman NICKLES. Senator Murray, Thank you very much.

Senator SESSIONS.

Senator SESSIONS. Thank you, Mr. Chairman. You know, on the medical issue that Senator Murray raised, as a prosecutor, I have been amazed in recent years the shock people have that they think you cannot subpoena library records. You can subpoena bank records. You can subpoena medical records. You can subpoena library records. There is no privilege for those things under certain circumstances.

Now, if somebody objects, they can file a motion to quash a subpoena, but Congress did vote to eliminate the practice of partial birth abortion, and I think we meant that. It was an overwhelming vote. The investigations surely are focused on the physicians who may be performing those procedures if they are ongoing. So I think you have at some point, any investigation to determine whether or not a physician is performing partial birth abortion contrary to the overwhelming vote of this Congress should be investigated and you will have to get some records. if there is an objection, they can be objected to through the court system.

Senator MURRAY. Mr. Chairman, let me just say that women were not party to the suit, to the——

Senator SESSIONS. But it is the records. You say they are taking their records, but it is really the doctors', physicians' files to deter-

mine whether or not he is performing that procedure, and he would have her history of whether or not that procedure was performed on her.

Your chart here showing your higher estimate on the prescription drug bill is more than troubling to me. I respect you though. We knew, and many of us were worried it may be higher than the $400 billion that was estimated. I know Chairman Nickles raised that concern. I am glad you brought it out. I am glad we have your estimate here. I think it is true that nobody knows exactly how much is this going to cost. Would you agree?

Secretary THOMPSON. That is true.

Senator SESSIONS. Could be more or less than the 534 you have estimated. I believe that Congress wanted to make a sizable historic step toward meeting the needs of those seniors who cannot afford drugs, and we authorized, this Budget Committee did, $400 billion for that purpose. I am just very distressed that we passed a bill that it pretty clearly appears now is going to go well above that. I think it is important for us, if we care about financial responsibility and sanity, that we come back and look at this bill, and perhaps as part of this budget procedure, to say that we want only that much money spent, and that if we have to have some higher copays instead of the 3 percent copays that are being paid now, maybe that could help keep it within the amount.

So I am frustrated that the numbers came out higher and disturbed by that, but I thank you for doing it because we need to know the truth and act on the best information that we can have.

Secretary THOMPSON. Senator, could I just clarify?

Senator SESSIONS. Yes.

Secretary THOMPSON. CBO still swears by the fact that it is only going to be $395 billion in its projections. CBO has experts that are projecting on drugs that we do not have as actuaries. So I do not think you can truthfully say that our figures are correct and CBO is wrong because they are not. These are our estimates.

For instance, on the first one—and this is something Senator Nickles argued quite strongly against—is the fact that the low income, where everybody wanted to help, is really wide open. It is a huge subsidized benefit for low income, those under 150 percent of poverty. That makes a difference of $47 billion. We cannot say for sure if it is going to be $47 billion more or $47 billion less.

For instance, the Balanced Budget Act of 1997, which is not nearly as complex as this law, our actuaries were $50 billion off from CBO and both of them were wrong. Both of them were wrong, in fact it came in at a different amount. And the second one, the higher participation, the next big tranche of $32 billion, this is the difference between 87 percent—CBO believes only 87 percent of the people that are eligible will participate. Our actuaries think it is going to be higher, they think it is going to be 94 percent. But you have to remember that in Part B only 91 percent participate, and that is what CBO is counting on. CBO is saying if you did not participate in Part B, why would you ever then participate in Part D? And so they have a solid argument for saying it is going to be less than 91 percent.

So it is just projection and expertise.

Senator SESSIONS. My simple view about it is you have raised—your official estimates raise the possibility that it would be higher. Hopefully it will not, but I think as a prudent Congress and as a Committee that is concerned about maintaining the integrity of the budget process, we ought to be thrilled that we were able to find and appropriate $400 billion, but I think we have every right to tell the administrators or the Finance Committee or others to keep the figure at $400 billion, and I think even if your numbers are correct, we are going to have the most historic increase in drugs for seniors ever. We have four people in my State whose drug bill exceeds their Social Security bill in thousands. My mother's drug bill does. I see that. It is $400 plus every month. It will be a help for people. There is no doubt about it, but we need to be responsible.

Mr. Secretary, you have a reputation for being a good manager and cutting waste and abuse. I have information that on the Children's Hospitals Graduate Medical Education program—thank you also for supporting full funding for that and not cutting that program. Level funding is what you propose. But there was a 5 percent increase, I believe, last year, and we now find that all but 267,000 of that 5 million went to administrative overhead. It is not getting out to the hospitals. I do not know if you are aware of that or not, but that is the information I have. I do not know if that is a one-time cost or just a rise in administrative cost. I would ask that if you are not familiar with it, I would understand it——

Secretary THOMPSON. Senator Sessions, it better not be that way. If it is, some heads are going to roll.

Senator SESSIONS. I appreciate your approach to it. That has been my impression of your approach to management.

Secretary THOMPSON. That is absolutely ridiculous.

Senator SESSIONS. I was disturbed to hear those numbers. Perhaps they are not correct, but I think they come from a good source.

Secretary THOMPSON. I will look into it before the end of the day.

Senator SESSIONS. Mr. Secretary, I appreciate your interest and work in dealing with AIDS, particularly internationally. And working with you and the Department we confronted this question of whether or not, or at least how large an impact unsafe health care has in the spread of AIDS in Africa in particular. Some studies came out and showed rather shocking numbers there based on studies that were in existence. So we asked your Department to review that and come up with a figure which they believe was accurate. You have contracted with somebody. We have preliminary numbers on that, and I was unhappy, frankly, that they did not come forward with a figure, they simply repeated really the language that WHO has been using which is: the reusing of needles is not a major part of the problem. I think even WHO estimates 2–1/2 percent of AIDS infections in Africa comes from reusing needles, and 7 percent of more comes from unsafe blood transfusions.

The good news is, Mr. Tobias and the money we funded is immediately going out, some money earmarked to focus on this unsafe health care, but I still believe it is important for us to have good numbers. What I do not understand from this study is that they are saying that the studies relied on by Dr. Gisselquist and others to say the figure is much higher were not good studies. Therefore,

they conclude that they are not accurate and that is it not a major cause, needle reuse. But I think you could take that other way too. If the study is not good it does not say anything. Maybe we need more studies to get an accurate number. We need a number here, and I have been frustrated by the stiff-arming of WHO, and even some in your bureaucracy on this question because I think it is a big one. Would you comment on that?

Secretary THOMPSON. Absolutely. Before I comment on that, I just wanted to point out that the Medicare Modernization Act has some real cost containments for the first time. Part B premiums, those with incomes over $80,000, are going to pay more, it is going to be indexed, and also the Part B deductible is going to be indexed for the first time, and there is a trigger for 45 percent. When Medicare gets to 45 percent of the general purpose revenue dollars going in to fund Medicare, there is a trigger indicating that we have to come back with reports to the President as members of the Trustees, which I am one, and to Congress, making suggestions on how we might be able to improve.

Senator SESSIONS. That is true, and Senator Nickles fought to get that in there. I would just say that overall Medicare is going to be difficult to deal with. We have not started this prescription drug program. We ought not to let it get out of control before it starts.

Secretary THOMPSON. I happen to agree with you, Senator Sessions. I also agree with Senator Nickles and Senator Conrad on the questioning, and I think we should continue to observe this and find ways in which we can enhance cost containment.

In regards to your issue, you have talked to me about it. I happen to agree with you. I think it is a higher percentage, and I think we do need an accurate figure. I was somewhat nonplussed by the fact that it came back with—after we contracted out. I think we do need further studies.

I happen to be very much involved, as you know, as Chairman of the World Global AIDS Fund, trying to make sure that our programs and our funding goes the right direction. And we also have just received a grant from the $15 billion special appropriation to ensure the safety of blood. This is going to be done by my Department. We have been awarded the contract to ensure the safety of blood. Needles are an absolutely integral part of that, so we are addressing this, and I would be more than happy to sit down with you and give you more information as we go along and set up our program on good reliable blood for Africa. But I also agree with you. I cannot disagree with you on the report as far as the percentage of people that are getting HIV positive transmitted by dirty needles.

Senator SESSIONS. We can take the transfusion infection rate to zero virtually. I think about 60 percent of the transfusions of Africa are checked now. 40 percent are not. And according to WHO's numbers, that represents maybe 7 percent of all infections in Africa. So we could take that to zero like we have done in the United States.

Chairman NICKLES. Senator Sessions, thank you.

Senator SESSIONS. My time is up. The Chairman is correct to call my hand. Thank you for your interest in that, and I look forward to working with you.

Secretary THOMPSON. Thank you, Senator Sessions. Appreciate it.

Chairman NICKLES. Senator Sessions, thank you very much.

Senator STABENOW.

Senator STABENOW. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. I have many questions I would like to pursue, but I will ask only two different subjects, and one I know that was pursued earlier, but I want to revisit it because I was so shocked, frankly, by it, and that is the $20 million ad blitz that has been started with taxpayers money, touting the new Medicare law, when in fact, other than the discount cards, no one will have the opportunity to sign up for it until 2006.

I have to say, when I saw the first television ad, and just watched it as it went through, I expected a tag line of "paid for by the National Republican Committee," and was very surprised to see that taxpayers were paying for it, given the fact that it went beyond what I believe are accurate statements. I have joined with others in requesting the GAO investigation that they are doing, which we appreciate, and have joined in writing you a letter asking that you stop the advertising until we know from the GAO whether or not this is legal. So I would ask, first of all, if that is something that you would do?

Secretary THOMPSON. I answered the same question from Senator Conrad. I told him I would go back and review all the things. I also wanted to correct some things, that I do not believe it is political. I think it is informational, and I am responsibe under the Act. I read the Medicare Conference Report language which says that I have to get out information on this new Medicare law and the money has been appropriated to do so. The best ways to do that is through TV, but we are also doing it through literature. We are also doing it through expanding the SHIPs program, voluntary programs in the community, through the Aging Commissions. We are also putting information out in more than one language so that especially Hispanics are able to understand the new law. GAO is going to review it. I am confident that they are going to come back and say that it is not political, but if they do, it certainly is going to be stopped immediately.

Senator Conrad had a subsequent, if I would go back and review the ad again, and I will this afternoon, and take a look at it, and that is as far as I am willing to go at this point in time.

Senator STABENOW. I appreciate your comments. I would like to share with you from my perspective in looking at this. There is no question that we need to educate people. Frankly, this is very complicated.

Secretary THOMPSON. Very complicated.

Senator STABENOW. What is going to happen for people in 2006 is very complicated because if they have at least one private insurance company and one HMO in their area, they would not be able to go through the traditional Medicare mechanism. Would you agree that they will be choosing between a private insurance company and an HMO if those are available in their area, is that not correct?

Secretary THOMPSON. No. They will also be able to maintain their current fee for service.

Senator STABENOW. They will be choosing. If they have at least one private insurance company and one HMO in their area for prescription drug coverage, they will go through one of those two and only have Medicare as a fall-back.

Secretary THOMPSON. That is correct.

Senator STABENOW. So it is a complicated system. There is no question about it.

Secretary THOMPSON. Very complicated.

Senator STABENOW. That people are going to have to know they are going to get a lot more information, a lot more paperwork. What others have called choices I would call a lot of paperwork, and I am not hearing from people, from seniors, that they want a lot more paperwork. They just want help with their prescription drugs. But we will have that. But I would like just a couple of comments——

Secretary THOMPSON. Could I just respond quickly to that? I would like to point out that the enthusiasm and the interest in the Medicare Modernization Act been overwhelming. At the 1-800-Medicare line. We have 106 companies and individuals and entities who want to put out the card. We have had a lot of companies that were in Medicare Plus Choice and want to come back, they want to expand and increase benefits and reduce premiums. So there is a great deal of enthusiasm. We want to get the right information out. I do not want to be political on this, and I pointed out that the head individual that won the request for advertising happens to be an individual that is a Democrat.

Senator STABENOW. But, Mr. Secretary, if I might, I understand the enthusiasm. Certainly from the pharmaceutical industry that is projected to gain $139 billion from this bill, and I understand the enthusiasm from those who will now be subsidized in the insurance industry and the HMOs so that they have a more favorable position in which to compete against Medicare. I understand their enthusiasm. We know that because of that enthusiasm and those subsidies, that down the road in 2010 we will begin to see, because of the change, fundamental change in Medicare, that will be experimented with at that time, CBO says we will see a 25 percent increase in cost for average Medicare, for those who stay in Medicare. So I understand the enthusiasm of those who will make money off of this bill.

I would just share with you I do not see the same enthusiasm among those who will be paying the bill and of those who want prescription drug coverage in my State. We have been overwhelmed with seniors and with families who are outraged by what has been done. And my concern—and I will move on to one other topic—my concern is that when we talk about advertising, we have a full page ad in Roll Call, and my staff reads that every day, not one of them is even close to being able to qualify for Medicare. I do not know why we run ads in Roll Call when we are trying to educate seniors around the country. This is a propaganda item, but it certainly is not educating folks, and I think any lobbyist or senior official reading Roll Call certainly has other opportunities to find out information about how this works. I would finally just say that——

Secretary THOMPSON. I did not know that it was in Roll Call.

Senator STABENOW. It is Roll Call. It has been in Roll Call, and that is certainly not where my constituents are reading about Medicare, so that is a concern of mine.

Then finally, I would simply say that in looking at the television and the print, when we say, "So, how is Medicare changing? Same Medicare, more benefits." I would strongly object to that statement. Same Medicare? For those on Medicaid who are now going on Medicare, if they want a brand name drug they are going to pay more. Their formularies may be different and they may have fewer choices on prescription drugs. For the people in my State that are on private retiree insurance today, the anticipation is that one out of four of them will lose their coverage. This is not accurate. And so I would strongly support efforts to accurately educate people about the complexities and about the choices, and for those that will benefit, we certainly want them to know about it. For those who will pay more, we certainly want them to know that as well. I just have great concern.

Secretary THOMPSON. Senator, I would just like to quickly respond if I might. I do not want to argue with you. Your interpretation is different than mine. I think that the ads that we are doing are very informative. I think the information—I wish you could listen in to the seniors that are calling in at 1-800-Medicare, they are overwhelmingly enthused about this opportunity. It is the same. You can stay in the same Medicare program like you always have, and you can get added benefits. That is the truth of the law.

Now, you and I differ on that, but that happens to be our interpretation of the law.

Senator STABENOW. Mr. Secretary, in 2010 in the six demonstration areas around the country, will Medicare remain the same?

Secretary THOMPSON. In 2010——

Senator STABENOW. 2010 with the demonstration projects, will Medicare remain the same?

Secretary THOMPSON. I do not think anybody around this table can say whether or not it will. It probably will not. In 2010 there is going to be two more Presidential elections, there is going to be three congressional elections——

Senator STABENOW. That is not what I am asking. I am asking if the law——

Secretary THOMPSON. I am just telling you, I do not know, I do not know, I do not know.

Senator STABENOW [continuing]. That we passed, Mr. Secretary——

Secretary THOMPSON. And I do not think you do either. I do not think it will be.

Senator STABENOW. Mr. Secretary, I do know under the law we passed that in the six demonstration areas around this country, starting in 2010 Medicare is not the same. It essentially moves from a defined benefit to a defined contribution, and it has been touted by Mr. Scully, by others, as a positive change, and I am not asking us to debate whether or not it is positive or not. I would argue it is not, but there are those that believe it is.

But my question is: is it a change? Is it different? In 2010 if you are in one of the areas with the six demonstration projects under Medicare, will it be different?

Secretary THOMPSON. In those six different areas in 2010, unless Congress changes it, there will be competition, yes.

Senator STABENOW. So it is different. So when we say "same Medicare, more benefits," this is not accurate, and if you change it so that it is accurate, that is fine. But it is not accurate to say it is the same because for many people it will not be the same.

Secretary THOMPSON. Yes, it will be, Senator, because seniors will still be able to get fee for service if they so desire.

Senator STABENOW. And it will cost more, up to 25 percent more under CBO.

Secretary THOMPSON. But the seniors will still be able to get their system if they want to.

Senator STABENOW. It would be great if it said that in here, that, "by the way, it will cost you more."

One other quick point—and I realize, Mr. Chairman, I know I am pressing.

Chairman NICKLES. We do need to run.

Senator STABENOW. Actually, I will wait. Thank you very much. You have been patient, and I will wait and do the additional question in writing. Thank you so very much.

Chairman NICKLES. I appreciate that so much because I am trying to get the Secretary out by 12 o'clock, and I have an additional question I want to ask him. But first we are joined by former Chairman and the most senior person on the Committee, Senator Domenici.

Senator DOMENICI. Can you hear me?

Secretary THOMPSON. Yes, I can, Senator. How are you?

Senator DOMENICI. Fine. Nice to see you. You got a haircut, huh?

Secretary THOMPSON. I hope so.

Senator DOMENICI. Looks good. I have to go get mine cut. Nickles does not have to cut his very often because——

[Laughter.]

Chairman NICKLES. I am well aware of that.

[Laughter.]

Senator DOMENICI. His is disappearing.

Chairman NICKLES. Mine does not cost as much as yours or it should not.

Senator DOMENICI. You get half price.

Mr. Secretary, I have about five or six questions that I am going to submit, and I would greatly appreciate it if you would answer them.

Secretary THOMPSON. Absolutely.

Senator DOMENICI. They are very important, and I just got through with a hearing where we had a Secretary who was letting, because of OMB or some reason was letting mail from Senators go very much unattended, and I do not want to get in that position with reference to you. You have a great staff and they ought to consider a Senator's question as being something important enough to be answered.

Secretary THOMPSON. If they do not, they will not be with me.

Senator DOMENICI. That is what I suggested to her, that they should not be.

In any event, let me ad lib for a minute, and then get to some written ones. First, Mr. Secretary, last year our President made a

little trip to New Mexico. It was probably one of the most exciting trips that he has ever taken to our part of the country, and he came to meet with a group of doctors and health professionals on the subject of insurance parity for the mentally ill.

Now, Mr. Secretary, I think that you know what parity is, and I think you probably know that this had resulted in a discrimination of coverage for families with a member who has one of the serious mental illnesses. I am not talking about need for counseling. I am talking about schizophrenia and bipolar and the like. It is growing more and more obvious that millions of families have no insurance, but do cover all the other things, cover heart conditions, cover tuberculosis, cover diabetes, but not somebody who is egregiously ill with depression.

As a result, the facilities that should be built and the excitement of the careers in research are not what they are in the other fields. Just think with me what has happened to heart. The heart has always been covered since they wrote insurance policies. Just think if they would have exempted hearts, said, we are not going to do anything under insurance policies for the heart. I would think we would have invented none of the great techniques.

So here we sit, and the President of the United States said, "I do not have to be convinced that the big mental illnesses are diseases." He said he had a personal experience with a friend on severe depression. You might know about that.

Now, let me ask you, because we are about to get a bill reported out of Health Committee, you support the President's position on this, do you not?

Secretary THOMPSON. Without a doubt. It is the right thing to do. I supported it when I was Governor of the State of Wisconsin. My family is very much involved in this thing. I compliment you for your leadership for years. It is time for us to get something done.

I also talked to Congressman Ramstad yesterday, the day before. He tells me that you have reworked a bill and it is able to come out.

Senator DOMENICI. Yes, sir.

Secretary THOMPSON. I said I would like to read it, but the concept I fully endorse.

Senator DOMENICI. Mr. Secretary, there is going to be a meeting of everybody, including your Departments and others, so that when it gets beyond our Committee, which is going to report it out, all of that work will have been done.

Secretary THOMPSON. Good. I would like to be included in that meeting.

Senator DOMENICI. You will be, and the only reason I raise it with you strongly today, I do not want staffers going there assuming that they have to go through the whole business of whether you are for it or not. I would assume administration——

Secretary THOMPSON. You do not have to go through. I have stated it publicly before, Senator.

Senator DOMENICI. OK. And I am for arranging it any way that we can be helpful to Senator Nickles on his budget, and I am also for limiting the amount, Senator, the percent, the cost, et cetera. Now, that is about all my big questions, but I have one with reference to New Mexico.

As it currently exists, the Medicare reimbursement system for health care provides and contains some inequities. We all know that. Some are intentional because you could not do it any other way. Some we are finding out about. But the reimbursement for health care providers nationwide vary greatly from region to region and from State to State. My home State, New Mexico, we are reimbursed less by Medicare for services provided than other States. Some of this started way back when we first did HMOs and the like, and you are aware of that. Although certain costs of providing care are more expensive in some areas than others, and that accounted to some extent in the disparity between reimbursement.

But it is my theory that New Mexico is being punished for its own efficiency. New Mexico was foresighted enough to allow health maintenance organizations to penetrate our market, while most States remained involved with fee for service providers, and you know better than I, were squabbling and arguing and litigating about issues. However, because New Mexico was efficient, they are now rewarded with artificially low Medicare reimbursement rates. What would you recommend be done to address geographic payment inequities that currently exist in the system, and what if anything is HHS doing to address the geographic payment inequities that currently exist in the system?

Secretary THOMPSON. Mr. Chairman and members, we are doing a lot. The new Medicare law is making changes, and wage disparities, for instance, have gone down from 72 percent to 62 percent in the law, something that I think is badly needed. It is going to benefit the State of New Mexico, the State of Wisconsin, the State of Oklahoma and the State of North Dakota. There is $26 billion of new programs for rural areas which is going to benefit the States of New Mexico, all the four States that are here. We have been discriminated against for a long time, Senator Domenici, and I would have to say that the Medicare law is a giant step forward in creating some equity as far as reimbursement, and it is going to benefit a great deal for the States that are up there, as well as my home State of Wisconsin, something that I have been for for a long time, and I thank you for bringing it to my attention.

Senator DOMENICI. Well, Mr. Secretary—incidentally, you called me Mr. Chairman a minute ago, and that is OK if you were in another Committee, but in this Committee you should call me "used to be Chairman."

[Laughter.]

Secretary THOMPSON. You have been Chairman of this Committee for so long, you are a Chairman——

Senator DOMENICI. Emeritus.

Secretary THOMPSON. —Emeritus, and I think you should wear that as a badge of honor.

Senator DOMENICI. Now, Mr. Secretary, I want to tell you, my friends here on this Committee that worked on another Committee that produced Medicare, have just informed me that the fix for the rural disparities versus the other more occupied States, that is the biggest fix we have ever had.

Secretary THOMPSON. It is.

Senator DOMENICI. I am looking forward to seeing the numbers because, Senators, I want to tell you—you probably know—but

when you have a State as poor as ours, and you have doctors and neurologists and neurosurgeons leaving, when you do not have enough to begin with, and they say, "Well, we are going over here to Texas because we get paid, reimbursed differently under the same law," you know, pretty soon you have riot sounding meetings with people wondering what the hell is the Federal Government doing? They know with Chuck Grassley and some of them, we have made some fixes, but we did not fix it enough. Now we might have.

Secretary THOMPSON. I think you are going to be very appreciative. This has been an issue for Senator Conrad and myself for a long time. He and I have been fighting it. Senator Grassley, Senator Nickles, I mean anybody that represents rural areas, this Medicare bill, that portion of the law was enough to vote for it.

Senator DOMENICI. Thank you very much.

STATEMENT OF SENATOR PETE V. DOMENICI FOR A HEARING BEFORE THE SENATE BUDGET COMMITTEE, FEBRUARY 11, 2004

Mr. DOMENICI. Good morning, I would like to begin by thanking Chairman Nickles for organizing this hearing.

Secretary Thompson, thank you also for coming here today to discuss the President's FY2005 budget for the Department of Health and Human Services. Your department will face many challenges in the coming fiscal year; improving the health and well being of our nation is not an easy task. However, this administration has shown they are committed to this goal, and Mr. Secretary, I know you have worked extremely hard in your capacity.

Last year, Congress passed the comprehensive Medicare Prescription Drug Improvement and Modernization Act. This historic legislation expands health plan choices for beneficiaries and adds a prescription drug benefit for the first time in the programs history. Additionally, seniors will receive preventative screenings, coordinated disease management, and protection against catastrophic drug costs. These benefits are greatly needed by our nation's seniors.

This legislation was the result of bipartisan work and is supported by many organizations including the AARP. We spent many months negotiating and debating this legislation, so that we could come up with a proposal that best addresses the needs of the Medicare program. Now, some of my colleagues, and certain interest groups, want to amend this new prescription drug law. They want to amend this prescription drug law without first implementing it and learning what works and what doesn't work.

Amending this law without first giving it a chance to be implemented is ridiculous. I have grown tired of the rhetoric and political attacks on this President because he was successful in an area where the previous administration failed. I for one am happy that our nation's seniors now have access to affordable prescription drugs. And, Mr. Secretary, I pledge to you my support and assistance in implementing this new law.

I have just a few questions for you today during our question period. These questions will primarily deal with Medicare reimbursements and also mental health issues. But, in the meantime, I just want to thank you again for coming here today, and I look forward to working with your agency to address the needs of our nation.

Senator Nickles, I will submit my own questions, and I assume he will answer them under your rules.

Chairman NICKLES. Senator Domenici, thank you very much.

And Secretary Thompson, it was almost enough to get some people to vote for it.

[Laughter.]

Secretary THOMPSON. I stand corrected, Mr. Chairman.

Chairman NICKLES. But I do stand by your statement, and I told Senator Domenici the improvements that we made in the resolving

or trying to fix some of the rural inequities was the most significant step since I have been working on it for many years.

I know you need to leave. I want to raise one other issue very quickly. Do you have four or 5 minutes?

Secretary THOMPSON. Sure.

Chairman NICKLES. Four minutes. Medicaid spending, we have not touched on Medicaid. It is an enormous program under your watch. It is $180 billion program. The last 4 years it has grown at 9.7 percent, 13.9 percent, 9.1 percent, and estimated to grow 10.3 percent this year. There is some abuse in the system.

Secretary THOMPSON. That is right.

Chairman NICKLES. Part of the abuse is what many of us call improper intergovernmental transfers. I have been concerned about it. Sometimes in the past we have called it upper payment limits, but some States, a lot of State actually, have developed what I would call a scheme to greatly enhance the reimbursements on Medicaid to where basically the Federal Government pays not their stated share, 60/40 or 50/50 or something like that, but in many cases it becomes a case where the Federal Government pays all of it, or pays a much greater share than frankly what it is supposed to do. Would you care to comment on it, maybe explain it, or give us 1 minute? I know you are pressed for time, and so I will not pursue it too long.

Secretary THOMPSON. Thank you for asking me the question. This has been something that needs to be corrected. The law allows for local participation with the State in order to get matching funds. Usually it is a 50/50 match. Some States are different. Mine is 57/43. I do not know what North Dakota and Oklahoma is, but it is probably somewhere around 57/43. But so many States have taken advantage of the failure to supervise, the failure to actually audit some of these accounts.

Let me just go through some examples of what we're finding. This State made upper payment limit, quarterly payments were being electronically transferred to the nursing home bank account. The State then immediately withdrew the amount of the payment from the provider's account less a $2,500 participation fee. The approximate amount of Federal Medicaid payment, what should have gone to the local, that went back to the State, was $191 million. That was one State.

Another State made supplemental——

Chairman NICKLES. Say that again. I am trying to get these figures.

Secretary THOMPSON. We found $191 million in this particular——

Chairman NICKLES. One State?

Secretary THOMPSON. One State.

Chairman NICKLES. So basically overpayment to one State of 191 million?

Secretary THOMPSON. It was a wrong payment because it was sent to the State. Then the State has got to send it down to a county hospital. But the State, instead of leaving the money to the county hospital, gave the county hospital $2,500 and took the money back to the State and used it for general purpose revenue.

Second example. Made supplemental payments to nursing facilities. Upon receipt of the payments, the nursing facilities, which are eligible for the funds, are required to return 99.5 percent of the payments to the State.

Chairman NICKLES. Wow.

Secretary THOMPSON. That was $938 million.

Chairman NICKLES. Just one State or is that nationally?

Secretary THOMPSON. One State.

Chairman NICKLES. One State.

Senator CONRAD. Can you tell us what State that is?

Secretary THOMPSON. I cannot at this point in time. In private, I will be more than happy to, but I do not want to—we are auditing these. This is what we are finding.

Third example. State makes payments to county nursing facilities. As a condition of receiving those payments, nursing homes must sign a participation agreement in which the nursing home agrees to return all but $10,000 of the payment. Those nursing homes are allowed to keep the $10,000 as a participation fee. The rest of the money goes back to the State to be used for whatever, and that accounted for $181 million.

The next one makes a payment to county home nursing facilities. Upon receipt of those payments, the nursing homes are required by State law to return the majority of the payments back to the State. This is accomplished by an electronic transfer of fund. That example is $18 million.

The next one makes a pro-share to county owned nursing facilities. Upon receipt of those payments, the nursing facilities are required by contract to return the majority, over 90 percent of the payments back to the State within three working days of the receipt. They traditionally remit portions of the payments to the State. That was 40 million.

The next one is $1.5 billion. So this one——

Chairman NICKLES. Can you explain that $1.5 billion?

Secretary THOMPSON. Yes. Make supplemental payments—this is a larger State—to large county nursing facilities. In order to receive the payments the county facilities borrow a total of $1.5 billion. Within 1 day these funds are transferred into the county nursing home bank accounts; from there to the State bank account; and then back into the county nursing home bank accounts as a Medicaid payment. The counties then repay the loan to the bank. At the close of the banking, the State claims the borrowed funds as an expenditure for nursing facility services of $1.5 billion and draws down $859 million in Federal Medicaid matching funds.

Chairman NICKLES. That 1.5 is that——

Secretary THOMPSON. Turns into a match from us of $859 million.

Chairman NICKLES. That really should not be allowed?

Secretary THOMPSON. Absolutely not.

Chairman NICKLES. We may want to have a hearing just on this issue, and I apologize maybe for bringing it up late. I knew there was a lot of interest on the card, on prescription drugs, the cost and so on, and I thought that was maybe primary, but I am outraged at this, and I think it needs to be stopped. I want to stop it. Frankly, when we are running these kind of deficits and when

I look at these double digit compounding growths of Medicaid, it just has to be stopped. We cannot afford this. I know that you have a proposal.

Secretary THOMPSON. We do.

Chairman NICKLES. That will require legislation to go through the Finance Committee, so Senator Conrad and I are both interested in that, but I wish to learn more about it. I want to fully understand it. I have heard about county hospitals and so on.

Secretary THOMPSON. Can we put up the chart? You have just a second?

Chairman NICKLES. Sure, I do. I know that you have to be—you have a commitment at 12:15 so I am trying to be quick.

Secretary THOMPSON. Dennis, you want to come up? Quickly go through it, Dennis.

Chairman NICKLES. Dennis, welcome back to the Committee.

Mr. SMITH. Thank you, Mr. Chairman. Through an intergovernmental transfer, this illustrates the process for which the county shares part of the match rate with the State which is permissible. But under this example—and this would have been allowed through upper payment limits—that the county provided $10 as a match to the State, the county provider. Any time you have a public entity, you have a potential for an intergovernmental transfer, be it a county hospital, county nursing home, but counties are providers for a wide range of other services as well.

Under this, the county provider had a claim for $100. The State, however, a claim-back was for $250. This is a State with a 50/50 match. The Federal Government, seeing a claim for $250, says, "OK, here is our share, $125."

Secretary THOMPSON. So the Federal Government pays more than the total claim.

Mr. SMITH. The reimbursement is made, and then the county provider transfers $150 back to the State. So the State has made $150.

Senator CONRAD. That is a scam.

Chairman NICKLES. So the Federal Government pays more than the original cost, and the State makes money on the procedure.

Secretary THOMPSON. Correct.

Mr. SMITH. The true cost was $100, but a claim for $250.

Chairman NICKLES. How prevalent is this?

Secretary THOMPSON. We think about 5 percent. We think it is going to be—it is growing. There are drummers out there selling this service to the States in order to get a percentage, and we think it would be about $6 billion.

Chairman NICKLES. $6 billion per what?

Secretary THOMPSON. Annually.

Chairman NICKLES. Per year. I am very interested in trying to stop this, and I look forward to reviewing your legislative proposal, and we will work with you. I would appreciate it if you could provide us more example that would help highlight the problem and help us get our hands on the reason why this change is needed so we can sell it to our colleagues.

I will tell you, regrettably, most of our colleagues do not have a clue about this. I mention intergovernmental transfers, and most

people do not know what we are talking about, so I think we will have to work to educate people first to make the legislative change.

I want to thank you and also I want to thank Jennifer Young, because I know that she has helped expose this. You have some excellent staff. I want to compliment Dennis, who I guess is now acting at CMS, who has done an outstanding job, both for the Finance Committee, and also in working in your Department. You have a great team, and we appreciate your bringing this to our attention.

Senator CONRAD.

Senator CONRAD. Mr. Chairman, I would just add my voice and say that is a scam, that is a pure scam on the Federal Government and the Treasury. That is tapping into the Federal Treasury in a way that is totally inappropriate and has got to be stopped. I would be very interested in finding out what States are involved.

Can you tell us how many States are engaged in this kind of activity?

Secretary THOMPSON. 34.

Senator CONRAD. 34 of the States. We have to call a screeching halt to this because that is totally beyond the pale.

One final point I wanted to make, Mr. Chairman, is on the Medicare Advantage, CBO tells us that the private plans cost more than traditional fee for service even outside of this bidding question, so I do not know if there is a disagreement between CBO and CMS on this.

Secretary THOMPSON. There is.

Senator CONRAD. There is apparently.

Secretary THOMPSON. There is a disagreement.

Senator CONRAD. CBO says that it costs more——

Secretary THOMPSON. CBO still believes that.

Senator CONRAD [continuing]. To do the private plans than traditional fee for service Medicare. The whole rationale for the private plans was to save money, so obviously that is a problem. Hopefully we can get to the bottom of that as we go forward.

I just conclude by saying I hope very much, Mr. Chairman, that we go back in and find places where we can save money out of this bill that has been passed. When we go to $530 billion and it was supposed to be $400 billion, that is what people thought they were voting on. We have an obligation to go back and try to save money. We have a runaway freight train here in terms of the Federal deficits. We have to find ways to save money wherever we can, and I hope very much this Committee plays a role in that.

I thank the Chairman for the hearing this morning.

Chairman NICKLES. Senator Conrad, thank you very much.

I want to make one final comment. Senator Conrad was trying to get your attention about some of the ads that were running advertising Medicare and Medicare changes. I will tell you that I was a participant—attended a football game. This is when Scully was still head of CMS. And I saw a blimp that was advertising 1-800-Medicare. I was embarrassed. I did not see too many people writing the number down. I am not sure. I think you do need to look at the ad campaign. I think people do need to be educated, and it probably will take TV, radio and print to get it out. I do not know about a blimp at a football game. Maybe I am missing the—I know in sales you have to consider a lot of different venues, but I was

kind of surprised about that and did not think it was the best use of taxpayer money.

Secretary THOMPSON. I agree with you.

[The prepared statement of Secretary Thompson follows:]

STATEMENT

BEFORE THE

U.S. SENATE

COMMITTEE ON THE BUDGET

TOMMY G. THOMPSON

SECRETARY

DEPARTMENT OF HEALTH AND HUMAN SERVICES

FEBRUARY 12, 2004

Good morning, Mr. Chairman and members of the committee. I am pleased to present to you the President's FY 2005 budget for the Department of Health and Human Services (HHS). I am confident you will find our budget to be an equitable proposal to improve the health and well-being of our Nation's citizens.

This year's budget proposal builds upon HHS accomplishments in meeting several of the health and safety goals established at the beginning of the current Administration. This year, Congress passed the comprehensive Medicare reform legislation, adding prescription drug coverage for seniors and modernizing the Medicare program.

- Since 2001, with the support Congress, the Administration has funded 614 new and expanded health centers that target low-income individuals, effectively increasing access to health care for an additional three (3) million people, a 29 percent increase.
- The Department established the Access to Recovery State Vouchers program, providing 50,000 individuals with needed treatment and recovery services.
- To support the President's faith-based initiative, HHS has created the Compassion Capital Fund for public/private partnerships to support charitable groups in expanding model social services programs. We awarded 81 new and continuing grants in 2003.
- HHS initiated a new Mentoring Children of Prisoners program to provide one-to-one mentoring for over 30,000 children with an incarcerated parent in FY 2004. The Department also created education and training vouchers for foster care youth, providing $5,000 vouchers to 17,400 eligible youth.
- In August 2001, the President and I invited States to participate in the Health Insurance Flexibility and Accountability (HIFA) demonstration initiative. States use HIFA demonstrations to expand health care coverage. As of January 2004, HIFA demonstrations had expanded coverage to 175,000 people, and another 646,000 were approved for enrollment.

I could go on listing our achievements to you and the Committee, Mr. Chairman, but instead I have chosen to highlight a few that we are most proud of.

For FY 2005, the President proposes an HHS budget of $580 billion in outlays to enable the Department to continue working with our State and local government partners, as well as with the private and volunteer sectors, to ensure the health, well-being, and safety of our Nation. Through the programs and services presented in the budget plan of HHS, Americans will receive new health benefits and services, be protected from the threat of bioterrorism, benefit from enhanced disease detection and prevention, have greater access to health care, and will see improved social services through the work of faith- and community-based organizations and a focus on healthy family development. This proposal is a $32 billion increase in outlays over the comparable FY 2004 budget, or an increase of about 5.9 percent. The discretionary request for the HHS budget totals $67 billion in budget authority, a 1.2 percent increase.

Allow me to draw your attention to several key factors of the HHS budget so that we may continue to work together to address the needs of our Nation.

Medicare and Medicaid Reform/Modernization

I am proud to have worked closely with so many members of this Committee on the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA), which President Bush signed into law December 8, 2003. With the implementation of MMA, the Department faces many challenges in the coming fiscal year. As the most significant reform of Medicare since its inception in 1965, the law expands health plan choices for beneficiaries and adds a prescription drug benefit. MMA will strengthen and improve the Medicare program, while providing beneficiaries with new benefits and the option of retaining their traditional coverage. The HHS FY 2005 budget request includes about $482 billion in net outlays to finance Medicare,

Medicaid, the State's Children's Health Insurance Program, the Health Care Fraud and Abuse Control Program, State insurance enforcement, and the Agency's operating costs.

Drug Discount Card

MMA establishes a new, exciting Medicare approved prescription drug discount card program, providing immediate relief to those beneficiaries who have been burdened by their drug costs. From June 2004 through 2005, all Medicare beneficiaries, except those with Medicaid drug coverage, will have the choice of enrolling in a Medicare-endorsed drug discount card program. With the discount card, beneficiaries will save an estimated 10 to 15 percent on their drug costs. For some, savings may reach up to 25 percent on individual prescriptions. A typical senior with $1,285 in yearly drug expenses could save as much as $300 annually. To enroll, beneficiaries will pay no more than $30 annually. Those with low incomes will qualify for a $600 per year subsidy to purchase drugs. Medicare also will cover the enrollment fees for low-income seniors.

Voluntary Prescription Drug Benefit

Responding to President Bush's pledge to add meaningful drug coverage to Medicare, MMA establishes a new voluntary prescription drug benefit under a new Medicare Part D. Starting in 2006, Medicare beneficiaries who are entitled to Part A, or enrolled in Part B, can choose prescription drug coverage under the new Part D. Under Part D, beneficiaries can choose to enroll in stand-alone, prescription drug plans (PDPs) or Medicare Advantage prescription drug plans (MA-PDs), and will be able to choose between at least two plans to receive their benefit. The law contains important beneficiary protections. For example, while the plans are permitted to use formularies, they must include drugs within each therapeutic category and class of covered

Part D drugs, allowing beneficiaries to have a choice of drugs. In instances in which a drug is not covered, beneficiaries can appeal to have the drug included in the formulary. To reduce the number of prescribing errors that occur each year, HHS will develop an electronic prescription program for Part D covered drugs.

Medicare Advantage

MMA replaces the Medicare+Choice program with a new program called Medicare Advantage, which will operate under Part C of Medicare. Starting in 2004, the new law changes how private plans will be paid. In response to the increasing costs of caring for Medicare beneficiaries, the law increases payments to managed care plans by $14.2 billion over 10 years. These enhanced payments will allow private plans to provide more generous coverage, including benefits that traditional Medicare may not offer. Specifically in 2004, plans must use these funds to provide additional benefits, to lower premiums and/or cost-sharing, or to improve provider access in their network. This increased compensation will also encourage more private plans to enter the Medicare market, improving beneficiaries' overall access to care.

Under Medicare Advantage, local managed care plans will continue to operate on a county-by-county basis. Beginning in 2006, Medicare Advantage also will offer regional plans, which will cover both in-network and out-of-network services in a model very similar to what we in the Federal Government enjoy through the Federal Employee Health Benefits Program. There will be at least 10 regions, but no more than 50. The regional plans must use a unified deductible and offer catastrophic protection, such as capping out-of-pocket expenses.

The changes in the Medicare advantage program will provide seniors with more choices, improved benefits, and provide beneficiaries a choice for integrated care – combining medical and prescription drug coverage. We project that 32 percent of Medicare beneficiaries will enroll in Medicare Advantage plans by 2010.

Providers and Rural Health

Recognizing geographic disparities in Medicare payments, MMA provides much needed relief to rural providers by equalizing the standardized amounts paid to both urban and rural hospitals. Along with standardizing the base payment amounts to both urban and rural hospitals, MMA reduces the labor share of the standardized payment amount. In addition MMA increases payments for Disproportionate Share Hospitals (DSH) and provides greater flexibility to Graduate Medical Education (GME) residencies. The new law also increases flexibility for hospitals seeking Sole Community Hospital (SCH) status and reduces the requirements for achieving Critical Access Hospital (CAH) status. Critical Access Hospital status will receive increased payments under MMA, as the payment rate will be increased to 101 percent of allowable costs.

Providers will see increased reimbursements under MMA. Physicians practicing in defined shortage areas will receive an additional 5 percent payment bonus. Home Health Agencies in rural areas also will receive a 5 percent bonus. In a change for rural hospice providers, more freedom will be given to utilize nurse practitioners. The law also creates an Office of Rural Health Policy Improvements and requires demonstration projects involving telehealth, frontier services, rural hospitals, and safe harbors.

Preventive Benefits

MMA expands the number of preventive benefits covered by Medicare beginning in 2005. Through a particularly important provision, an initial preventive physical examination will be offered within six months of enrollment for those beneficiaries whose Medicare Part B coverage begins January 1, 2005 or later. The examination, as appropriate, will include an electrocardiogram and education, counseling, and referral for screenings and preventive services already covered by Medicare, such as pneumococcal, influenza and hepatitis B vaccines; prostate, colorectal, breast, and cervical cancers; in addition to screening for glaucoma and diabetes. Diabetes and cardiovascular screening blood tests do not have any deductible or co-payments, as Medicare pays for 100 percent of these clinical laboratory tests.

Regulatory Reform/Contracting Reform

MMA includes a number of administrative and operational reforms, as well. For example, regulatory reform provisions require the establishment of overpayment recovery plans in case of hardship; prohibit contractors from using extrapolation to determine overpayment amounts except under specific circumstances; describe the rights of providers when under audit by Medicare contractors; require the establishment of standard methodology to use when selecting a probe sample of claims for review; and prohibit a supplier or provider from paying a penalty resulting from adherence to guidelines. In addition, MMA allows physicians to reassign payment for Medicare services to entities with which the physicians have an independent contractor arrangement. Under the new law, final regulations are to be published within three

years, and all measures of a regulation are to be published as a proposed rule before final publication.

Also under the law, as Secretary, I will be permitted to introduce greater competitiveness and flexibility to the Medicare contracting process by removing the distinction between Part A and Part B contractors, allowing the renewal of contracts annually for up to five years, limiting contractor liability, and providing incentive payments to improve contractor performance. These changes will enhance HHS efficiency and effectiveness in program operations.

Regarding Medicare appeals, MMA changes the process for fee-for-service Medicare by requiring the Social Security Administration and HHS to develop and implement a plan for shifting the appeals function from SSA to HHS by October 1, 2005. MMA also changes the requirements for the presentation of evidence. This also will enhance the efficiency and effectiveness of the operation of the Medicare program.

Medicare and Medicaid Estimates

Historically, HHS and the Congressional Budget Office (CBO) have provided differing estimates of Medicare and Medicaid spending. It is not uncommon for different assumptions underlying the respective estimates to produce differences in cost projections. This year's new estimates include the changes resulting from enactment of MMA.

When Congress considered this act, Mr. Chairman, CBO estimated the cost of the bill at $395 billion from 2004 to 2013. The HHS actuaries have recently estimated the cost of the law as

$534 billion from 2004 to 2013. Last week, the CBO Director told the House and Senate Budget Committees that CBO has not changed its estimate and that they continue to believe that the cost of the bill is $395 billion. Because the Medicare legislation makes far-reaching changes to a complex entitlement program with many new private-sector elements, there is even larger uncertainty in these estimates than usual.

The two sets of estimates provide a reasonable range of possible future cost scenarios for Medicare spending. The tremendous uncertainty surrounding estimates of the newly-enacted Medicare law has resulted in a plausible range of estimates of future cost scenarios for Medicare spending, from the $395 billion estimate from CBO to the $534 billion estimate from the Medicare actuaries. It should be noted that this difference of $139 billion is approximately two (2) percent of the projected $7 trillion in total Federal Medicare and Medicaid spending over the same period, as projected by HHS.

Additional MMA Changes

MMA addresses other issues facing the Medicare program including the program's long-term, financial security. To contain costs in the Medicare program, the law requires the Medicare Trustees, beginning in the 2005 annual report, to assess whether Medicare's "excess general revenue funding" exceeds 45 percent. As defined in the law, excess general revenue funding is equal to Medicare's total outlays minus dedicated revenues. The Medicare Trustees shall issue a "warning" if general revenues are projected to exceed 45 percent of Medicare spending in a year within the next seven years. If the Trustees issue such a warning in two consecutive years, the

law provides special legislative conditions for the consideration of proposed legislation submitted by the President to address the excess general revenue funding.

In addition to implementing MMA, the HHS budget request includes provisions for the State Children's Health Insurance Program, the New Freedom Initiative, and Medicaid.

State Children's Health Insurance Program (SCHIP)

As you know, Mr. Chairman, SCHIP was created with a funding mechanism that required states to spend their allotments within a three-year window, after which any unused funds would be redistributed among states that had spent all of their allotted funds. These redistributed funds would be available for one additional year, after which any unused funds would be returned to the Treasury.

On August 15, 2003, President Bush signed Public Law 108-74. The law restores $1.2 billion in FY 1998 and FY 1999 SCHIP funds, and makes them available to states until September 30, 2004. The law also extends $2.2 billion in FYs 2000 and 2001 SCHIP funds, and revises the rule for the redistribution of the unspent funds from these allotments. For FYs 2000 and 2001 allotments, the law allows states that do not spend their entire allotment within the three-year period to keep half of those respective year's unspent amounts. The other half would be redistributed to states that have spent their entire amount of the respective year's allotments. The law also extends the availability of funds from the FY 2000 allotments through September 30, 2004, and the availability of FY 2001 allotment through September 30, 2005. The law gives

some relief to states that expanded their Medicaid programs to cover additional low-income children prior to the enactment of SCHIP.

New Freedom Initiative

The Administration is committed to ensuring that people with disabilities and/or the long-term care needs receive the supports necessary to remain in (or return to) the community as opposed to remaining in an institutional setting. One of the Administration's priorities is relying more on home- and community-based care, rather than costly and confining institutional care, for the elderly and people with disabilities. The New Freedom Initiative signifies the President's commitment to promoting at-home and community-based care. There are several components to this initiative, Mr. Chairman, which I would like to bring to your attention.

Under the "Money Follows the Individual Re-Balancing Demonstration" states could participate in a five-year demonstration that finances services for individuals who transition from institutions to the community. Federal grant funds would pay for the home- and community-based waiver services of an individual for one year at an enhanced Federal match rate of 100 percent. As a condition of receiving the enhanced match, the participating State would agree to continue care at the regular Medicaid matching rate after the end of the one-year period and to reduce institutional long-term care spending.

The New Freedom Initiative is very important to me and to the President, and we would like to work closely with Congress to secure its passage this year. The Administration recognizes the success of consumer directed programs that give people the opportunity to manage their own

long-term care, as delineated by the development of its Independence Plus Waivers. Thus, we propose allowing individuals who self-direct all of their community-based, long-term care services to accumulate savings and still retain eligibility for Medicaid and Supplemental Security Income. Under current law, beneficiaries are discouraged from accumulating savings because it could jeopardize their eligibility for Medicaid and SSI. Under the Living with Independence, Freedom, and Equality (LIFE) Accounts Program, individuals who self-direct all of their Medicaid, community-based, long term supports will be able to retain up to 50 percent of savings from their self-directed Medicaid community-based service budget at year end, contribute savings from employment, and accept limited contributions from others. Ultimately, LIFE Accounts would enable individuals to save money to reach long-term goals (for example, to purchase expensive equipment or attain higher education) and to obtain greater independence.

The Administration looks forward to working with Congress to pass legislation authorizing me, as Secretary, to administer demonstrations to assist caregivers and children with serious emotional disturbances. Two demonstrations will provide respite services to caregivers of adults with disabilities and to children with severe disabilities. A third demonstration will offer home and community-based services for children currently residing in psychiatric facilities. The fourth demonstration will address shortages of community, direct-care workers by providing grants to States to identify best practices and develop models. Direct-care workers play an important role in providing care to individuals living with disabilities in the community and this demonstration should help address these workforce challenges.

Medicaid and SCHIP Modernization

This Committee is well aware that Medicaid spending continues to rise each year. Total Medicaid spending for 2004 is projected to be $304 billion, nearly a tripling in spending over 10 years. Medicaid -- not Medicare -- is currently the largest government health program in the United States. Since Medicaid expenditures are a large and growing proportion of most state budgets, the Medicaid program is an area to which states turn to reduce costs including dropping optional Medicaid benefits or limiting optional groups from enrolling.

These concerns have fostered a dialogue between the Federal government and the states regarding ways to improve and modernize Medicaid and SCHIP. Building on this dialogue, the Administration will continue to work with Congress and other stakeholders to seek new ways to strengthen and improve the Medicaid and SCHIP programs.

In addition to structural reform, improving the fiscal integrity of the Medicaid program will continue to be a priority for the Administration and HHS. Among these efforts, the Administration proposes capping the reimbursement level to individual state and local government providers to no more than the cost of providing services to Medicaid recipients and restricts the use of certain types of intergovernmental transfers. The proposal would deem as "unallowable" certain Medicaid expenditures that result in Federal Medicaid and disproportionate share hospital (DSH) payments returned by a government provider to the state. The proposal would not affect legitimate intergovernmental transfers that are used to help raise funds for the state share of Medicaid costs. Rather, this proposal would only apply to

intergovernmental transfers that are used to recycle Medicaid payments through government providers.

Other Medicaid Legislation

Extension of the Qualified Individual (QI) Program

The Administration is committed to helping low-income seniors afford not only prescription drugs, but also health coverage through Medicare. Under current law, as authorized by MMA, Medicaid programs will pay Medicare Part B Premiums for qualifying individuals (QIs) through September 30, 2004. QIs are defined as Medicare beneficiaries with incomes of 120% to 135% of the Federal Poverty Level and minimal assets. The HHS budget would continue this premium assistance for one additional year.

Extension of Transitional Medical Assistance

As families make the transition from welfare to work, health coverage is an important component to ensure their success in contributing to, and remaining in, the work place. Transitional medical assistance (TMA) was created to provide health coverage for former welfare recipients after they entered the workforce. TMA extends up to one year of health coverage to families who lose eligibility for Medicaid due to earnings from employment. This provision will expire March 31, 2004. The Administration proposes a five-year extension of TMA with statutory modifications to simplify administration of the program for states. States would have the option to eliminate TMA reporting requirements; provide twelve months of continuous eligibility; and to request a waiver from providing the mandatory TMA program in

their Medicaid program if their eligibility income level for families is set at 185 percent of the Federal Poverty Level or higher.

Partnership for Long-Term Care

The budget request, Mr. Chairman, includes a proposal to eliminate the legislative prohibition on developing more partnership programs for long-term care (LTC). The partnership for LTC was formulated to explore alternatives to current LTC financing by blending public and private insurance. Four states currently have these partnerships in which private insurance is used to cover the initial cost of LTC. Consumers who purchase partnership-approved insurance policies can become eligible for Medicaid services after their private insurance is utilized, without divesting all their assets as is typically required to meet Medicaid eligibility criteria.

Refugee Exemption Extension

Under current law, most legal immigrants who entered the country on or after August 22, 1996, and some who entered prior to that date, are not eligible for SSI until they have obtained citizenship. Refugees and asylees are currently exempted from this ban on SSI for the first seven years they reside in the United States. To ensure refugees and asylees have ample time to complete the citizenship process, the President's budget proposes extending the current seven-year exemption to eight years.

Special Enrollment Period in the Group Market for Medicaid/SCHIP Eligible

This legislative proposal would make it easier for Medicaid and SCHIP beneficiaries to enroll in private health insurance by making eligibility for Medicaid and SCHIP a trigger for private

health insurance enrollment outside of the plan's open season. This proposal will help states implement premium assistance programs in Medicaid and SCHIP.

Marriage and Healthy Family Development

This year the President is proposing a new marriage and healthy family development initiative. This Initiative is supported by funding increases in this Department's FY 2005 budget, encompasses a variety of new and existing programs, and impacts both mandatory and discretionary programs.

I am very grateful to the Finance Committee for acting to advance Temporary Assistance to Needy Families (TANF) reauthorization last fall, and I look forward to working together as the bill is considered on the Senate Floor in weeks ahead. Building on the considerable success of welfare reform in this great Nation, the President's FY 2005 Budget maintains the framework of the Administration's welfare authorization proposal. We are committed to working with the Congress in the coming months to ensure the legislation moves quickly and is consistent with the President's Budget. The President's proposal includes five years of funding for the TANF Block Grant to States and Tribes; Matching Grants to Territories; and Tribal Work Program. A new feature, intended to support the President's Marriage and Healthy Family Development Initiative, is a proposal for increased funding for two key provisions in our welfare reform package.

A cornerstone of the President's commitment to strengthen and empower America's families through welfare reform provides targeted resources to family formation and healthy marriage

strategies. Statistics tell us that children from two parent families are less likely to end up in poverty, drop out of school, become addicted to drugs, have a child out of wedlock, suffer abuse or become a violent criminal and end up in prison. Building and preserving families are not always possible. But it should always be our goal.

Beginning in FY 2005, the FY 2005 budget would provide an additional $20 million, a total of $120 million, under TANF to support research, demonstrations, and technical assistance primarily focused on family formation strategies and healthy marriages and an additional $20 million for matching grants to States, Territories, Tribes, and Tribal Organizations for innovative approaches to promoting healthy marriage and reducing out-of-wedlock births. A dollar-for-dollar match to participate in the grant program will be required, generating another $20 million in matching State and local funds. States can use Federal TANF funds to meet this matching requirement. In total, $360 million in Federal and State funding would be available in the FY 2005 Budget to broaden the Administration's efforts to support healthy marriages and promote effective family formation.

To reverse the rise in father absence and improve the well-being of our Nation's children, the budget includes a total of $50 million for grants for public entities; nonprofits, including faith-based; and community organizations to design demonstration service projects. These projects will test promising approaches to improve outcomes for children by encouraging the formation and stability of healthy marriages and responsible fatherhood, and to assist fathers in being more actively involved in the lives of their children.

As the Committee may remember, President Bush announced in his State of the Union address a new initiative to educate teens and parents about the health risks associated with early sexual activity and to provide the tools needed to help teens make responsible choices. To do this, the President proposes to double funding for abstinence education activities for a total of $273 million, including a request of $186 million, an increase of $112 million, for grants to develop and implement abstinence educations programs for adolescents aged 12 through 18 in communities across the country; the reauthorization of state abstinence education grants for five years at $50 million per year as part of the welfare reform reauthorization; another $26 million for abstinence activities within the Adolescent Family Life program; and a new public awareness campaign to help parents communicate with their children about the health risks associated with early sexual activity.

In addition, the budget provides for significant increases to two State child abuse programs reauthorized this past year as part of the Keeping Children and Families Safe Act of 2003. The increase for the Child Abuse Prevention and Treatment State Grants will enable State child protective service systems to shorten the time to the delivery of post-investigative services from 48 to 30 days. The Community-Based Child Abuse Prevention program will increase the availability of prevention services to an additional 55,000 children and their families.

Child Welfare

The Administration is proposing a nearly $5 billion budget for Foster Care. These funds will be used to support the President's child welfare program option, which provides states more flexibility in both the population served and allowable activities. The funds will be used to

provide payments for maintenance and administrative costs for more than 230,000 children in foster care each month, as well as payments for training and child welfare data systems. The HHS budget request reflects savings associated with a legislative proposal to clarify the definition of "home of removal" in the foster care program in response to a court decision. The President's FY 2005 budget also requests $140 million for the Independent Living Program and $60 million for the Independent Living Education and Training Vouchers program. Additionally, to support the Administration's commitment to helping families in crisis and to protecting children from abuse and neglect, the President's FY 2005 Budget requests $505 million, full funding, of the Promoting Safe and Stable Families program.

Child Support Enforcement

The President's FY 2005 budget, building on the high level of success achieved by the Child Support Enforcement Program, focuses on critical improvements in the arena of medical child support. Legislation will be proposed to enhance and improve state's efforts to collect medical support on behalf of children. These efforts include providing Child Support agencies with notifications of lost coverage (COBRA notices) so they can assist families in providing continuous health care coverage. Additionally, legislation would require states to consider both parents' access to health care coverage when establishing child support orders, with the option of enforcing medical support orders against both custodial and noncustodial parents. By assuring that IV-D agencies receive notice of a child's loss of health insurance coverage, and by seeking health insurance from either parent, more children will have access to continuous health coverage, which will result in healthier children and families.

These proposals build on the policies in the FY 2004 budget that increase resources for the Access and Visitation Program to support and facilitate non-custodial parents' access to visitation of their children, and various proposals to enhance and expand the existing automated enforcement infrastructure at the Federal and State level. When combined with the opportunities to increase child support outlined in the President's FY 2003 budget, such as expanded passport denial, the offset of certain Social Security benefits, and the optional pass through of child support to families on TANF, these proposals offer an impressive $8.1 billion in increased child support payments to families over 10 years.

Compassion and Faith Based Agenda

Compassion Capital Fund

The FY 05 budget requests $100 million for the Compassion Capital Fund, which creates public/private partnerships that support charitable organizations in expanding or emulating model social service programs.

Samaritan Initiative

The President's budget also continues and strengthens the Administration's commitment to end chronic homelessness by proposing $70 million for the Samaritan Initiative, a new competitive grant program jointly administered by the Departments of Housing and Urban Development, Health and Human Services, and Veterans Affairs that supports the Administration's efforts to end chronic homelessness by 2012. These grants will support the most promising local strategies to move chronically homeless persons from the streets to safe permanent housing with

Our Nation's health, Mr. Chairman, is not dependent solely on access to care and treatment, but also on the security of our health in a global context. Our Nation faces threats from bioterrorism, disease outbreaks in other countries, and food-borne diseases and illnesses. The HHS budget targets $373 million of investments to accelerate the detection of and response to potential disease outbreaks of any kind, regardless of whether the pathogen is naturally occurring or intentionally released. The Food and Drug Administration (FDA) has already expanded its work dramatically to prevent intentionally contaminated foods from entering the U.S. The President's FY 2005 budget takes the next step by making the needed investments in FDA to expand substantially the laboratory capacity of its State partners, and to find faster and better ways to detect contamination, particularly at ports, processing plants, and other food facilities.

Management Improvements

Finally, I would like to update the committee on the Department's efforts to use our resources in the most efficient manner. To this end, HHS remains committed to setting measurable performance goals for all HHS programs and holding managers accountable for achieving results. I am pleased to report that HHS is making steady progress. We have made strides to streamline and make performance reporting more relevant to decision makers and citizens. As a result, the Department is better able to use performance results to manage and to improve programs. By raising our standards of success, we improve our efficiency and increase our capability to improve the health of every American citizen.

Improving the Health, Safety, and Well-being of Our Nation

Mr. Chairman and members of the Committee, the budget I bring before you contains many different elements of a single proposal. The common thread running through these policies is the desire to improve the lives of the American people. Our FY 2005 HHS budget proposal builds upon our past successes to improve the Nation's health; to focus on improved health outcomes for those most in need; to promote the economic and social well-being of children, youth, families, and communities; and to protect us against biologic and other threats through preparedness at both the domestic and global levels. It is with the single, simple goal of ensuring a safe and healthy America that I have presented the President's FY 2005 budget today. I know this is a goal we all share, and with your support, we at the Department of Health and Human Services are committed to achieving it.

Chairman NICKLES. Thank you very much. I appreciate your testimony before the Committee. The Committee is adjourned.

[Whereupon, at 12:12 p.m., the Committee was adjourned.]

Brief Statement
February 12, 2004

Thank you, Mr. Chairman.

Also, thank you Secretary Thompson for joining us this morning. This is the fourth time the Budget Committee has had the opportunity to discuss the President's budget request with you. Last year, we discussed how to pay for landmark Medicare legislation and modest increases to the Health and Human Services Budget. This year, we are still discussing how to pay for the landmark Medicare legislation and even more modest increases to the budget. The recurring theme of this hearing points to both the challenges and the opportunities we face in 2005. I thank you for sharing your views with us today.

I would like to preface my statement by saying that I am encouraged by the steps we are taking to address the risks to our nation's health and well-being. While the budget only provides modest increases, which is prudent given our ballooning deficits, we are funding the research that will keep America advancing towards new medical breakthroughs and more effective treatments. We have renewed our efforts to fight HIV and AIDS across the

World. Mr. Secretary, some of your agencies will play an important role in carrying out President Bush's Emergency Plan for AIDS Relief and I am interested in hearing your thoughts on this issue.

Of course I would be remiss in not mentioning the Medicare Modernization Act that my congressional colleagues and I passed last year. This Act will give seniors more options for health care coverage and the ability to afford the prescription drugs they need.

It has been obvious for a long time that seniors are in desperate need of prescription drug coverage. Unfortunately, under the old Medicare system, the flexibility to change with the needs of Medicare recipients just wasn't there. With the new Medicare Act, seniors will start saving immediately with their Senior Discount Cards. When the voluntary prescription drug benefit begins in January, 2006, seniors will get an even better deal on their prescriptions. The typical senior who signs up for Medicare drug coverage will save 50 percent on their out-of-pocket costs, and that's not small change.

One of the most controversial provisions of this Act is the role that private companies will play in providing the medical insurance and drug coverage that seniors need. As a former businessman, I appreciate the ability of market-oriented solutions to spur innovation and drive down prices through competition. However, I also realize that the healthcare marketplace is not like any other market. Not every senior is going to have the same needs and no senior should be forced to have only one choice when it comes to health care providers. At the same time, flexibility comes at a price.

There has been a lot of discussion about whether Medicare should negotiate prices for drugs directly with pharmaceutical companies, or whether Medicare should leave these negotiations up to the plans that win the bidding to offer Medicare drug coverage to seniors. I understand that the federal government negotiates directly with drug manufacturers in the Veterans Affairs healthcare system. I also understand that in the Federal Employees health plan, the government leaves the negotiations up to the private plans to which you and I belong. Can you explain why you believe it makes more sense for Medicare to address drug prices the same way our Federal Employees health plan does?

Budget Committee Hearing
Department of Health and Human Services
February 12, 2004
Statement of Senator Tim Johnson

Given the precarious position of the federal government's finances, I can not begin any discussion of a particular department's budget without first commenting on the priorities and direction afforded to this country by the President's fiscal stewardship. The President's budget projects an all-time record budget deficit of $521 billion. In February 2003, the FY '04 budget submitted by President Bush anticipated a $304 billion deficit. However, the picture is even bleaker if you exclude the surplus receipts of the Social Security Trust Fund, the actual size of the projected FY'04 budget balloons to $696 billion.

The President's budget pledges to reduce the size of the deficit in half to $237 billion by the end of the decade. Keep in mind, however, that last February, the President's FY'04 budget predicted a 2004 budget deficit of $304 billion, which is $217 billion less than what the White House is predicting today - $521 billion.

I am pleased that Secretary Thompson is before this committee today to discuss the Administration's 2005 budget. I have submitted several questions to the record and I look forward to the Secretary's response. The budget request before this committee today is very disappointing. It shows that this Administration has little interest in making domestic issues a priority. The domestic issues that are being financially abandoned by President Bush are issues that are most important to the every day lives of every day Americans. South Dakotans are going to feel very let down by the President when they learn about the budget cuts in this request.

While the Fiscal Year 2005 budget requests $571.6 billion for the Department of Health and Human Services or an approximately $15 billion increase over 2004, 88 percent of those dollars are for the mandatory Medicare and Medicaid programs. The discretionary spending budget request is $68 billion, which is a $1.1 billion decrease from last year. There are countless programs that are cut in this budget. So many, that there is simply not enough time to raise them all. A few areas of great concern to me that I would like to highlight include the cuts to programs that assist rural communities and programs intended to protect public health.

The President's budget includes a $610 million cut for programs at the Health Resources Services Administration or HRSA. HRSA programs are critical to rural communities. The cuts include the entire elimination of the Rural Health Flexibility Grant Program and Small Rural Hospital Improvement Program or SHIP. The President's cuts in these areas represent a 70% reduction in HRSA's rural specific programs, the largest reductions to rural programs in more than 10 years.

The SHIP program provides significant dollars for small rural South Dakota hospitals so they can meet governmental confidentiality guidelines and improve quality of care. While urban providers have been able to work with Medicare Quality Improvement Organizations, rural

hospitals have been left out in responding to quality requirements brought by third-party payers. The SHIP program will help rural providers keep up with the pace and in 2003, South Dakota received $400,000 through this program and was able to help 42 small rural hospitals.

The Flexibility Grants Program that the President proposes to eliminate has provided significant funding for hospitals in my state. In 2003, South Dakota received $650,000 for this program, which provides enhanced reimbursement for rural hospitals. These funds have been used to help hospitals determine whether they should convert to Critical Access Hospital status. They have also been used for rural health planning, network development and rural emergency medical services. The elimination of this program threatens not only the viability of rural hospitals, but also the viability of rural communities which rely on those providers to sustain their existence.

The President has also requested a $17 million reduction in rural outreach grants at HRSA, leaving only $11 million for this program. These grants have provided important funding sources to various rural providers across the country. In South Dakota, these funds have helped the University of South Dakota to create a project jointly with Cheyenne River Sioux Tribe to provide critical pediatric specialty services. The Yankton Sioux Tribe has also developed a drug and alcohol counseling and treatment grant program through use of these funds. Outreach grants are awarded for three years, meaning grantees awarded grants the past two years will be unable to complete their projects. Project directors will lose their jobs and rural communities will face an economic loss caused by the loss of the projects. It is estimated these cuts will affect as many as 80 rural health projects and rural health networks across the country.

The President's 2005 budget also cuts funding for health professions programs by $283 million, leaving only $11 million for this program. The Administration proposed similar cuts last year. Luckily, Congress denied those cuts by and provided $436 million for all health professions and nursing programs in 2004. It is my hope that we will do at least the same for 2005. The proposed cuts include programs such as: Training in Primary Care and Dentistry, Pubic Health Workforce Development Program and the Quentin N. Burdick Rural Interdisciplinary Training Program. Health care workforce shortages are evident all across the country, but the problem is particularly acute in rural communities and enhanced funding rather than reduced funding is essential.

The budget also requests $39 million less for bioterrorism hospital preparedness funds, from $515 million in 2004 down to $476 million. These dollars have been used in my state to promote coordination between hospitals, health departments and other providers. Not only have these funds helped the state prepare for a bioterrorist attack, but have also improved the state's capacity to deal with infectious diseases including: SARS, West Nile Virus, TB and Smallpox.

The Administration has indicated that the funding cuts mentioned here are justified due to the recently enacted Medicare prescription drug bill which included provider payment fixes. It is wrong to assume the provisions of the Medicare bill eliminates the need for grant programs that specifically address the health needs of rural communities. The Medicare provisions address only Medicare payment policy. Rural communities face a number of issues apart from Medicare payments. Making this assumption shows a clear lack of understanding of the problems rural

areas face in the delivery of health care.

I am also concerned that while the Administration touts its $274 million request for a new biosurveillance initiative, the Center for Disease Control or CDC's overall budget would be reduced by 8.9 percent to $4.2 billion. The new initiative is established on the backs of important state and local funding programs, which receive significant cuts in the President's budget. Rural states such as mine rely heavily on these sources of funding for public health infrastructure and programming development.

The President's CDC budget includes cuts of $105 million for State and Local Capacity Grants and $25 million for capacity research. The state and local capacity grants program was an integral part of South Dakota's ability to build it's new public health lab, which monitors infectious disease outbreaks such as West Nile Virus and the flu. The President's 2005 budget includes only $113 million for public health improvement programs, which is $59 million less than the 2004 level of $172 million. These dollars will no longer be available for important state public health projects, as well as extramural prevention research. The capacity of our public health infrastructure is critical to protecting the public health from infectious disease and chronic disease threats. The Administration's proposal signals a disinterest in improving the health status of our communities.

There are numerous cuts in this proposed budget. There is less money for Medicaid and the State Children's Health Insurance Program (SCHIP). A flat-lined budget of $125 million for disease prevention initiatives for diabetes, obesity and asthma at a time when the rates of these diseases are skyrocketing. A flat-lined budget for the Administration on Aging for the third year in a row, at a time when the elderly population is growing. And I am also concerned that we may not be doing all we can to ensure that our Native American health programs are appropriately funded. All of these budget shortfalls should send a clear message to the American people of where President Bush's priorities are and are not. I plan to work hard through the Appropriations committee to correct these shortfalls and I urge all of my colleagues to join me.

THE PRESIDENT'S FISCAL YEAR 2005 BUDGET PROPOSALS

FRIDAY, FEBRUARY 13, 2004

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in room SD–106, Dirksen Senate Office Building, Hon. Don Nickles (chairman of the committee) presiding.

Present: Senators Nickles, Domenici, Allard, Bunning, Crapo, Cornyn, Conrad, Byrd, and Stabenow.

Staff present: Hazen Marshall, majority staff director; and Cheri Reidy, senior analyst for budget review/revenues.

For the minority: Mary Ann Naylor, staff director; and Jim Klumpner, chief economist, Steve Bailey, senior analyst for revenues.

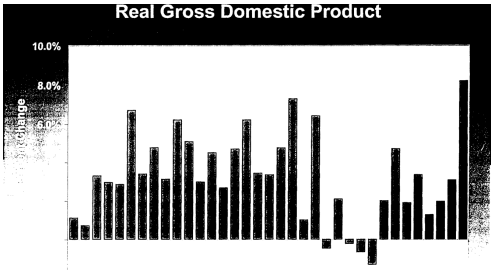
OPENING STATEMENT OF CHAIRMAN NICKLES

Chairman NICKLES. The committee will come to order. I want to thank Secretary Snow for being with us today and thank all of our colleagues. We appreciate their willingness and cooperation to change rooms.

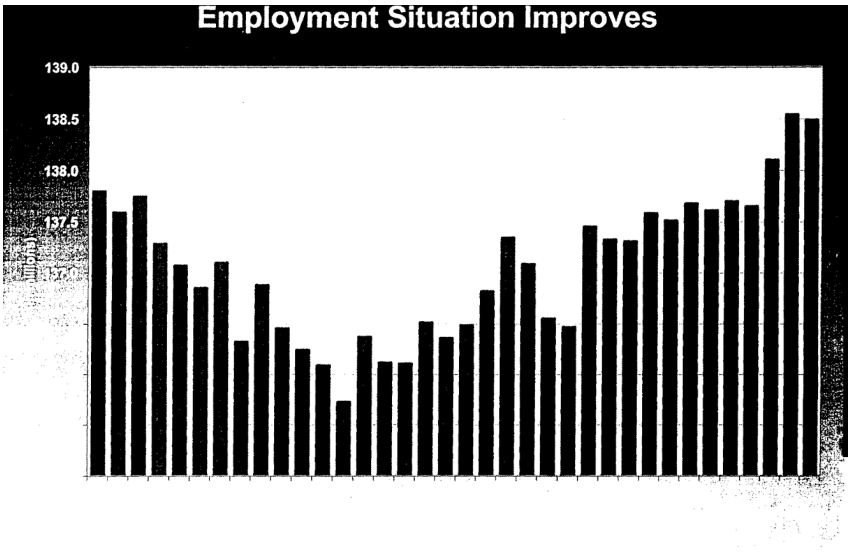
Let me just make a couple comments. I am delighted that Secretary Snow is with us today. A year ago, Secretary Snow assumed office, and he did so at a very difficult and challenging and troubling time. The economy had been in a slide, revenues had declined for 3 years in a row, and the economy was still very, very slow. I met with Secretary Snow, and others did, and he and the President proposed an economic package to grow the economy.

And, Mr. Secretary, but you made a proposal to grow the economy and you succeeded. And I want to compliment you for that, and I will show a couple of charts to give some evidence to that.

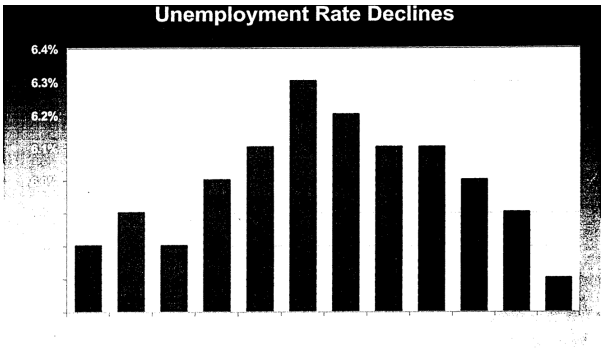
The first chart is gross domestic product, and it shows very significant growth in the last year, I think in large part because of some of the changes that we have enacted.



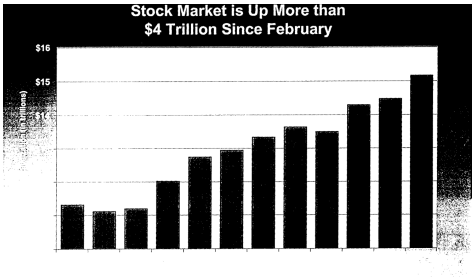
Look at the next chart, and it shows the unemployment situation has actually improved. Now, this is a chart of the household survey figures, and, granted, there is a difference between the household survey and the payroll survey. But the chart shows all-time record employment, and it is significant and it is real.



The next would be the unemployment rate, and that shows, again, we have had a significant reduction in the unemployment rate, and that is positive. It was, I think, something like 6.3 percent; now it down to 5.7 percent. So it is certainly moving in the right direction.



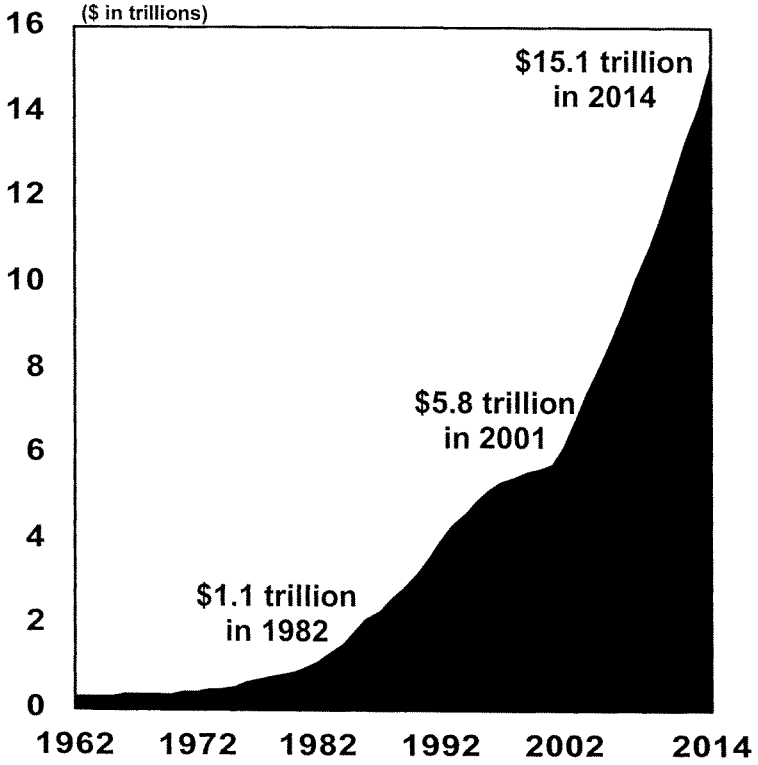
The stock market has risen, as a result, greatly, I think, because of the tax changes that we made, cutting the dividend rate about in half and cutting the cap gains rate from 20 to 15 percent, which we did in last year's bill. It is up from $11 trillion to over $15 trillion in assets in the market. That is a $4 trillion increase, that is about a 40-percent increase. That is a very significant increase. So our tax changes made a difference.



I would also just show the top marginal rate as a result of some of our efforts. It was 28 percent at the end of Ronald Reagan's term. It was 31 percent at the end of President Bush I's term. It was 39.6 percent at the end of President Clinton's term. And we reduced it 35 percent. I might note we did not take it all the way down to 31 percent; we took it to 35 percent. Again, I think as a result of some of those changes, we have made significant positive improvement in the economy.

Gross Federal Debt

Assuming Extension of GOP Tax Cuts, AMT Reform, and Bush Defense Policies



Source: OMB, CBO, Senate Budget Committee
Note: CBO January 2004 baseline plus the extension of the GOP tax cuts (EGTRRA/JGTRRA), other expiring tax provisions (except bonus depreciation), AMT reform, the President's defense request, and estimates of new funding required to maintain ongoing military operations and war on terror. Discretionary totals treat $87 billion supplemental as a one-time expenditure.

Mr. Secretary, you came in a year ago. You had a significant challenge that you presented to us to make changes in tax policy to help grow the economy. We did that, in large part following the outlines that you gave us a year ago, a big challenge. And I think we have had some very good results. So I compliment you for that.

We have big challenges now. The deficits are unacceptable. They need to be brought down. The administration says they want to reduce them by half in 5 years. I hope that we can beat that. I would like to accelerate that goal as much as possible, and that will not be easy. So I am going to be asking you some tough questions on how we can get the deficit down. The tax code that you have charge over has a lot of tax revenue in it, but it also has a lot of expenditures in it. And I want to examine both. I want to be working with your Department to find loopholes. I want to be working to find tax shelters. I want to be working to find things that lead to unreported income.

I happen to think—and Senator Conrad has mentioned it to me—there is a lot of income that is not taxed, that is not reported, that is underground. We need to find it. We need to be aggressive. We need to stop programs that have significant expenditures to them that have very large error rates. I am talking about the earned income credit program. We need to fix it. We need to make sure the money goes to those people who deserve it, but not to people who don't deserve it.

There are billions of dollars at stake, so we have a very aggressive challenge. We have to get our fiscal house in order. Four or five hundred billion dollar deficits are not acceptable. And I plan on doing everything I can in this year, in this budget, working with you, maybe in- or outside of a reconciliation package, but I want to do as much as we can to get our fiscal house restored. I look forward to working with you, but, again, I want to compliment you for your first year in service. I think you have had a remarkable, successful tenure as Secretary of the Treasury, and I compliment you and the President for the results that I have just illustrated.

I call on my colleague and friend, Senator Conrad.

OPENING STATEMENT OF SENATOR CONRAD

Senator CONRAD. Thank you, Mr. Chairman, and let me just start by saying how welcome this discussion has been from you this morning with respect to the need to get deficits down. You have said this at a number of our meetings, and I agree with you entirely. These deficits are too large. They are unacceptable and we need to make far more progress than is being suggested.

We have to look on the spending side of the equation, and we have to look on the revenue side of the equation. I agree with you entirely that one of the areas we need to look at on the revenue side of the equation is this tax gap, the difference between what is being paid and what is being owed. The Revenue Service now says that is over $250 billion a year. That is a stunning amount of leakage in the system.

There is one thing the chairman did not mention, and let me just put it up in terms of—and that is the growth of the deficit. And it has been dramatic, and it is of record proportion. The deficit now

in dollar terms is by far the biggest it has ever been. Last year was a record, and this year surpassed it by more than $100 billion.

Mr. Secretary, I mentioned to you when I greeted you that I wanted to recall some of my favorite Secretary Snow quotes from before you were Secretary. This is my all-time favorite: "A balanced Federal budget is the best choice to ensure a bright future for the Nation's economy." Yesterday you were talking in the Finance Committee about how we have to pay attention to the economy. That is what creates jobs. And I entirely agree. And the question is how threatening the pile-up of deficits and debt are to a vibrant economy.

John Snow's Recipe for a Bright Future

"A balanced federal budget is the best choice to ensure a bright future for the nation's economy."

– John Snow, "Balanced Federal Budget Would Benefit Americans in Many Ways," Richmond *Times Dispatch* November 13, 1995

Let's go to the next. I also remember well this ad that appeared in major newspapers that you were a signatory to. I very much applauded you at the time. The headline was: "Without a balanced budget the party's over, no matter which party you're in." And I agree with that sentiment as well. We have to get back to balance as quickly as possible, given especially the baby-boom generation which is about to retire.

A22 THE NEW YORK TIMES, TUESDAY, DECEMBER 19, 1995

A Bipartisan Appeal from Business Leaders to the President of the United States Bill Clinton, House Speaker Newt Gingrich, Senate Majority Leader Bob Dole, Senate Minority Leader Tom Daschle, House Majority Leader Dick Armey, House Minority Leader Dick Gephardt, and All Members of Congress:

WITHOUT A BALANCED BUDGET, THE PARTY'S OVER. NO MATTER WHICH PARTY YOU'RE IN.

There are moments in history when a single choice can mean the difference between vastly differing futures — one bright, the other dark. We believe that you, the political leaders of this country, are now confronting such a choice in your deliberations over a plan to balance the federal budget.

We are convinced that the health of our economy rests on your ability to avoid political gridlock and give the American people what leaders of both parties say they favor and, indeed, have agreed to — a credible plan to balance the budget. By "credible" we mean that such a plan should:

- Use realistic projections that assume the fiscal and economic scenario developed by the Congressional Budget Office and reviewed by objective third parties;
- Take no longer than seven years as the maximum time period by which a balanced budget would be achieved;
- Ensure that the process of deficit reduction is achieved in roughly equal steps throughout these seven years, rather than "backloading" the politically difficult decisions into the next century; and
- Have everything on the table, including long-term entitlement programs as well as the size and shape of any tax cuts.

Included among us are Democrats and Republicans, Liberals and Conservatives. What unites us in this appeal is our common concern for America's future.

All of us are leaders of institutions keenly sensitive to interest rates and the short- and long-term outlook for the U.S. economy. We believe that the recent decline in long-term interest rates and much of the boom in the stock market is directly predicated on the financial markets' expectation that a successful bipartisan budget-balancing compromise will be reached quickly, and that a credible long-term plan will be put in place in short order.

Federal Reserve Board Chairman Alan Greenspan recently observed: "If there is a shattering of expectations that leads to the conclusion that there is indeed an inability to ultimately redress the corrosive forces of deficit, I think the reaction would be quite negative — that is, a sharp increase in long-term interest rates.... I think we would find that with mortgage rates higher and other related rates moving up, interest-sensitive areas of the economy would begin to run into trouble."

As you continue your negotiations, we ask you to reflect on the full consequences of success or failure. However Americans ultimately resolve our honest and principled disagreements over the size and scope of government, America must begin to live within its means.

The time for good economics as well as good politics is NOW.

America is waiting.

Respectfully yours,

Paul Allaire
Chairman and CEO
Xerox Corporation

Jon Corzine
Chairman and Senior Partner
Goldman, Sachs & Co.

M.R. Greenberg
Chairman and CEO
American International Group, Inc.

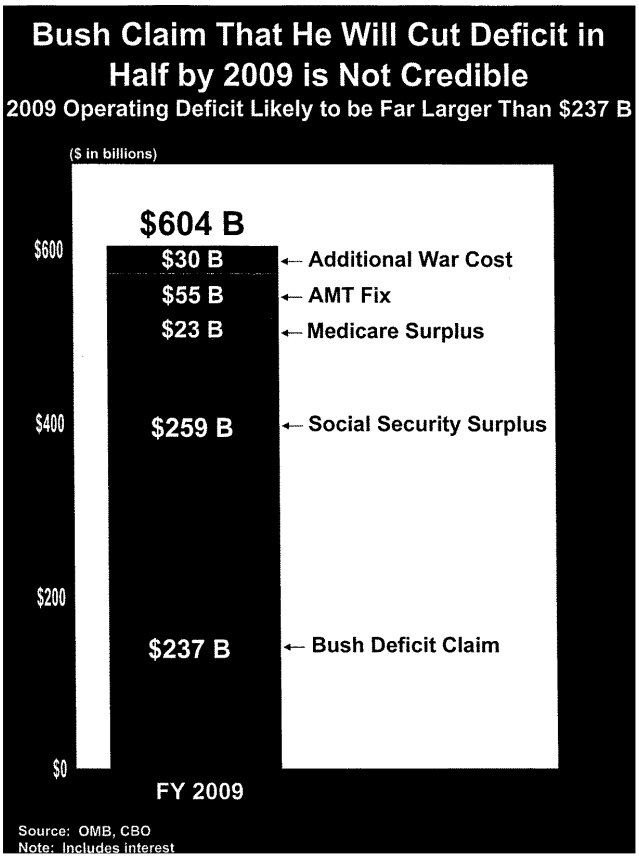
Richard H. Jenrette
Chairman and CEO
The Equitable Companies, Incorporated

Peter G. Peterson
Chairman, The Blackstone Group
President, The Concord Coalition

John Snow
Chairman and CEO, CSX Corporation
Chairman, The Business Roundtable

This message has been paid for by the above named individuals and organizations.

But when I look at the President's budget proposal and the suggestion that he is going to cut the deficit in half, it is simply not credible to me and I do not think it is credible to anybody that takes a hard look at what the assumptions are, because the President has achieved a reduction by largely leaving out substantial parts of the budget.



The President is saying that the deficit 5 years from now will be cut in half to $237 billion. But in that same year, he will be taking under his plan $259 billion from the Social Security Trust Fund, every penny of which has to be paid back. In addition, he will be taking $23 billion from the Medicare Trust Fund. And if we are going to continue to address the problem with the alternative minimum tax, which is rapidly growing into a crisis. Three million people affected now by what is supposed to be a millionaire's tax, there are going to be 40 million people affected by the end of this budget

period. It is becoming a middle-class tax increase. That costs $55 billion to fix. The President just left it out. And it costs $30 billion, according to the CBO, for residual work costs in that year. All of these things are left out, and so you have an increase in debt in that year not of $237 billion but of over $600 billion.

Let me go to the next, because the President's own budget shows in the fifth year that the debt is going to increase not by $237 billion, but the debt is going to increase by $633 billion.

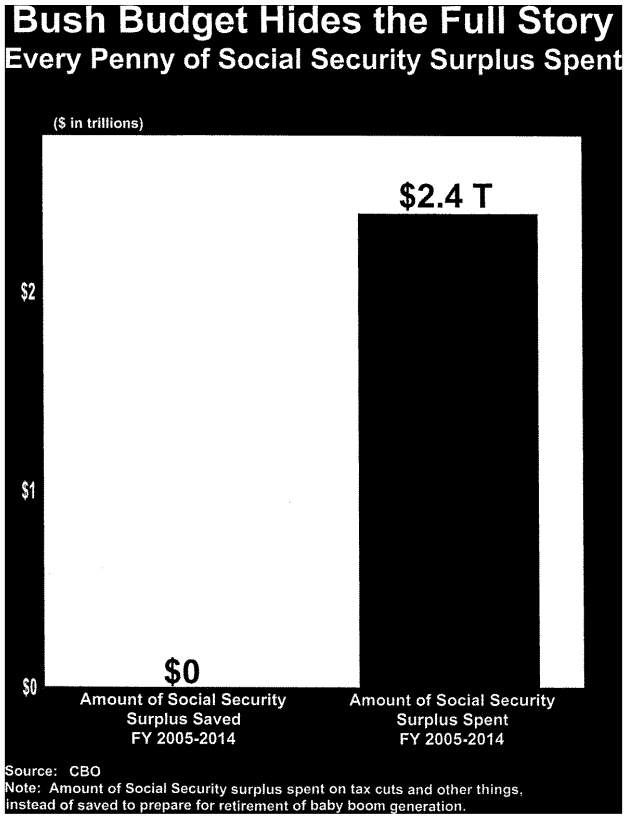
Gross Debt Increases by $633 Billion in FY 2009

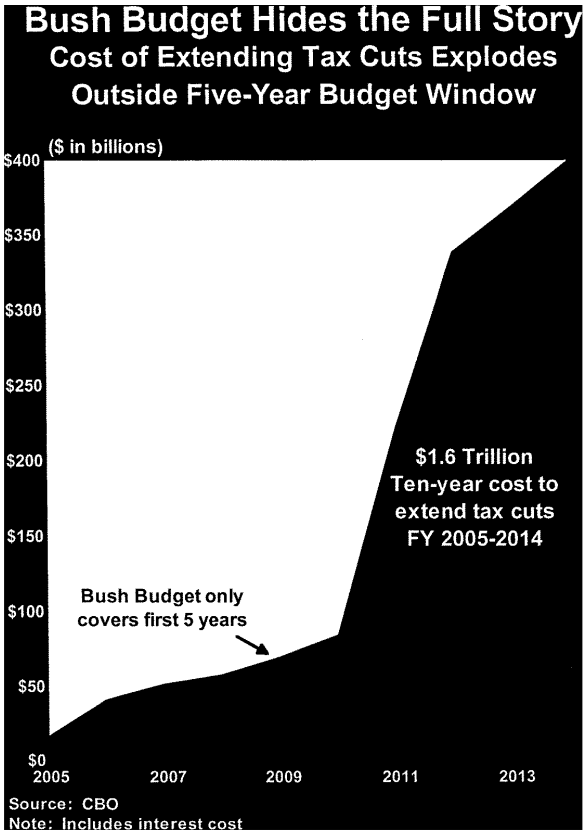
Function	2003 Actual	Estimate					
		2004	2005	2006	2007	2008	2009
Debt Subject to Statutory Limitation, End of Year:							
Debt issued by Treasury	6,733	7,459	8,106	8,700	9,292	9,906	10,540
Adjustment for discount, premium and coverage	5	5	5	5	5	5	5
Total, debt subject to statutory limitation	6,738	7,464	8,111	8,705	9,297	9,911	10,545
Debt Outstanding, End of Year:							
Gross Federal debt: [6]							
Debt issued by Treasury	6,733	7,459	8,106	8,700	9,292	9,906	10,540
Debt issued by other agencies	27	27	26	26	26	25	24
Total, gross Federal debt	6,760	7,486	8,133	8,726	9,318	9,931	10,564
Held by:							
Debt held by Government accounts	2,846	3,066	3,341	3,652	3,985	4,342	4,720
Debt held by the public [7]	3,914	4,421	4,792	5,074	5,333	5,589	5,844
As a percent of GDP	36.1%	38.6%	39.8%	40.1%	40.2%	40.0%	39.8%

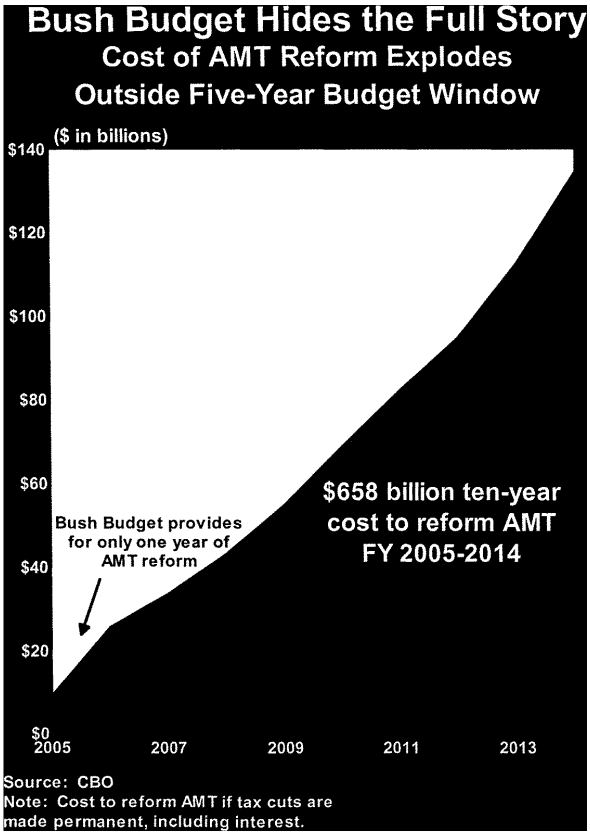
Source: President's Budget for FY 2005, Table S-17, p. 392.

Let's go to the next. Here is the problem that I see. If we adjust what the President is saying for the effect of his tax cuts beyond the 5 years, the alternative minimum tax problem, and his defense policies—not, you know, this idea that defense costs will not grow for the war after September 30th, but put in what CBO tells us is going to happen. We don't see the deficits being reduced for the next 10 years. We see an ocean of red ink.

Let's go to the next one. Here are part of the reasons why. One, we are not accounting for the $2.4 trillion of Social Security money that is going to be taken—$2.4 trillion during this next 10 years, every penny of which has to be paid back. The President just shows the effect of the first 5 years of his tax cut proposal, and what you can see is this dotted line is the fifth year. The cost of the tax cut explodes beyond the 5-year window. We have to account for that if we are going to be accurate with people.


Bush Budget Hides the Full Story
Every Penny of Social Security Surplus Spent
($ in trillions)
$2.4 T
$2
$1
$0
$0
Amount of Social Security Surplus Saved FY 2005-2014
Amount of Social Security Surplus Spent FY 2005-2014
Source: CBO
Note: Amount of Social Security surplus spent on tax cuts and other things, instead of saved to prepare for retirement of baby boom generation.

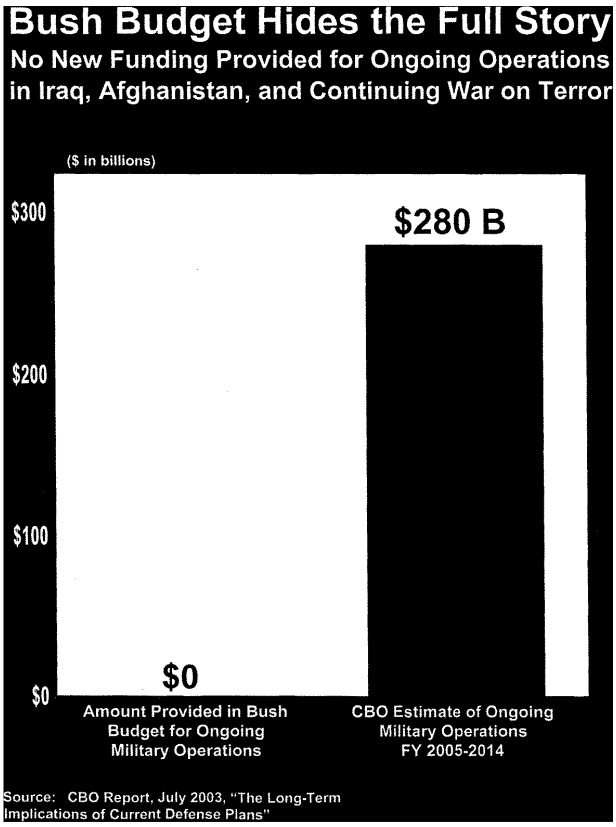

Bush Budget Hides the Full Story
Cost of Extending Tax Cuts Explodes
Outside Five-Year Budget Window
($ in billions)
$400
$350
$300
$250
$200
$150
$100
$50
$0
2005
2007
2009
2011
2013
$1.6 Trillion
Ten-year cost to
extend tax cuts
FY 2005-2014
Bush Budget only
covers first 5 years
Source: CBO
Note: Includes interest cost

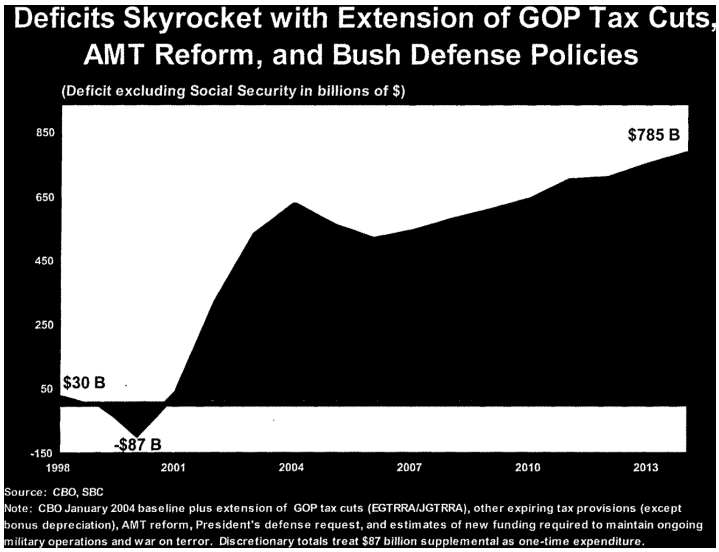


Let's go to the next one. The alternative minimum tax, the same kind of pattern. The President pays for it in the first year, but the cost of fixing it, according to the Congressional Budget Office, explodes in these outer years.

And, of course, war costs. The President says no war costs past September 30th. The Congressional Budget Office tells us $280 billion of costs, none of this accounted for in the President's budget.

The result is we have a debt that is not under control, but a debt that is skyrocketing, and at the worst possible time—right before the baby boomers start to retire.





So, Mr. Secretary, I think we have a lot of work to do to get serious about the growth of deficits and debt and the risk that that growth poses for our economic security.

Chairman NICKLES. Senator Conrad, thank you very much.

Mr. Secretary, we are delighted to have you with us, and please make your presentation, and then we will have a few questions.

STATEMENT OF HON. JOHN SNOW, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary SNOW. I think I am on here. I am not sure.

Chairman NICKLES. You are.

Secretary SNOW. Thank you very much, Mr. Chairman, Senator Conrad, members of the Senate Budget Committee. It is an honor to be before you, and I appreciate, Mr. Chairman, your opening comments and those of Senator Conrad as well.

The budget that is before you reflects basically four priorities:

One, winning the war on terror. That has to be at the center of everything that we are engaged in today. It has to be a national priority of the highest rank, as the President said in his State of the Union message, and protecting the homeland that goes hand in hand with that. And the budget reflects that with some 7-percent increase in defense spending and some 10-percent increase in the homeland security budget, which isn't found just in the Department of Homeland Security but throughout many other agencies as well.

And the budget reflects the President's commitment to continuing to keep the economy on a path of creating jobs, growing and expanding, because a bigger economy is good to deal with the problems of the future, the problems of how we are going to pay for the Social Security and the Medicare responsibilities of the future, fund those unfunded commitments.

But it also reflects a commitment, Mr. Chairman, in line with your suggestion, that we really have to get serious about the deficit, and those of Senator Conrad as well. The President's budget seeks to cut the deficit in half within 5 years. If we can do better than that, that is terrific. We really ought to be pointing toward a convergence to zero. That is where we need to do. We need to get on a path to truly balanced budgets. But you can only do it through two ways. There aren't a lot of avenues open to us. One is growing the economy because that creates more governmental revenues, and, of course, back in the late 1990's, when the surpluses developed, 2000, we had extraordinarily high governmental revenues coming in: receipts from the good stock market, from capital gains, from a full-employment economy, and from high profitability.

We had the recession. Government receipts fell down. Now they are at quite low levels, but we project them to go back up toward the 18-percent average that they have been historically, 18 percent of GDP as they historically have been, down to 16 today, 15.7.

The other thing to do, though, in addition to growing the economy, you have to cut spending, and spending cuts have to be at the forefront of achieving that objective. That is why the highway bill is so important to the President and to many of you, because it represents spending levels that, if embraced in the actions of the Congress, will make it difficult ever to hit those targets, important as and good as much that is in that bill is. Actually, I would acknowledge it, but it has to be done within restraints of a fiscal balance.

I appreciated very much your comments on where the economy is today. It is really in a tremendously different and better posture today than when I appeared before you a year ago. There was a lot of talk of a double-dip recession. Then there was talk of deflation—deflation that could become destabilizing. Even those who were fairly optimistic a year ago about the economy acknowledged that it was on a wobbly path; it was an anemic pickup. Today, nobody says that. I think today everybody acknowledges that the economy is on a strong growth path, with the numbers you showed, extraordinary growth—for the year as a whole, 4.4 percent; third quarter, over 8 percent, with projections for over 4 percent for this year. If we can sustain that—and I think we can—we are going to create a lot of jobs in this economy, as Chairman Greenspan has said, as the private forecasters say, as the administration says.

I think it is important to recognize where we have come from. These deficits are large. They are unwelcome. They are unacceptable. And they must be brought in line. They have to be reduced.

But they are understandable, too. They are understandable in the context of the President having inherited a recession that took a tremendous amount of revenue out of the Government receipts, and a recession that was made worse by corporate scandals, by the meltdown of the stock market that took $7 trillion out of the household wealth of the country, by 9/11, the war in Afghanistan, the war in Iraq. All of those things have had significant effects on the economy.

When I talk to business people from other parts of the world, they are astonished that the American economy has sustained itself as well as it has through all this period, and that is, I think, a compliment to the resourcefulness of the American people and to

the adept ability of our institutions, including the Congress, which responded with the tax bill last year.

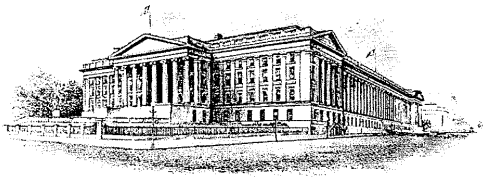
Let me close by saying that without the tax bill last year, Mr. Chairman, members of the committee, the economy would not be where it is today. Without that tax bill we never would have had growth rates of 8.2 percent in the third quarter and 4.4 for the year.

I will remind you, we started the year with a growth rate of 1.4 percent for the first quarter, a stock market that over the course of the year gained something well over 20 percent, creating, as you said, nearly $4 trillion of additional value from then until now. The reductions you made in dividend taxes and the reductions you made in capital gains taxes, the lowering of marginal tax rates across the board have had a profound effect on this economy and have created a strong upward movement in the economy that otherwise simply would not have existed.

We regret the deficits. We are going to go after the deficits. They have to be reduced. They do threaten long-term prosperity. But working together, I think we can manage our way through that problem.

I thank you very much for the opportunity to appear before you.

[The prepared statement of John Snow follows:]



DEPARTMENT OF THE TREASURY
WASHINGTON

Secretary John W. Snow
Opening Statement before the Senate Committee on the Budget
Testimony on Revenue Proposals in the President's FY 2005 Budget
Friday, February 13, 2004
Embargoed until 10:00am

Thank you, Mr. Chairman.

Thank you all for having me here today to talk about the President's budget.

I believe you'll find that this budget reflects the priorities of our nation as well as the leadership of President George W. Bush.

The over-riding theme of the budget, and the President's plan for the future, is that a safer world is a more prosperous world. That's why I'll be discussing both national and economic security here today.

Decisions about how to collect and spend taxpayer dollars – for this is what a budget is – must be made with both caution and vision.

The Fiscal Year 2005 budget proposal is, therefore, a plan that does three core things:

- One: Keeps Americans safe by providing the resources necessary to win the war on terror and protect our homeland;
- Two: Increases the economic security of our citizens as well, by strengthening our economy; and
- Three: Exercises the kind of spending discipline that is required by a government that respects the source of its money (hard-working taxpayers!) and is unwilling to live with a deficit.

Discussions of our budget and our economy are not, and should not, be separate. The two are inextricably connected.

Today, our economy is doing better.

Homeownership is up, unemployment is heading down, and GDP growth has been strong.

This administration came to office when those indicators were not nearly as positive.

The President inherited an economy that was in decline… one that was then battered by terrorist attacks and revelations of corporate corruption dating back to the 1990s.

The President and his administration took these challenges seriously and we have made *serious progress* in changing the economic direction of this country.

The President's tax cuts – passed by you – have worked. They provided the stimulus that was necessary to turn the economic ship around… and they are now encouraging and allowing for the economic growth that is continuing into the future.

- Economic growth in the second half of 2003 was the fastest since 1984;
- New home construction was the highest in almost 20 years;
- Homeownership levels are at historic highs;
- Manufacturing activity is increasing;
- Inflation and interest rates are low;
- Over 360,000 jobs have been created in the past five months;
- Unemployment claims – both initial claims and continuing claims – are well off their peaks last year, indicating improvement in the labor market;
- This Wednesday, the Dow closed at a 32-month-high. This translates into more than three trillion dollars of growth in value in the markets.

These economic indicators all point to the same conclusion: economic growth is robust and will be sustained.

However, there is more to do. We are not, by any means, satisfied.

There are still Americans who want to find work and cannot… and this Administration will not rest until that most critical need is met and until every American looking for work can find a job.

Our budget addresses that need by continuing to focus on improving our economy.

For example, the President's Jobs for the 21st Century plan, announced in his State of the Union Address, directs the resources of several branches of government toward matching skills with jobs, and helping workers acquire the skills they need to qualify for the jobs in their community.

We can also encourage the creation of jobs by sticking to the President's six-point plan for growth.

That includes making health care more affordable and costs more predictable.

We can do this by passing Association Health Plan legislation that would allow small businesses to pool together to purchase health coverage for workers at lower rates.

We also need to promote and expand the advantages of using health savings accounts … how they can give workers more control over their health insurance and costs.

And we've got to reduce frivolous and excessive lawsuits against doctors and hospitals. Baseless lawsuits, driven by lottery-minded attorneys, drive up health insurance costs for workers and businesses.

The need to reduce the lawsuit burden on our economy stretches beyond the area of health care. That's why President Bush has proposed, and the House has approved, measures that would allow more class action and mass tort lawsuits to be moved into Federal court -- so that trial lawyers will have a harder time shopping for a favorable court.

These steps are the second key part of the President's pro-jobs, pro-growth plan.

Ensuring an affordable, reliable energy supply is a third part.

We must enact comprehensive national energy legislation to upgrade the Nation's electrical grid, promote energy efficiency, increase domestic energy production, and provide enhanced conservation efforts, all while protecting the environment.

Again, we need Congressional action: we ask that you pass legislation based on the President's energy plan.

Streamlining regulations and reporting requirements are another critical reform element that benefit *small* businesses, who represent the majority of new job creation: three out of every four net new jobs come from the small-business sector! Let's give them a break wherever we can so they're free to do what they do best: create those jobs.

Opening new markets for American products is another necessary step toward job creation. That's why President Bush recently signed into law new free trade agreements with Chile and Singapore that will enable U.S. companies to compete on a level playing field in these markets for the first time -- and he will continue to work to open new markets for American products and services.

Finally, we've got to enable families and businesses to plan for the future with confidence.

That means making the President's tax relief permanent.

Rate reductions, the increase in the child tax credit and the new incentives for small-business investment – these will all expire in a few years. The accelerated rate reductions that took effect in 2003 will expire at the end of this year. Expiration dates are not acceptable – we want permanent relief.

The ability of American families and businesses to make financial decisions with confidence determines the future of our economy. And without permanent relief, incentives upon which they can count, we risk losing the momentum of the recovery and growth that we have experienced in recent months.

The tax relief is the key stimulus for increased capital formation, entrepreneurship and investment that cause true economic growth.

Budgets work better when the economy is growing… because a growing economy means more jobs. That means more tax revenue… which leads to all-important deficit reduction.

Which leads me to my next area of discussion.

Let me be clear on this:

- The budget deficit that we face today is unwelcome.
- It needs to be addressed.
- The President's budget calls for cutting the deficit in half over the next five years.
- While addressing the deficit, we must remember that it is not *historically* overwhelming.
- It is understandable, given the extraordinary circumstances of recent history. Remember that we are fighting a type of war that we have never fought before. We are fighting an enemy that requires a much broader variety of government resources than anything we've ever confronted. And we began this fight when we were economically wounded.

What's most important to remember is that *we will be able to fight this war and climb out of the deficit.*

We can manage this deficit, and we can cut it in half over the next five years by *controlling spending and growing our economy.*

Three-quarters of the discretionary spending increases during this Administration have been related to the global war on terror and the response to 9/11.

Meanwhile, President Bush has reduced the rate of increase in non-security-related discretionary spending every year he has been in office: to six percent in 2002, five percent in 2003, and to four percent in the current fiscal year.

For Fiscal Year 2005 we're going to reduce the rate of increase in non-security discretionary spending to less than one percent.

Total annual appropriated discretionary spending will increase by less than four percent next year.

Holding the line on spending – while ensuring that our country is safe and our most important needs, from jobs to health care, are met – will achieve deficit reduction when coupled with all-important economic growth.

Again, this is why the budget cannot be discussed separately from the economy. Separating the two is what gets government into trouble.

Make no mistake: President Bush is serious about the deficit.

We see it as unwelcome, but manageable… and we intend to achieve: *rapid deficit reduction.*

A recent CBO report raised concerns about this matter, and it is important to note that recent and short-term projected budget deficits and the existence of long-term deficits for Social Security and Medicare are *not connected.*

These unfunded long-term net obligations are also a concern, and ones that this Administration has highlighted and invited bipartisan dialogue on.

The President has been clear on this: younger workers should have the opportunity to build a nest egg by saving part of their Social Security taxes in personal retirement accounts. His vision for the program is economically wise, and it is that we should make the Social Security system a source of ownership for the American people.

Are we dedicating ourselves to increased spending on the war on terror and protecting the homeland? The answer is yes. Yes, without sacrificing other necessities.

And that is because a nation must be safe in order for it to be prosperous.

A nation of entrepreneurs must also be able to plan, and to be relieved of as many burdens as possible, in order to be prosperous.

All of the budget issues and policy proposals that I've discussed today may seem, at times, to be a complicated recipe. But these ingredients combine to make something that is simply put, and is of utmost importance – and that is economic growth.

Growth is the key to every economic problem we confront. That's why we urge other countries to institute pro-growth policies. It's good for them, and it's good for the global economy that we are a significant part of.

Thank you for hearing my testimony today. I'll be happy to take your questions now.

Chairman NICKLES. Mr. Secretary, thank you very much for your opening remarks.

I will ask all of my colleagues—we do not have strict time limit, but I am going to assume the Secretary needs to get out around 12. So if people could try and keep their remarks to 7 or 8 minutes, we ought to be able to accommodate that, and we will have some flexibility if necessary.

A couple comments. I mentioned to you and Senator Conrad that there might be $250 billion of leakage or uncollected receipts that

might be out there, underground economy, you name it. I will just ask you a couple questions. Is that figure close to being accurate? Are there some things we could do that we are not doing to help close that leakage or to collect taxes that are due but not paid?

Secretary SNOW. Mr. Chairman, that number I think is a number that goes back some years. There clearly is a tax gap. There is an underground economy. There are people who should be paying taxes who aren't paying taxes. There are people paying taxes who should be paying more taxes. There clearly is a tax gap.

I don't know that the $250 billion number is accurate anymore, but it is a large number, whatever it is, and the IRS is doing a study with the help of Treasury, the assistance of Treasury, to try and get a better handle on it.

We do know there are some programs that do not work well. The one you mentioned, the earned income tax credit, will require some improvements because there are both underpayments and overpayments there.

The IRS budget this year, Mr. Chairman, reflects a very large increase—I think it some $300 million, roughly—primarily devoted to greater enforcement. We think we need to put more energy into compliance, more effort into compliance across the board, for business, small business, large business, but taxpayers generally in all income categories. And I hope we will see that significant enhancement of the IRS budget for enforcement carry the day.

Chairman NICKLES. Mr. Secretary, just a couple comments. One, I would appreciate it if you and/or the IRS, which is under your domain, would give us a list of, I am going to say, loopholes, for lack of a better word. I will just mention a couple. I mentioned the earned income credit. In 1999, IRS estimated that between 27 and 31.7 percent of claims were in error, should not have been made. That was an estimate of $8.5 to $9.9 billion. That was in 1999, and we were spending $31 billion on the program. We now are spending almost $35 billion. This is a program, keep in mind, that cost about $7.5 billion in 1990 and now costs $35 billion. People wonder how spending has grown. That program has gone up by a multiple of about 5 times, 500 percent in the last 14 years.

But it is not acceptable to have a program that has an error rate of 30 percent. Senator Sessions has suggested maybe we should make those payments on a monthly basis instead of an annual basis and take out some of the incentives for corruption and fraud. That is a proposal.

Anyway, I would solicit from you and from your outstanding staff some possible ways to address fraud—some of this is going to require legislation. So give us some recommendations, if you would, and if you would also give us a list of other abuses.

There is one that I will ask about in my second round—the sale-in lease-out transactions that I think your Department has identified. But this is a loophole, an abuse of the system that is costing billions, maybe as much as $28 or $30 billion over 10 years. It needs to be stopped. It is growing dramatically, Senator Conrad said so.

I will get on to that one in the second round, but I mentioned earned income credit because I think most people are more familiar with that. But this is on the spending side. We have a lot of spend-

ing in the tax code, and we have some abuses of the tax code that at least this Senator wants to stop. I am not really interested in having the IRS chasing down babysitters and lawn mowers to make sure they pay taxes on, you know, the $30 they have ten. I am interested in stopping a corporation buying a non-taxable entity's assets and then getting a lot of tax benefits and leasing them back to the city and have it be a shell game.

Senator Conrad and I yesterday, when we had Secretary Thompson up, we found out that a lot of States were doing a shell game and costing taxpayers billions and billions of dollars. And we hope to close that loophole, and I hope that we can close this. And maybe if we can discover some other things that are really an abuse of the system, we should shut them down earlier rather than later. So if you and/or your staff would provide us some abuse list, we will be happy to work with you to do what needs to be done legislatively. You may be able to do a lot of these things administratively.

Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman——

Senator DOMENICI. Would you yield for one observation?

Senator CONRAD. Certainly I would yield to the former chairman.

Senator DOMENICI. Senator Nickles, as I listened to you, if I were the Secretary, I would be a little bit confused as to what you want. So maybe I could ask you for a minute.

One thing is loopholes. People have a lot of arguments of what loopholes are. One man's loophole is another man's necessity. But what you spoke of were abuses and places where the laws were being used to cheat. But there also are tax expenditures that this committee and the tax committee might want to look at and say these used to be pretty good, but they aren't any good anymore. And I would assume you want him to give you both of those lists.

Chairman NICKLES. Absolutely, and I appreciate your clarification.

Senator DOMENICI. Thank you.

Chairman NICKLES. Senator Conrad.

Senator CONRAD. I want to again thank the chairman for introducing these subjects because I think they are hugely important as we go forward.

Let me just say on the tax gap calculation, your IRS Commissioner was just on—I think it was CNN I saw him, and he referenced the $250 billion, which, as you correctly point out, I think is a result of an analysis that was done in the mid-1990's.

Secretary SNOW. Yes.

Senator CONRAD. I think we all know that number has done nothing but grow. And we have to go after—it is utterly unfair to the vast majority of Americans, American taxpayers, American corporations that pay what they legitimately owe, to have some escape. That is just not fair. And I believe that number is much bigger.

I, frankly, have concluded we need to consider fundamental tax reform. I don't think using our current system and just increasing audit and enforcement will ever capture perhaps even an insignificant part of this tax leakage. So I think we need to consider fundamental tax reform in conjunction with increased enforcement.

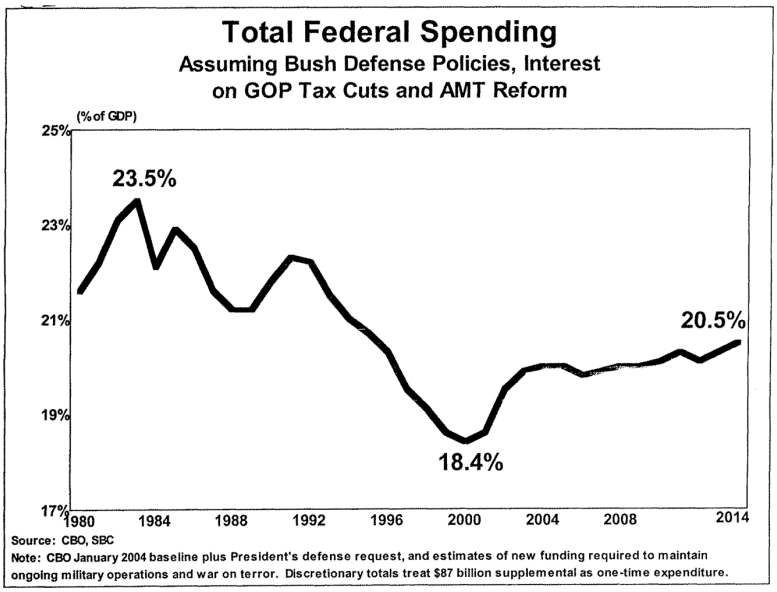
Let me just go to this question of revenue as a share of GDP because it really does jump out at one what has happened here. We did have in 2000 revenue as a share of GDP that was at a very high level historically. Now we have revenue at a very low level historically, the lowest as a percentage of GDP, which you referenced, Mr. Secretary, since 1950.

reuvenue as a share

When revenue was high as a share of GDP, the President said we need tax cuts to rebalance. Now that it is low as a share of GDP, he says we need more tax cuts. Frankly, I do not think that squares with the reality that we confront.

I would say that a tax increase should not be the first place we look. I think the first place we look ought to be this tax gap, because there is an enormous amount of money that could be recovered.

Let's go to the next one. This shows spending as a share of GDP, and it is very interesting. This goes back to 1980. We see spending got up to 23.5 percent of GDP. It came down steadily until 2000 to 18.4 percent of GDP. We have now had a substantial uptick, and we see that leveling out.



So we do have a spending problem, but I hasten to point out that 92 percent of this increase has been in just three areas: defense, homeland security, and response to 9/11. So the spending side of the equation is going to be very tough, but it simply has to be attended to.

Let me put up—this is my question. This was in the Washington Post on January 26th with an article headlined, "Weak dollar helps U.S. firms for now." The article said in part, "Currency traders fretting over that dependency"—and the dependency they were talking about are these massive deficits, both budget and trade—"have been selling dollars fast and buying euros furiously. The fear

is that foreigners will tire of financing Americans' appetites. Foreign investors will dump U.S. assets, especially stocks and bonds, sending financial markets plummeting. Interest rates will shoot up to entice them back. Heavily indebted Americans will not be able to keep up with rising interest payments. Inflation, bankruptcies, and economic malaise will follow."

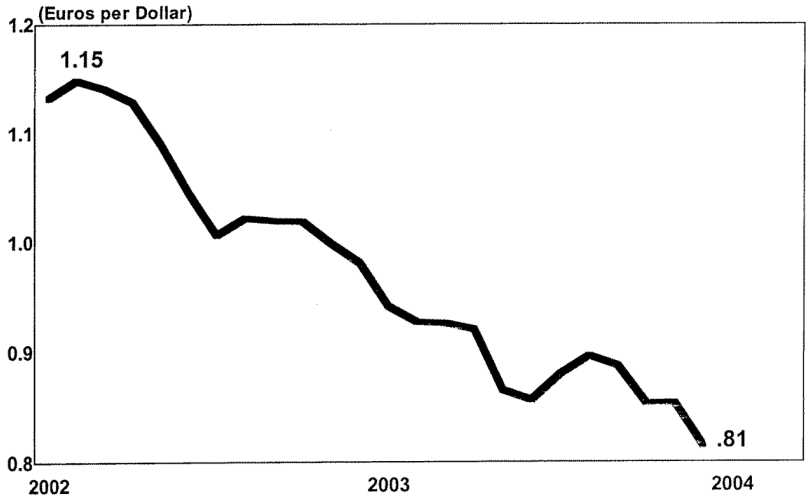
Economists Worry About Long-Term Effects of Weak Dollar and Heavy U.S. Borrowing

"Currency traders fretting over that dependency have been selling dollars fast and buying euros furiously. The fear is that foreigners will tire of financing America's appetites. Foreign investors will dump U.S. assets, especially stocks and bonds, sending financial markets plummeting. Interest rates will shoot up to entice them back. Heavily indebted Americans will not be able to keep up with rising interest payments. Inflation, bankruptcies and economic malaise will follow."

– *Washington Post* article
"Weak Dollar Helps U.S. Firms, for Now"
January 26, 2004

Let me just top it off with this. This is what has happened to the value of the dollar against the euro, which you are intimately familiar with after meeting with your G–7 partners. I am sure they were talking to you about this—what has happened to the value of the dollar in the last 18 months.

Dollar Declines Almost 30 Percent Against Euro



Source: Federal Reserve Board

My question to you is this: Are you concerned about what the IMF warned us about, what the Comptroller General of the United States has warned us about, what these economists are warning us about: that this pile-up of deficits and debt could threaten to put

upward pressure on interest rates which would threaten to reduce economic activity and that an early warning sign is what is happening to the value of the dollar?

Secretary SNOW. Well, Senator, clearly the deficits, —unless dealt with—pose a threat to the long-term well-being of this country and they, therefore, must be dealt with and have to be dealt with. I think virtually all the economists agree that if deficits become embedded in the financial structure of a country and financial markets view the deficits as entrenched and rising, there will be a perfectly predictable reaction in the marketplace. Lenders will demand higher premiums, which mean higher interest rates. And that would be extraordinarily unfortunate.

One of the great boons to the American economy today is the low interest rates we have. They have helped create a very strong housing market, a very strong construction market, strong demand for any number of credit-based consumer products—automobiles.

So I share your concern that we must deal with the deficit and that the deficit represents national dissavings. And we have the Government dissaving through deficits. We have an extraordinarily low savings rate on the part of households today at 2 percent or so versus 7 or 8 in the past. And we do have a large current account deficit, which is really the difference between our domestic investment and our domestic savings. And since our domestic investments, thanks to the strong economy, are high—we have lots of good investment opportunities in America. We want to keep that up. But we don't have adequate savings to fund it. We need to call on other nations of the world. And the current account deficit reflects our own national dissavings. I certainly agree with you.

Senator CONRAD. Let me just conclude by saying that the problem that I see is that the President's plan does not deal with the deficits. Here is what we see happening under the President's plan with the growth of the accumulated deficits, which is the debt, and the gross debt is just going through the roof under this plan.

So to me the President has not given us a plan that deals with the deficits. I would just ask you—I know it is very difficult for the President, once he set up his budget, to reconsider, but I think as we work through this, we have to be much more serious about where this is all headed.

Secretary SNOW. Senator, I cannot see the chart in terms of the out years. That goes out to?

Senator CONRAD. 2014.

Secretary SNOW. This would be too long an answer, but I think your debt numbers include a good deal of intra-governmental debt too.

Senator CONRAD. Oh, yes. This is the gross debt. But remember, we have a totally different situation than we faced before. That different situation is we have the baby-boomers that are about to retire, and we have been ramping up Social Security dramatically, $160 billion of surplus this year, $260 billion in the fifth year of Social Security surplus, and under the President's plan every dime of it is being taken for other things.

Secretary SNOW. As you and I had the exchange yesterday, I think we are in agreement that we need to find a way to deal with those long-term unfunded commitments represented through Social

Security and Medicare where—demographics are really destiny, as they say, and the demographics are just about to hit us. I am in full agreement that we absolutely have to confront the issue of our baby-boomers retiring and the consequences of the demographics on these very large systems which will require us to take actions on a number of fronts, to do things like hold down health care costs.

Senator CONRAD. Let me just conclude by saying to you I agree with that, but I will tell you, you have to look on the revenue side as well. But the 75-year costs of the President's tax cuts are three times the shortfall in Social Security. So we have to look at both.

Chairman NICKLES. Senator Conrad, thank you very much.

Next call on the Chairman Emeritus, Senator Domenici.

Senator DOMENICI. Thank you very much, Mr. Chairman.

Mr. Secretary, it is good to be with you.

Secretary SNOW. Thank you, Senator.

Senator DOMENICI. My first question will be of great interest to the distinguished former Chairman of Appropriations, who sits over here on my left. Could I ask you, if you know, what percent of this budget is appropriated?

Secretary SNOW. Not offhand, I do not.

Senator DOMENICI. I should know it like that, but I do not.

Senator BYRD. About a third.

Senator DOMENICI. About one third?

Senator BYRD. About a third. When I came to Congress more than 51 years ago, the percentage was somewhere in the high 80's or 90. Today it is less than a third, less than a third.

And one other thing we need to remember, when we are talking about Government spending, we are also talking about for the military, spending for the military and for homeland security. But to hear these witnesses, you would think it is all domestic discretionary. You just think it because they do not stop to say that.

Excuse me, Mr. Chairman.

Senator DOMENICI. That is fine. Just so I get my chance to do a couple of questions, I am very pleased.

I wanted to amplify that by saying not too long ago, when President Kennedy was President, 59 percent of the entire budget of the United States was for the defense of our country, and that much was all discretionary, if you can imagine.

The reason I raise the question, I know our Chairman works very, very hard on trying to get the discretionary accounts of our Government down, and I commend him for it, but I really think every now and then we have to be realistic when we try to look at how big that deficit and how we get it down. We have to be realistic as to how much of this budget is domestic. I mean you cannot take 10, 15 percent of this budget is appropriated. You cannot take 10, 15, 20 percent of it each year. The kind of money that is needed to get into balance is 10, 15, 20 percent of the budget of the United States.

I really think it is nice to go through this exercise, and he will produce a budget that ratchets down this appropriated account and we will struggle terribly, and when we are through, if we are lucky, if we are lucky, we will save 1 percent or 2. So I want to make sure you know that because you are kind of in charge of the overall pic-

ture, and you must know the overall picture is a lot more than the appropriated accounts.

Having said that, I want to suggest something to you. There is an old tax code sitting around your shop that one of your men there knows a lot about. It is called the USA tax. You have heard of it.

Secretary SNOW. I sure have.

Senator DOMENICI. It is the only reform measure that is an entire tax code, done by Senator Nunn and I with great help from the business community, and USA stands for Unlimited Savings Accounts. It was going to change our tax code so that you paid money on what—excuse me—taxes on what you spent, not on what you saved. But I would tell you there is a separate section on corporations, and it might be worthwhile to look at it. It very well might work by itself. It completely changes corporate taxes. It starts with the premise you are going to get as much money as you do now, but believe it or not, if you were in business, how do you think it would be for business to have no depreciation schedules? Would that not be exciting? Everything they purchased is on a cash basis. That is the premise of the USA. It is just a phenomenal way to change and put some energy into that.

I do not want any long answer, because I have some things, and I want to proceed.

Secretary SNOW. Senator, I am aware of those proposals back in the mid 1990's. Former Secretary O'Neill, Leonard Alcoa and I and others were engaged——

Senator DOMENICI. You all raised the money to put it together.

Secretary SNOW. Yes. And it had an extraordinary amount of promise and merit to it.

Senator DOMENICI. Mr. Secretary, I remember back in the day—obviously, I was not here, but I remember reading that President Dwight Eisenhower used to say—and lots of people did not understand it and did not much care—but he used to say the greatest thing for America is to have low inflation. A lot of leaders have said that. You remember when we used to struggle because inflation would go up and down just like a roller coaster? And everybody was trying to figure out why, and some people would say, well, labor contracts are all up this year. We are going to have inflation.

The great thing that is happening to America is lack of inflation. Is that not correct?

Secretary SNOW. Absolutely.

Senator DOMENICI. Second, everybody, including Greenspan, for years used to say, Americans will be healthy. There will be plenty of jobs if we increase productivity. I just noticed, Mr. Secretary, and fellow Senators, that productivity in the third quarter of last year was 9.3, second quarter was 7.1, and third was 2.2. Then it went along at 5.6 average for 2 years. The fastest rate of growth in any 2-year period since 1950.

Mr. Secretary, I am very perplexed and I do not understand any more. How could you have the two most important things for a healthy economy, inflation under control and productivity humming at the highest rate we have ever had, and somehow people

are running around saying this is a bad economy, No. 1, and second, that we do not have enough people employed?

Mr. Secretary, either these things are no longer relevant, inflation low and productivity high, that is one possibility; or we do not know what we are talking about in terms of what productivity means any more. I believe it is the second one. I do not think we understand productivity. I do not think we know how to measure it very well. But I would like you to do two things quickly, to comment on what I have said, and then second, would you produce for this Committee, if the Chairman agrees, an analysis of productivity and what it is, how we measure it, who measures it, and how much confidence you have in it?

Secretary SNOW. Senator, yes, we will be delighted to do the latter, produce that assessment for you.

Senator DOMENICI. All right.

Secretary SNOW. On the question of inflation, I agree with you. We are blessed with extraordinarily low inflation rates today. That is a reflection of high productivity. It is a reflection of global competition. It is a reflection of some excess capacity that is hanging over from over investment back in the late 1990's, and it shows up in the fact that businesses do not have any pricing power. Business after business after business will tell you they simply cannot raise prices.

Productivity is also a terrific thing for the economy in the aggregate because productivity means you got more output, and that means more potentially to share with everybody. Right now productivity is probably having a somewhat negative effect on job creation because businesses are finding they can produce more with less, so a given level of output can be done with fewer workers or now a larger level of output can be done with the same old level of workers. But productivity will show up as higher profits in corporations and businesses and hire-free cash-flows. That will get competed away, as it always does, marketplace competition. Then the employers will need to expand their businesses, they will be led to expand their businesses by the profits, and as they do, then the labor share will go up.

I think if we look at our national income statistics, we will be in a period here where the share to capital will be higher temporarily, and then it sets in place a healthy process where the share of the capital shifts and it moves more to labor.

The labor markets are pretty strong, but given this high productivity, Senator, there has been a slower pickup in jobs than economists would have expected from growth rates as high as they are, but of course, as the Chairman said, we have some differing interpretations of labor markets given the fact that the household survey is showing the creation of quite a few jobs, a lot of jobs, and the establishment survey, payroll survey, is showing a much, much less fast rebound in jobs. There should be a convergence there because they end up measuring the same thing, but right now they are showing different results.

Senator DOMENICI. You would not like to be running for President and answer the issue about less jobs having been produced by saying we had too high a productivity, would you? Would that not

be a nice answer out there? Who would understand that and would that——

Secretary SNOW. I was trying to explain why the job pickup rate in this recovery is a little slower than the economists would have predicted.

Senator DOMENICI. Yes, I understand. But you think it is going to get better in due course?

Secretary SNOW. Oh, absolutely. I think all our forecasts, the private sector forecasts, are for a good job pickup over this year, over 1904.

Senator DOMENICI. Thank you.

Chairman NICKLES. Senator Domenici, thank you very much.

Senator STABENOW.

Senator STABENOW. Thank you, Mr. Chairman.

Welcome Mr. Secretary. We thank you for your service.

To followup on what I thought were very excellent points of my friend and esteemed Senator, Senator Domenici, on two points I guess, two points that I was going to ask about. First of all, when we look at how we bring this budget back into balance—and it is astounding the red ink that we have now. I was privileged to be in the U.S. House in 1997 when we balanced the budget for the first time in 30 years and were focusing on paying down the debt, and it was a time of great economic growth for us. But Senator Domenici spoke about the fact that to only look at the discretionary spending side would not be to look at the largest way in which to bring down the deficit. In fact, I have said before the Committee at earlier times this year, this year's nondefense domestic budget, discretionary budget, everything but defense. Homeland security, education, health care, non-Medicare health care, the environment, law enforcement, everything, adds up to $445 billion, which is less than this year's debt.

So if you eliminated every penny of everything we did in domestic spending and only funded the military, you would not eliminate this year's debt. So we can debate whether domestic spending, discretionary, should go up, Mr. Chairman, a half a percent or a percent or 2 percent, but I share Senator Domenici's position that that is really moving around the edges when we look at the huge debt that we have. In fact, when we look at this as shared GDP, 24 percent of what we are looking at in terms of the debt and revenue losses comes from spending as shared GDP, 76 percent is revenue losses and about half of that is the tax cut, which leads to what I feel is a very important debate, and it goes back to what you are talking about in terms of productivity and really world view economically of how we look at things today.

We had an economic report released earlier this week that said basically if you can get it cheaper in another country, it is good business to do that, that on balance outsourcing or exporting jobs is a net plus for us. That is a different view, and when we look in the context of what we are seeing now, we really have a world view that says focus on wealth creation. Those who have wealth, hoping it will trickle down, focusing on wealth in terms of tax policy and trade policy and so on, versus focusing on work and the value of work in America. How do we get there? How do we get to the work part?

When Chairman Greenspan came in yesterday to the Banking Committee, talking to us about the fact that it was surprising that with the economic growth we have not seen the job creation, but one question I would ask is we are beginning to hear theories about productivity that look at this larger issue of exporting jobs. One theory would say it used to take a hundred people, let us say, for a job in the United States. Now it takes 80 people in the United States, but 20 in India or 20 in China and 20 in Mexico, and that we are not looking at productivity in a way that would measure that. So that when we look—I had asked CRS to look at minimum wage rates around the world if they were converted to hourly rates for U.S. dollars. In China the minimum wage rate, compared to ours, is 33 cents, 33 cents in Mexico. So there is a major push, even as you talk about more dollars coming; you indicated more productivity, higher profits and then reinvestment. The question is, where in a world economy are they going to invest? It may not be in this country.

We have Electrolux, which is a plant that makes refrigerators in Greenville, Michigan, a community of 9,000 people, 2,700 jobs. Electrolux makes a profit in the United States. They have added a third shift. They admit they make a profit, but they could make a bigger profit by paying 2.50 an hour and no health benefits in Mexico, and they are closing the plant.

Mr. Secretary, how do we compete with that if we do not go right to the heart of smart trade policies, currency manipulation with these countries that are taking our jobs, and focus on more than wealth accumulation of a few? We need to focus on work, the value of work, the value of a middle class, and the value of making sure that that household income that Chairman Greenspan talked about to us yesterday, that is driving this economy, buying those cars which we want to buy in Michigan, American made cars, and buying the refrigerators and buying the homes, we are not going to be able to do that if we are being asked for our workers to receive 2.50 an hour and no health benefits, or go to China for 33 cents as an average wage. So how do you speak to all of that?

This vision that I see coming out of the administration is one that is working for a few, but I do not see it working for the people in my State of Michigan.

Secretary SNOW. Thank you, Senator. The question you raise is a large one, and a critical one. It is really the central issue of economic policy. How do we make the American citizens better off? I think basically the answer is, by allowing the dynamics, the dynamism, the creativity, the energy of the American system to play out. You know, you go back 100 years and think of what the country was. We were an agricultural Nation, industrialization was just beginning. We had 40 percent of the work force engaged in agriculture. Today, as you know, it is less than 2 percent.

And yet, the standard of living, year after year after year after year, as people left agriculture and moved into industry, and then left industry and moved into other things like computer chips and technology and health care and so on, we have had a progression from low value jobs in the United States to higher and higher and higher value jobs.

The reason—and you know this as well as I—the reason American workers have high wages is they are productive. Wage rates reflect the productivity of the work force. Our work force is the best in the world. They have the highest wages in the world. They are the most productive in the world. Our job, I think, in public policy, is to continue to create the conditions where the inherent talent and ability of the American work force and our businesses can reflect itself in the marketplace.

Senator STABENOW. Mr. Secretary, with all due respect, these are different times now in a global economy. I understand going from agriculture economy to manufacturing, and we have all been told that now we are moving into high tech, value-added positions, and we need to focus on education and innovation, all of which I support, and I wish it was more reflected in this budget, by the way, since we do need to be doing that.

But with all due respect, we are not talking about only manufacturing jobs or low-end jobs that are now being lost or exported because of the pressures internationally. We are talking engineers. We are talking about—in this report, at the beginning of the week with the Council of Economic Advisors, it was recommended that one of the ways to lower health care cost is by exporting health care providers, like radiologists. I have friends of mine in Lansing, Michigan, high-end engineers who are now in custodial positions because they cannot find high-end engineering or computer jobs that are being exported to India and other place.

This is not, at this point in time, just about an evolution of economics in a world economy. If we are not smart about trade, if we do not address currency manipulation——

And I would just ask one question, and then, Mr. Chairman, I am sure I have used my time, but I just want to ask one question on that because if we in fact are saying we are productive and can compete with anybody, which I agree totally—when manufacturers sit in my office this week from Grand Rapids, Michigan and say, "Just give us a level playing field." By the way, they were outraged about this report that came out the beginning of the week. They are saying, "What are we going to do about a level playing field and currency manipulation by China?"

I would just simply ask, in conclusion, what are we going to do about that? Mr. Secretary, we certainly know that something is going on, and we would welcome, and we need your leadership on that issue.

Secretary SNOW. Thank you very much, Senator. I think we are making some good progress with the Chinese on that subject. We have engaged them. You know I spoke with Premier Wen, went to Beijing and had a long meeting with him and his economic policy leaders, the head of the Central Bank, Governor Zho, and the finance minister, Minister Jin, and a number of leaders in the economy. We are straight with them. We said, "You know, this system does not hold together. It does not work. It is not right for the world economy. It is not right for the world trading system, and you need to move to a flexible set of exchange rates that allows the market to set the value, rather have you arbitrarily establish the value."

We have an agreement on that with them. They have acknowledged the need to move to a flexible exchange rate. They rightly point out they cannot do it tomorrow because their financial structures are so rudimentary, but they are beginning to take steps. There is increasing talk about maybe moving to a partial float or a currency basket, but I want you to know we are very much engaged on that issue and want to hold their feet to the fire on continuing to make forward progress there.

Chairman NICKLES. Secretary Snow, thank you very much.

Senator Stabenow, thank you.

Senator ALLARD.

Senator ALLARD. Thank you, Mr. Chairman, and welcome, Mr. Snow.

When the President came into office, I think it has pretty well been established that the stock market began to decline well before that election. Then when he was sworn into office at that time, that is when you started your 3-year downturn and went into actually a recessionary period, and the President's plan for economic growth was to cut taxes. At that particular point in time, I think relatively speaking to the history of the country, taxes were pretty high. I agreed with the President that when you have that high tax rate, if you begin to drop taxes, then you will stimulate the economy.

We are saying that now. I do not think that anybody can deny that the economy is not in recovery, even at the last parameter to change which is unemployment rates, and I would have real concern for us to raise taxes in any sector of our economy at a time when we are looking at recovery that is just beginning. I wonder perhaps maybe you might comment on the impact that raising taxes would have as we are just starting in this growth period.

Secretary SNOW. Senator, I would be very much opposed to that. I think it is about the single worst thing we could do. It would undermine this recovery, which as you point out is a very firm and good recovery. I think it is singularly bad economic policy that would jeopardize the recovery and put us on the wrong path.

Senator ALLARD. I would like to followup a little bit on my statement now on the labor market and the unemployment figures. The unemployment rate fell to 5.6 percent in January, and it is well below the peak of 6.3 percent in June, and the payroll employment increased by 112,000 jobs. But I want to go to this household survey because the figures I have, they show a gain of 500,000 in January. As we move along, it seems like there is a greater discrepancy between the payroll employment and the household survey, and nobody seems to come up with an answer as to why this is occurring.

I happen to feel that it reflects, and talking to many economists, they feel it reflects what is happening in the small business are, the self-employed area. I talked with some executives in the high-tech companies that say, "Well, when you separate your employees, you cut back, you give them a bonus or you give some kind of a separation stipend, and they take this cash" and they say, "Now is my opportunity to go in business for myself," so they start their business in their home, and that is not really reflected perhaps in that. That has kind of been my view and what I have picked up.

I wonder, perhaps if you have any real things that you can add to that discussion that might enlighten us?

Secretary SNOW. Thank you, Senator. You are absolutely right, there is a marked discrepancy between the two surveys, one showing relatively modest, the 112,000 pickup for January versus the five times that pickup in the household survey. I must say economists are sort of puzzled on this. I do not think anybody has a real good answer for it, but I would credit your hypothesis. I think your hypothesis may well explain the difference because the establishment survey or payroll survey, as it is known, deals with established businesses.

There is a phenomenon going on that you mentioned that I think is very real, and that is more self employment. The large companies, in order to shed overhead costs of pensions and of rising health care costs, are in effect outsourcing functions that used to be done in the business. An H.R. department will be outsourced and the people who used to do the pension planning, who used to do the benefits planning and so on, are now doing it, but they are not doing it as an employee of the ABC Corporation. They are doing it as a sole practitioner. The household survey does not pick that up the same way. It may eventually pick it up, but it does not pick that up the same way the establishment does.

I had a friend come visit me recently to sort of illustrate your story. He worked in a big establishment. He had a good job in a big establishment. He left, and he founded his own small business. He now has 12 employees plus himself. And he is not in the household survey. They may get him eventually——

Senator ALLARD. I am almost thinking you have that backward. Is it not the household survey that picks up those people that are doing work at home and so on, and the payroll survey does not?

Secretary SNOW. Yes, that is right. I flipped it on you. But he is not in the payroll survey. I think there is more of that going on, but we cannot quantify it very well. It needs to be quantified, I agree. But that is a working hypothesis that a lot of people are now trying to test.

Senator ALLARD. I would like to approach this manufacturing job issue a little bit. I had an opportunity to hear testimony yesterday from Alan Greenspan, and he agreed with me that this is not a new phenomenon, that we have been seeing a decrease in manufacturing jobs since 1979, and he agreed that that was the date when we started seeing that phenomenon. But he also elaborated on it and said, "Look, it is not only what is happening here in the United States, but that is happening worldwide." I said, "Even China?" He said, "Yes, because of the productivity efficiencies that are being built into the system."

I had a number of manufacturers come to me 2 years ago and say the value of the dollar in comparison to the yet or the euro was so high that it was making it difficult for them to move their goods and services overseas because they could not compete. Now the value of the dollar has dropped down, which is a good sign I think for our exports. It means that things that we import is going to be more expensive, things that we sell overseas is going to be less expensive. I cannot help but think that is going to have a positive impact.

Do you have any way of knowing how much of an impact the decrease in the dollar is going to have and whether we are going to—I mean is this going to be sort of a sustained thing, the drop of the value of the dollar compared to the yet and euro, for example, or not?

Secretary SNOW. Senator, that is an important and interesting question, but I have made a habit of not trying to predict where the dollar is going, or getting into commentaries on relative values of currencies for good reasons that you know.

Senator ALLARD. Sure.

Secretary SNOW. But your opening point of manufacturing, there is the secular trend, long-term trend that Chairman Greenspan talked about, much more pronounced on jobs than on output of manufacturing. We still have a tremendously big, vital and important manufacturing sector. In fact, our manufacturing sector, if the United States did nothing else but carry on manufacturing, nothing else, would be I think the fifth largest economy in the world. I think our manufacturing sector has an output valued at 1.6 or 1.7 trillion, with the Chinese economy at less than a trillion. So it is a huge vitally important sector. It is also a extraordinarily productive sector, and its productivity rates have been running well above the GDP growth rates. So the effect of that is, it is becoming a somewhat smaller part of GDP, but more importantly, it does not need as many workers. It is staying competitive. If we can reduce barriers in the rest of the world, which we are intent on doing, which is a tax on our manufacturers, we can expand manufacturing.

But this recession was different in some ways in that on top of this long-term secular, we ended up with a cyclical downturn which was really harsh and dramatic. Senator Stabenow knows that being from a manufacturing area; Michigan, Ohio, Pennsylvania, Illinois, and Indiana really were hit very, very hard by this and still have not come back from it.

I remember when it started. It started in the summer of 2000, because I was then, with my former employer, a transportation company that hauls lots of things for the manufacturing sector, set up automobiles as a major product line. And I got the reports in from the subsidiaries, the barge line and the ocean carrier, the container carrier and the logistics company and the railroad, and there was all the same story. The economy had hit a wall or gone over a cliff, whatever metaphor you want to use, and it has not come back to that level yet today.

So it was a dramatic downturn in the manufacturing sector. It is beginning to show better results now. Finally, we are starting to come out of it. But the jobs have very much lagged.

Senator ALLARD. Well, Mr. Secretary, I know that the chairman wants to call on other members. To me, I think things are—our economy is definitely recovering, and I am pleased to see it has moved toward a small business sector. I mean, I see that trend. And I think that that is exciting for competition. I think that is exciting for our economy because it is the small business sector that develops—they are the originators of new thoughts and ideas and new jobs. That is where large companies come from. And I think

it is good for the consumer because competition holds down goods and services and gives the consumer lots of choices.

So I cannot help but be positive, bullish on the economy. I think it is because of Bush's tax cuts that he put out as part of his program.

Thank you, Mr. Chairman.

Chairman NICKLES. Senator Allard, thank you very much.

Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman, and thank you, Mr. Secretary.

My relations with the Secretary have been very good over a good many years, and I value his work. I also value my association with him.

Secretary SNOW. Thank you.

Senator BYRD. I think he and I both are supporters of Amtrak, which serves many rural areas of this country.

But on another matter, the Secretary speaks today about the commitment to deficit reduction, and my observations lead me to believe that the criticism of the administration's commitment to deficit reduction is growing. And the price of loyalty—former Treasury Secretary Paul O'Neill says the administration put tax cuts and short-term political gain ahead of the Nation's long-term economic well-being. Mr. O'Neill's says his warnings about the risk of a fiscal crisis were dismissed.

The International Monetary Fund, which typically censures the budget policies of Third World, debt-heavy countries, recently warned that U.S. budget deficits risked destabilizing financial markets and stunting global investment and economic growth.

The General Accounting Office issued a similar warning, along with Federal Reserve Chairman Alan Greenspan and former Treasury Secretary Robert Rubin. Even the conservative Heritage Foundation has blasted the administration's reckless fiscal policies.

Secretary Snow, why is the administration having such a tough time convincing the American public that it is truly committed to deficit reduction?

Secretary SNOW. Senator, let me begin by saying that I reciprocate those kind comments you made and have the deepest admiration for you, and that goes back a long, long time that we have worked together.

The administration is committed to this objective. We have to be committed to this objective. The future well-being of the country is what is at stake here. And as I said earlier, this is a deeply serious issue. We cannot afford to lose the confidence of our financial markets. We cannot allow our deficit to become a threat to our future. And I want to tell you that I am committed to seeing us bring that deficit down, and bringing it down in real terms, and then going on and dealing with the longer-term set of issues that Senator Conrad and I talked about.

Senator BYRD. Mr. Secretary, my time is limited. I am sorry. But why is the public not responding positively to the President's proposal to cut the deficit in half?

Secretary SNOW. Well, Senator, maybe it is our fault in not being more persuasive. I guess I need to do a better job of getting out

there and talking about what we are doing and why we are doing and our commitment to doing it. It is a job of persuasion.

Senator BYRD. Well, Mr. Secretary, while the administration argues that the deficit will be cut in half over the next 5 years, your own budget documents show the deficit will be worse in 2009 if the President's budget is enacted than if Congress took no action at all. The administration's budget is filled with holes and magic asterisks by failing to include any funding for the war Iraq—this I cannot understand—failing to include any funding for the war in Iraq—to which I am vehemently opposed, I might say for the record, if there is anyone in here who does not already know it—or to address the impending crisis in Social Security. I think the administration has given the American people little reason to take its deficit promises seriously.

Now, if I might go to a second question, I know there is plenty that could be said on both sides here about that question I have just asked. But I must go on. Our time is limited.

Tax cuts for the wealthy. On page 131 of its budget and economic forecast, the CBO shows that during the Bush administration, corporate tax receipts have fallen by $76 billion; estate and gift tax receipts have fallen by $7 billion; while social insurance payroll taxes, which fall primarily on working-class American families, are at their highest levels ever, up $60 billion since 2000.

So the question is: Why is it that during the Bush administration taxes that fall most heavily on middle-class working families are rising while the taxes that fall on the most affluent are falling?

Secretary SNOW. Senator, the issue of corporate taxes I think is explained by the fact that the President inherited a weak economy, and with that weak economy, corporate profits have fallen significantly, and with lower profits, there is less to be taxed, as well as the fact that many companies lost money during that period and, as you know, acquired these tax-loss carry-forwards and so on that they applied against their tax returns.

The numbers I have seen—and I will be pleased to share these with you—suggest that actually after the President's tax cuts, the share of the burden of the total tax bill rises on the highest income and falls on the lower income. That is the effect of taking a number of people off the tax rolls, 3 million in 2003, putting into effect the 10-percent tax bracket, the marriage penalty, and the child credits, and a variety of things. But the net effect of that is that the lower-income groups pay a smaller share of the total tax burden today.

Senator BYRD. Mr. Secretary—do I have time for a short statement?

Chairman NICKLES. The Senator does. I will note Senator Bunning told me he needed to leave at 11:30. If you don't mind, we will call on him, and then I will call on you again.

Senator BYRD. Well, I would love to do that. I can't do it. I have to take my wife to the doctor. I am running short of time now. I would love to accommodate to Senator Bunning, and I shall. Let him go ahead. I will leave and take care of my wife first. She is my first duty.

Chairman NICKLES. You have your priorities——

Senator BYRD. I have them straight. And I have had them straight for almost 67 years.

Chairman NICKLES. My compliments to you.

Senator BYRD. I have a lot further questions to ask, and all this business about increasing taxes, you see, covers up the fact that these cuts that have been made are really deepening the deficits, and the war in Iraq is deepening the deficits. And we have these problems that are confronting us now. It is one thing to say that we are raising taxes, but nobody says very much about the fact that the war in Iraq is costing us—is not included in this year's budget. The President is not asking for anything in this year's budget for Iraq. But it is going to cost us.

I will close with this final thing, if I may. In response to mounting budget deficit projections, President Ronald Reagan signed into law 12 bills to increase taxes, including legislation to repeal part of his 1981 tax cut. Similarly, in response to alarming deficit projections, in 1990 President Bush's father made the courageous decision to break his "No new taxes" pledge. Although President Bush's father paid a high political price, it was the right move at the right time, and it started the country's finances on the road to recovery.

Presidents Reagan and Bush were confronted with the same choice that this administration will soon have to make, and they concluded that the budget could not be balanced without repealing tax cuts. In 1990, the Congress likewise concluded that all pieces of the budget—discretionary, mandatory, and revenues—would have to yield savings. Until this administration acknowledges this seemingly obvious fact, it will never bring the budget into balance.

Again, I want to thank you, Mr. Secretary, and I look forward to talking with you further.

Mr. Chairman, thank you for your patience, and I thank all my colleagues for their patience.

Chairman NICKLES. Senator Byrd, thank you, and best wishes to you and your wife.

Senator BYRD. Thank you.

Chairman NICKLES. Senator Bunning.

Senator BUNNING. Thank you, Mr. Chairman. Secretary Snow, thank you for coming.

I noticed in the White House budget proposal—and we have talked about this prior, and I hope you have been brought up to speed because the last time you begged off on it—includes $83 million for a new regulatory agency in Treasury to oversee certain GSEs. I have spoken with your staff in the past about regulation of GSEs. Assistant Secretary Abernathy stated before the Banking Committee that he believes that the Tennessee Valley Authority, TVA, should be under SEC jurisdiction. And I have a videotape, if you want to see it, just so that there is no misunderstanding.

Do you think that all GSEs, including non-housing GSEs, should be regulated?

Secretary SNOW. Senator, we have proposed that the housing GSEs be under, the Federal Home Loan Banks as well as Freddie and Fannie. Our proposals at Treasury have not gone beyond that.

Senator BUNNING. Well, you are not answering my question. My question was: Do you think that all GSEs should be regulated?

Secretary SNOW. All Government-sponsored entities——

Senator BUNNING. Should be regulated.

Secretary SNOW. Should be regulated. I am not sure what other entities you might have in mind.

Senator BUNNING. Well, there are other GSEs other than Freddie, Fannie, and the Federal Home Loan Bank.

Secretary SNOW. Who are not regulated?

Senator BUNNING. Who are not——

Secretary SNOW. To your knowledge——

Senator BUNNING. Who are not being put into the new regulator that we are trying to create.

Secretary SNOW. Right. Well, the reason that we are putting these in is that they have to do with housing and housing finance and present a very significant—play a very significant role in the whole issue of housing finance. And in our view, these entities have become so large relative to the housing finance business and actually to the whole financings of the United States that a strong regulator is necessary so we can assure the soundness——

Senator BUNNING. I don't argue that fact with you. I agree with you 100 percent. I am asking you about those that are falling outside of the purview of what you have proposed. We have no one regulating TVA right now. No one, except they do have $26 billion in debt on the market, which is considered guaranteed by the Federal Government. They are not regulated by the Securities and Exchange Commission. They are not regulated, not by any public service commission in the service areas that they serve. And I just think that it is time we got a hold on the three commissioners who make all the decisions and have an oversight. And this would be a very nice time if we could include them in some type of oversight and regulatory commission.

Secretary SNOW. Senator, could I take a hard look at that? You have asked me this before. The answer I haveten back is that they are different.

Senator BUNNING. Yes, they are different, but they are a GSE.

Secretary SNOW. Well, the response I haveten—and I will probe into it further to make sure I can really talk to this with my own knowledge rather than relying on others—is that they are not quite like Fannie, Freddie, and the Federal Home Loan Banks because they are actually—not just sponsored, they are owned by, they are the U.S. Government.

Senator BUNNING. Well, the U.S. Government needs to regulate them, and that is the question I am giving you.

I really feel naked up here because I do not have any charts to put up.

[Laughter.]

Senator CONRAD. Do you want to borrow some?

Senator BUNNING. Yes, I could borrow the chairman's because he talked about taxes. You know, already expired at the end of 2003 were the AMT relief, work opportunity tax credit, above-line deductions for teachers' classroom expenses, enhanced deductions for donations of computers to schools, and medical savings accounts. Those are already gone. Those were in the tax bills.

Expiring at the end of this year are R&D tax credit, accelerated marriage penalty relief, accelerated child tax credit, and the 50-percent bonus depreciation. We are about to jettison them at the end of 2004.

After 2005, small business expensing up to $75,000, it is gone, and $3,000 deduction for education and tuition expenses.

Expiring in 2008, capital gains reduction rate, dividend rate reduction, and there are many of them that expire after 2010.

My question to you, Mr. Secretary, is: If we do not do something soon, most of the good things that we did as far as tax reduction are going to disappear. My question is: Do you have a priority?

Secretary SNOW. Yes, we do, Senator. A number of the items you mentioned are in our budget.

Senator BUNNING. I understand that, but do——

Secretary SNOW. The R&Ds and the child credits and the marriage penalty and so on. And I think it is critical that Congress act and make them permanent. I would go beyond that and say I would like to see the out-year——

Senator BUNNING. The 2008's and 2010's.

Secretary SNOW. Going out to there, exactly, because there is an awful lot of good tax policy embraced in what you did last year that goes out, and if Congress fails to act on it, it means a tax increase, a large tax increase on the American people.

Senator BUNNING. That is what my—and in this recovery period, in my opinion, and in the opinion of a lot of people that are smarter than I am, if we have a tax increase in this critical period with a recovering economy, we will send this economy the other way rather than allow it to grow as it should grow.

Secretary SNOW. I agree with you fully.

Senator BUNNING. OK. There are other questions I have, and I am going to submit them to you in writing. As a courtesy to the chairman, I will yield back. Thank you.

Chairman NICKLES. Senator Bunning, thank you very much.

Senator Cornyn.

Senator CORNYN. Mr. Secretary, it is good to see you. I recall a statement that I heard you make shortly after you became Secretary of the Treasury, and it struck me as profound, but something simple enough that a humble barrister could understand, somebody who has not been, like you, very successful in business or an economist or someone with that sort of professional training. And you said simply this, that if you want more of something, you should tax it less. And, indeed, I think that has been the policy of the President and the policy of this Congress in passing the President's tax relief and growth package, and I think we are seeing that come to fruition with the economy roaring back. And I am, like everyone, grateful for it.

Obviously, employment is not yet where we want it to be, but I am gratified by what you have told us this morning in terms of your expectations, and I think that is consistent with everything I have heard from everyone who knows or should know something about this subject.

But I, too, share concerns about the deficit, but I think we had a fundamental choice to make when we looked at the tax relief and growth package, and that is, did we want to try to address deficits alone at the risk of killing the economic recovery in the cradle, or did we want to take a chance that we could get the economy roaring back again and put people back to work and then have time

in a healthy economy sufficient to deal with the deficit, as I understand this budget proposes to do?

But I also am concerned about when I hear members of this body and the others on the other side of the Capitol talk about the deficit. Indeed, you have been asked this morning has the President—or the statement has been made, The President has not given us a plan to deal with the deficit. But, you know, I was always under the impression that it was Congress who passed a budget. Indeed, that is what we are in the process of doing. I always believed that it was Congress that appropriated the money to spend it, and the President's role, albeit that of the bully pulpit and given the power of the veto, that his role was really different, and that it is our responsibility. So I just say all that because I do believe that if there is an enemy in this process, as Pogo said, "We have met the enemy and it is us."

I recall, finally—and I will lead up to a question—that as we debated last year both the budget resolution and we debated appropriations, that there were amendments proposed on the floor of the U.S. Senate totaling $85 billion, or $1.2 trillion over time, to add to Government spending. And thank goodness we had the self-discipline to not agree to those huge increases in spending.

But really what I want to ask you about is this: Yesterday, the Senate Judiciary Subcommittee on Immigration had a hearing on the President's proposal for a temporary worker program. And I must tell you that as complex the subject that you deal with every day is, to me the issue of immigration reform rivals that in complexity. But one of the things that does make sense to me is that if we get people out of the shadows and onto the tax rolls, that represents a net benefit for the economy and the American people.

Do you have any comments you would like to share with us along that line?

Secretary SNOW. Yes, Senator. I agree with you. There was a time when Treasury had more to do with that whole area. The Immigration and Naturalization Service had been part of Treasury at one point, but, of course, now is not. And I agree with you that is one of the more complex areas that we deal with.

But the President's policy of giving an identity to these people so that they become part of the recognized—they are recognized for tax purposes and so on, will clearly help, as you say, bring people out of the shadows and put more revenue into the tills of the United States. They are here. We ought to recognize the reality that they are here. And we ought to make sure that they are not part of an underground economy but become part of the regular and visible economy. Yes, I think it is a very forward-looking policy.

Senator CORNYN. And if I have time to ask one other question, I would like to ask you a little bit about some of the concerns that Senator Stabenow raised about job loss. And I appreciate very much your concern and the President's concern and the concern we all share when people are out of work and they want to work and provide for their families. Yet we all understand we are in a very dynamic time with a global economy. And the example that you used about the dislocation that occurred in agriculture, for example, because of automation and now that less than 2 percent are

doing what 40 percent of the work force used to do at one time. And I guess we could all harken back to the day before the computer when it took a lot more people to perform functions now that, thanks to technology, take less people. But the truth is that consumers have benefited at reduced costs, but it does place a burden on us, I believe, those of us in positions to help, particularly when it comes to education and making sure we have an educated work force that is capable of earning the good wages that the higher-paying jobs that will inevitably remain in this country are capable of paying.

I know the President talked about that some in his State of the Union as it relates to community colleges. Would you address that issue?

Secretary SNOW. Yes, Senator, I would be delighted to. The President in the State of the Union talked about his jobs for the 21st century program, and the linkage between jobs and education is just absolutely perfectly clear. And the community colleges that he referenced in the jobs for the 21st century program provide the pathway to the training that gives you the opportunity to participate in the economy.

It is not just the effects of globalization that we are dealing with in this economy. There are really many more jobs displaced by domestic competition than from global competition. And that is evident by the fact that there are about 40 or 50 million new jobs every year in this country, but there is also 40 or 50 million jobs where people are moving on.

I was at a community college in Florida, in Jacksonville, the Jacksonville Community College, earlier this week. And it was a moving and inspiring experience to listen to the faculty of the school—and they call it the Advanced Technology Center at Jacksonville Community College—talk about the effect this school is having on the larger Jacksonville community. It is supported by the business people who work with the faculty to design the courses, indicating what the job skill needs are that they see coming along, and they in effect tell the students, If you get these skills, you will have a job with us.

Now, this is not just putting time in to get an associate degree. This is actually learning. And the school commits to actually conveying the knowledge and hands-on experience in large part. And they told some moving stories. I will tell you just one that makes the point about how community colleges provide the pathway from the present to the jobs of the future.

A cab driver who had modest earnings as a cab driver, who went to the school, night school, and he would get calls, and he would have to go, give a ride, and then he would come back. And he did this for two or 3 years and finally got the skills to get a full-time job at much higher compensation levels. And he came back to the school with his first—he had never had a check before. He had always depended on these fares. He now had a check, and he brought it back to the college, to the faculty, and he said, "I just want you to know what you have done for me and my family by giving me the skills that I can get a full-time job earning $50,000 a year."

Now, there are a lot of people who are like that, who are looking to get higher-level skills so they can move into higher- and better-

paying jobs. The community colleges are the link between those people and the skills they need to get those jobs. And he had not been displaced by global competition. He was a fellow who had a job in the United States and wanted a better job.

And that is really how America works, people looking for better jobs and acquiring—and we need to make sure we give them the ability to acquire the skills to get those jobs.

Senator CORNYN. Thank you very much.

Secretary SNOW. I appreciate your asking that question.

Chairman NICKLES. Senator Cornyn, thank you very much.

Mr. Secretary, I thank you for your presentation. I have a couple questions, and I think Senator Conrad may, too. Are you OK? Is 12 fine?

Secretary SNOW. Yes, 12 o'clock is good, Mr. Chairman.

Chairman NICKLES. One of the issues that we have in the Finance Committee deals with international trade, deals with compliance with WTO, and that is the FSC/ETI legislation. The bill that was reported out of the Finance Committee has a lower corporate tax rate for manufacturers than for other corporations. It has a tax rate of 32 percent, ultimately—it takes a few years to get there—for manufacturers and 35 percent for other corporations, whether they be financial or service.

I personally think that is a mistake. I think it is a complication in the code. I think it is an inefficiency. I believe my history tells me that Canada tried a differential rate for manufacturing and repealed it. I would hope that the administration and your office and yourself would lend some advice to Congress before, in my opinion, making a mistake. I think we have to pass legislation to be compliant with WTO, and I want us to do that. I do not want to see the European Union get into a trade war with the U.S. That would be a lose-lose situation for both sides.

But, conversely, I would like to see us fix it in a way that I would be willing to sipport. I personally would be very troubled by having a differential corporate rate. I think that is a serious mistake. Would you care to comment on that?

Secretary SNOW. Well, I agree with you, Mr. Chairman. I think what the Canadians found when they had the differential rate favoring one class of economic undertaking over another, manufacturing, that all of a sudden there was a lot of entry into the manufacturing business by people who formerly had not been manufacturers, but for purposes of the tax code showed up as manufacturers. You create real distortions, I think, with that sort of approach. The better approach would be simply if we treated everybody the same.

So I agree with you, and I think we are sending that message to both the House and the Senate in terms of what would make good tax policy.

We feel strongly that we need to be in compliance with WTO. But we need to do it in a way that does not distort the Tax Code and create disincentives for one sector of the economy versus another. And we need to do what seems to me in a way that moves forward—it cannot get all the way, but moves forward in modernizing this 40-year-old set of tax policies that I think fundamentally

prejudice the interests of American manufacturers—American businesses, manufacturers and service providers as well. You know, those rules came into effect before the United States had emerged as a great trading country with 20 percent or so of our GDP tied up in trade, imports and exports.

We need to modernize that whole system and remove the non-economic limitations on foreign tax credits that do so much harm, reform the rules that increase the cost of U.S. companies doing business in foreign markets. I would hope at some point we could go to the larger issues. Maybe some of them can be dealt with in the FSC/ETI. The more that can, the better in the FSC/ETI framework. But I see the priority now on just getting us into compliance in a way that doesn't prejudice U.S. businesses and doesn't create distortions in the Code.

Chairman NICKLES. I mentioned I was displeased with what passed out of the Finance Committee. Would you work with us to try to help us, one, come up with a proposal that is within the revenues available, to be WTO compliant, and give us what I would say is a uniform corporate rate? And if there are other things on the international tax side that would help make us more competitive—and you mentioned one or two, and Senator Conrad and I have been around long enough that we know that there is a lot of work that needs to be done on the international tax code. But we need to move pretty quickly. I think we are looking at potential tariffs within 30 days. That might be postponed somewhat, but it is important for us to move expeditiously.

And so if you could help assist us in maybe coming up with a package that would be WTO compliant in your view and would be fair to corporations, we would appreciate your assistance.

Secretary SNOW. We will commit to do that, Mr. Chairman.

Chairman NICKLES. I appreciate that. One other thing from my opening comments, and I was reading through it a little bit more, and that is the corporations that are engaging in the sale-in lease-out or SILO and qualified technological equipment transactions. You are familiar with these?

Secretary SNOW. Yes, I am.

Chairman NICKLES. I was asking my staff for an example, and they said, well, there are a lot of transit systems that are using it. Senator Conrad is familiar with some others, and my staff said it has already happened for leasing the Berlin subway system. U.S. corporations doing this, getting depreciation tax benefits, and it is a shell game. It looks to me like it is one of these things that I am alluding to that needs to be stopped. It may be legal, but it is an abuse of the tax system. I am a person, who doesn't have to tell people where I am coming from. I want lower tax rates and I want an efficient system, but I find this an abuse, and I want to stop it and I plan on working to stop it.

Would you care to comment?

Secretary SNOW. Yes, I agree fully with your statements on that. The SILO transactions, which we have analyzed now, have no meaningful economic purpose or utility other than to create a transfer mechanism for tax benefits. There is no economic utility at all. There is simply a mechanism for a tax transfer. I think they need to be stopped. The spread of them is really a dangerous thing

to the revenues of the U.S. Government. The cost of the SILOs is so great that the Treasury Department has had to revise its corporate tax baseline, because of so much erosion of revenue. It is really, Mr. Chairman, a critical issue and I am sympathetic to the States and cities and so on, but the revenue they get for that is so small relative to the erosion of the revenues of the Federal Government, that it is no comparison.

And now, of course, it is not even our cities and municipalities in the States, but it is the cities and provinces and so on of the rest of the world, Frankfurt and so on, getting the benefit of tax transfers that is paid for by subway system, paid for really by the taxpayers of the United States. So there is something just fundamentally wrong about this, and it needs to be stopped. Let us be real blunt about it, this is a real bad deal for the taxpayers of America.

Chairman NICKLES. I appreciate your statement. I told Senator Conrad that I think part of our challenge now is that most of our colleagues on the Finance Committee and Ways and Means Committee probably are not aware of it. Since we are both on the Finance Committee, we may ask you or somebody from your staff to help us have an additional hearing on it to expose it. We are going to send some signals that we are going to try and stop it.

There are a lot of banks, a lot of municipalities that are involved in this, but from my preliminary estimates, it looks like for every dollar the municipalities are getting out of this sham deal, the Federal Government is losing about 10 times as much.

Secretary SNOW. A 10 to 1 ratio.

Chairman NICKLES. That is not a very good deal.

Secretary SNOW. If I can help you publicize what a bad deal this is for American taxpayers and how abusive this scheme is, just call on me.

Chairman NICKLES. What do you estimate the savings to be if we close this door?

Secretary SNOW. I do not have a real good number on that, but it is in the billions of dollars, 33 billion, I am advised.

Chairman NICKLES. I have heard about the $30 billion figure.

Secretary SNOW. 3 billion a year.

Chairman NICKLES. If it is going international as much as it evidently is, it is pretty wide open.

Secretary SNOW. It could be much larger than that because it is a growing phenomenon. I mean that is why I hesitated to put a 3 billion a year. It could be a 4, 5 or 6 unless we stop it.

Chairman NICKLES. Thank you.

Senator CONRAD.

Senator CONRAD. Let me just pick up on that point and say the Chairman and I have been talking about the need to close that particular loophole. What is happening, for those who are listening and watching, is municipalities are selling their subway systems, they are selling even their sewer and water systems to private entities, that then can take the tax benefits from the ownership of those facilities, depreciate them, for example, over time, and then the municipalities lease back these systems. This is truly a scam, and it has to be stopped.

I am advised that companies have gone to meetings of city officials, national meetings of cities officials and pitched these pro-

posals, and now it is going offshore. The Chairman referenced a Berlin subway system. I mean this has got almost no limit to its potential for abuse, and it is one area that has got to be dealt with.

I would go back, if I could, to the other conversation you were having with respect to FSC. I think we now have to consider, in light of the tax gap, in light of our WTO challenges, fundamental tax reform in this country. I do not think it can be postponed any more. All of us understand it is not going to happen this year in an election year. There has not been enough time devoted to it.

I would hope, Mr. Secretary, that we could begin the process though, focusing on these challenges, the tax gap, the hemorrhage in the current revenue system, our WTO problems, the fact that our trading competitors have taxes that are rebatable at the border that confers an advantage onto their businesses and that we have tried to match this with FSC and all the rest, but over and over we are ruled out of compliance with WTO. There is a short-term solution, but I think there is a much more fundamental need to review our entire tax system.

Let me ask you this question: what is the deficit; in your judgment, how would you define the deficit?

Secretary SNOW. The deficit is, I guess, best thought of as the difference between the Government's annual expenditures and its annual receipts.

Senator CONRAD. And what is the debt?

Secretary SNOW. The debt is the obligation that the Government has to its creditors.

Senator CONRAD. I ask those—I know they are very fundamental questions, but I ask them because I find there is enormous confusion in the public because the deficit and the debt, and of course, Mr. Secretary, you have defined them with precision. I find when I am visiting with people there is confusion between the deficit and the debt. When the President says he is going to cut the deficit in half, a lot of people confuse that with the debt.

Let me show you the thing that very much worries me about the President's plan. I know this is very busy. I am not asking to try to decipher this, but I want to talk about—this is from the President's budget. It shows the increases in the debt at the end of the year. It shows the debt right now is $6.76 trillion. Next year, at the end of this year, 2004, it says the debt will be $7.486 trillion, an increase of $726 billion, not the $521 billion that the administration has been talking about, but $200 billion more. The big part of the difference obviously is Social Security, but all of that money is owed. They are our creditors. We are borrowing, under the President's budget from Social Security.

The next year the debt goes up by $647 billion. The next year by $593 billion, the fourth year by $592 billion. In 2008 it starts to go up some more, $613 billion, and in the fifth year from 2004, the debt is going up $633 billion. I do not see this growth of the debt being cut in half anywhere, do you?

Secretary SNOW. Well, the deficit is cut in half under our numbers, and pretty much the CBO numbers.

Senator CONRAD. But the deficit, that is where we have this confusion. The deficit, you are talking about on a unified basis, when you put all the money in the same pot, trust fund money and reg-

ular money, and the problem with that is, I think that fundamentally misleads us as to the magnitude of the problem.

Secretary SNOW. Senator, it also——

Senator CONRAD. Do we not owe the money back to Social Security?

Secretary SNOW. Senator, it also though, as you and I have discussed on prior occasions, calls attention to the things that we really have to get focused on. You mentioned Social Security and Medicare. That is really what that chart says. We have to get focused on these large commitments we have made to the future.

Senator CONRAD. Mr. Secretary, the problem I have, when the President goes out and tells the American people he is going to cut the deficit in half, I think that gives them comfort. I think that leads them to conclude that we are getting this thing under control. We are not getting it under control. Under the President's plan, the debt is going up. In no year is it going up less than $600 billion.

Secretary SNOW. Senator, I would hope that that chart and what it shows on debt will lead to furtherance of this large public discussion on the subject of Social Security and Medicare. I think we need to deal with Social Security first, in my view. The President has put it on the table with his call for the Commission, with his call for the personal accounts, tried to engender a broad national dialog. I think we are getting more and more attention to it. I commend you for bringing the fundamental longer term issue to our attention. It needs to be addressed.

Senator CONRAD. The thing that I do not hear you talking about is the revenue side of the equation, and here we are, we have this addition to the debt every year, massive increases, and that is before the baby-boomers retire, that is before the full effect of the President's tax cuts which make this situation pale by comparison to what is going to happen.

So I would say this to you, maybe we can make a deal here. I am willing to talk about the long-term entitlement imbalances, but I would hope you are willing to talk about the long-term imbalances on the revenue side, because deficits are a product of the difference between spending and revenue, and just to talk about spending misses half the equation.

Secretary SNOW. Senator, thank you.

Chairman NICKLES. Senator Conrad, thank you very much.

Mr. Secretary, so you know, Senator Conrad and I already plan, probably after we finish the budget cycle, on having hearings on some of the long-term obligations that our country is facing, Medicare and Medicaid being the two of the largest. Incidentally, the unfunded liabilities that are facing Medicare are about three times that of Social Security. But we plan on having hearings on those and trying to maybe set the stage on what can and could and should be done in the long term to help make those programs more affordable. He and I have little difference of opinion on whether you should focus on gross debt or debt held by the public, but that is a debate for another day. Also we will get into—I do not know if it will be at the same hearing or another, a discussion about trust funds. So we will need your participation on those, maybe both for educational purposes.

I want to compliment you on your hearing performance today. You were very educational, very forthright, very helpful to us in helping us maybe meet some of these challenges, find some of the problems, solve some of the problems, and I would encourage Mr. Manciw to listen to your presentation on employment statistics. I think that would be helpful. I compliment you and your outstanding staff. Thank you very much for your participation.

Secretary SNOW. Mr. Chairman, thank you very much.

Senator Conrad, thank you.

Chairman NICKLES. The meeting is adjourned.

[Whereupon, at 12:03 p.m., the Committee adjourned.]

Opening Statement of Senator Pete V. Domenici
Budget Committee Hearing with Sec. Snow
February 13, 2004

Mr. Chairman, thank you for holding this hearing today – I know it's been a little bit of a challenge given the recent temporary closure of the Senate Office Buildings. Nonetheless, you've done a great job of squeezing a number of hearings into a short time frame. I hope that we can maintain this pace and once again pass a budget by the statutorily required time.

Thank you, as well, Secretary Snow for taking time out of your busy schedule to spend some time with us today to explore the President's FY 2005 Budget for the Department of the Treasury. I also hope that we have an opportunity today to talk about our nation's economy.

We have faced unprecedented challenges in this country in the last couple of years – unprecedented certainly in my time in the Senate – probably unprecedented in the life of our country. Between a recession this President inherited, multiple terrorist attacks on our country, and a continuing War on Terror fought on the battlefields of both Afghanistan and Iraq, we have seen our economy take numerous hits.

I believe we are extremely fortunate that this President and Congress had the foresight to pass tax relief which has helped the economy to recover as quickly as it has. Despite this recovery, we have not seen all of the benefits of an economic recovery as we would have hoped. I am curious about the reasons for this and I hope we can talk about it during my time to ask questions.

Thank you again, Mr. Chairman. I look forward to hearing from Secretary Snow.

STATEMENT FOR SENATOR BUNNING
SENATE COMMITTEE ON BUDGET
TREASURY DEPARTMENT BUDGET REQUEST - FY 2005 BUDGET
February 13, 2004

Thank you, Mr. Chairman.

Welcome to the Committee today Secretary Snow. I look forward to a meaningful discussion of the President's budget proposal for the Department of Treasury.

In my dual role as a member of both the Budget and the Finance Committees, I have reviewed many of the details of the budget request for your Department and have paid particular attention to the revenue proposals contained in this year's budget. I have been happy to see the attention paid by the Administration to so many important areas – making health care more affordable, encouraging charitable giving, simplifying the tax laws, encouraging savings, as well as extending many expiring provisions.

I have been pleased with much of the economic data that we have been receiving lately – most of it pointing to a strengthening recovery. Economic growth in the second half of last year was the fastest in almost two decades, the Dow is at its highest level in almost three years and inflation and interest rates continue to stay low. While unemployment rates are higher than we would like to see, we know that over 360,000 jobs – to cite a very conservative estimate - have been created in the past five months and that unemployment claims are down from their peaks. Numbers like these point to a robust recovery – one that I largely attribute to the tax cuts that the President proposed and that we enacted.

I look forward to what I anticipate will be a lively discussion today.

Thank you.

PRODUCTIVITY

QUESTION:

Secretary Snow, I understand that we have seen marked increases in worker productivity in recent times. Most people believe this is a good thing. After all, a more efficient work force, that is, one where fewer workers do the same job or more, means greater profitability for companies and higher wages for employees.

It seems to me that there is a downside to productivity as well, at least as it is reflected in the Establishment Survey. Because American employees are becoming more efficient, businesses do not need as many employees to meet the same demands. Simply put, there are fewer traditional jobs.

Question 1: Will you explain the difference between the Establishment Survey and the Household Survey?

Answer:

The **household survey** (also known as the Current Population Survey) is based on interviews with about 60,000 households and provides information on approximately 112,000 persons 16 years and older. Employment in the household survey represents the number of *people* who are employed. In addition to nonfarm wage and salary workers, it includes agricultural workers, unpaid family workers, domestic help, the self-employed and those who are on temporary unpaid absences from their work.

The **payroll survey** (also called Current Employment Statistics) measures the number of *jobs* and only includes nonfarm wage and salary workers who are on business payrolls. It is based on a survey of 400,000 individual worksites covering nearly one-third of nonfarm payroll jobs. Some workers, who hold multiple jobs or switch jobs within a pay period, may show up on payrolls more than once and could inflate the payroll results when the labor market is strong.

Quantitatively, the difference between the household and payroll surveys widened by about 2.5 million between January 2002 and February 2004. **Only about a third of the widening gap is explained by self-employment.**

Question 2: Which do you believe is a more accurate representation of the employment picture?

Answer:

Each survey has strengths and weaknesses. The payroll survey is a larger sample and less volatile from month to month. However, the payroll survey ignores self-employment and may understate job growth at new firms during the early stages of economic recoveries. The household survey includes self-employment and may more rapidly incorporate job growth at new firms at this stage of the business cycle, although it is volatile from month to month.

Senator Domenici QFR

Question 3: What do the respective surveys show when a company outsources jobs; that is, the decide to contract with an outside company for a service (like janitors) rather than put the employees on their payroll?

Answer:

The employment accounted for by jobs that are outsourced is included in both the payroll and household survey if the company contracts with another company to provide the outsourced labor. For example, if a manufacturing company outsources its janitorial services to a company that specializes in providing those services, the employee (the janitor) appears in both the household and payroll surveys. Before outsourcing, the janitor would appear as a manufacturing worker. After outsourcing, the janitor appears as a service-providing worker (probably in the business services category).

If the outsourced worker is replaced by an independent contractor – a self-employed worker – then the payroll survey would show a loss of one job, while the household survey would show no change. Within the household survey, there would be one person less working in the wage and salary sector, and one person more working in the self-employed sector.

Senator Domenici QFR

ECONOMIC RECOVERY

QUESTION:

Secretary Snow, I am puzzled by the state of our economy today. Virtually every economic indicator tells us that we are in the midst of a tremendous recovery. But there is apparently something that is changing with our economy. In the past, when we have come out of a recession, the recovery has been accompanied by large increases in jobs. The news reports I have seen continually bemoan the lack of job creation in this recovery.

1. Are these news reports correct; that is, are there fewer jobs being created in this recovery than in previous, comparable recoveries?
2. Is there an explanation for this phenomenon?
3. What else can Congress do to help complete this economic recovery, thereby ensuring that every American who is willing to work can find a job?

ANSWER:

- The news reports have been correct, but have not told the full story. This recovery has generated fewer payroll jobs than other recoveries. However, the unemployment rate is down from 6.3 percent last June to 5.6 percent today, the household survey shows an increase in employment of 1.9 million in the past two years, and initial claims for unemployment insurance have fallen substantially.

- There is no single explanation that accounts for the very sluggish payroll growth. A major part of any explanation, however, must recognize that the dearth of payroll job gains is related to the rapid productivity growth that the economy has experienced over the past two years.

- Analysts are still undecided about the major reasons for the productivity acceleration. Potential explanations include the lagged effects of recent innovations in computers, networks, and communications hardware and software, which allow for greater efficiencies. This faster pace of adoption for technological advances could be running ahead of the economy's capacity to generate demand, and thus temporarily reducing the demand for labor.

- Other factors that may be holding down the demand for labor include business uncertainty. The economy has been hit by a series of shocks, including the terrorist attacks, the war with Iraq and in Afghanistan, revelations of corporate malfeasance, and the after-effects of the stock market crash. Currently, there is considerable uncertainty about the future of the recently passed tax law changes, some of which are set to expire at the end of this year.

- Congress can help reduce overall uncertainty by passing legislation to make the JGTRRA tax cuts permanent.

Question 1:

I noticed that the White House budget proposal includes $83 million for a new regulatory agency to oversee certain GSEs. I have spoken with your staff in the past about regulation of GSEs. Assistant Secretary Abernathy stated before the Banking Committee that he believes that the Tennessee Valley Authority should be under SEC jurisdiction – and I have video tape if you want to see it. Do you think that all GSEs, including non-housing GSEs, should be regulated?

Answer 1:

The GSEs are privately owned but federally-chartered companies, created by Congress to facilitate the flow of credit into certain segments of the economy. The Administration's position that the GSEs should voluntarily register with the SEC under the Securities Exchange Act of 1934 is based on the principle that privately owned companies that offer securities to the investing public should be subject to greater market discipline and the full disclosure of financial information to enhance that market discipline.

The Tennessee Valley Authority (TVA) is, however, a government-owned corporation, wholly owned by the U.S. Government. As a wholly-owned government corporation, the TVA's spending and collections are included in the Federal budget, and TVA's borrowing authority is treated as budget authority. Also, unlike the GSEs, the TVA's borrowing authority is explicitly limited by statute. While the TVA is thus legally and institutionally different from GSEs, it does share one important characteristic – by statute, the debt obligations of the TVA are not guaranteed by the full faith and credit of the U.S. Government. This commonality has led financial market participants often to include TVA's debt obligations with the debt obligations of the GSEs in what is commonly referred to as the "Agency Securities Market."

In noting the differences between GSEs and government-owned corporations, we are not implying that wholly-owned government corporations should not be subject to any standards of operation and review. (For example, the TVA is subject to the Government Corporation Control Act and the Government Performance Results Act.) While the Administration position regarding GSE registration under the Securities Exchange Act of 1934 did not extend to government-owned corporations like the TVA, the Administration is open to further consideration of what form of public disclosures are most appropriate for the TVA.

Question 2:

Recent numbers released by the Bureau of Labor Statistics from its comprehensive "household survey" for December 2003 reflect an employment increase of 1 million since January 2003 and 2.2 million since the declared end of the recession in November 2001. These numbers vary from those reflected in the "establishment survey" which has indicated that job growth is not as strong as the household survey would suggest. Alan Greenspan said this week that he believes that the Labor Department's establishment survey is superior to its household survey. As most of my colleagues know, I rarely agree with Mr. Greenspan on any issue, so I have doubts about his conclusion on the relative merits of the two surveys.

Could you please comment on the two surveys? Particularly, what do you feel are the strengths and weaknesses of each survey and if you have an opinion as to which one is a better reflection of what is going on in the U.S. economy.

Answer 2:

The household survey (also known as the Current Population Survey) is based on interviews with about 60,000 households and provides information on approximately 112,000 persons 16 years and older. Employment in the household survey represents the number of people who are employed. It includes nonfarm wage and salary workers, agricultural workers, unpaid family workers, domestic help, the self-employed and those who are on temporary unpaid absences from their work. The strength of this survey is the demographic information that it makes available, such as unemployment rates by gender, race, and age. Because it is a sample, however, the estimates of national employment and other aggregates provided each month depend on estimates of the total population and its components. When the population estimates change, so do the estimates of major employment indicators from the household survey.

The payroll survey (also called Current Employment Statistics) measures the number of jobs and only includes nonfarm wage and salary workers who are on business payrolls. It is based on a survey of 400,000 individual worksites covering nearly one-third of nonfarm payroll jobs each month. Some workers hold multiple jobs or switch jobs within a pay period and may show up on payrolls more than once. This could artificially inflate the payroll results when the labor market is strong and artificially depress payroll growth when the economy is recovering. The difference between the household and payroll surveys widened by about 2.7 million between January 2002 and February 2004. Increases in self-employment – in the household survey but not counted in the payroll survey -- account for about a third of the increased gap.

Each survey has strengths and weaknesses. The payroll survey is a larger sample and less volatile from month to month. However, the payroll survey ignores self-employment and may understate job growth at new firms during the early stages of economic recoveries. The household survey includes self-employment and may more rapidly incorporate job growth at new firms at this stage of the business cycle, although it is volatile from month to month.

Question 3:

I was pleased with your Department's recently announced crackdown on travel agencies that are arranging trips to Cuba for Americans. I want to take the opportunity to commend the administration for the strong stance being taken on this very important issue. I hope my colleagues realize the wisdom of the Administration's position.

Travel will never bring freedom to Cuba. In fact, the opposite is true. The foreign currency spent by tourists in Cuba does not reach the Cuban people who are suffering as we speak. It goes into the coffers of Castro and helps him to prop up his brutal dictatorship. Can you comment on the engagement of Canada, the European Union and other countries with Cuba? What positive impact, if any, has the U.S. Government observed in Cuba in the last few years that can be attributed to this engagement? Do you anticipate that the engagement of the U.S. with Cuba would have an impact that would be any different?

Answer 3:

There has been no change in the economic or political environment in Cuba as a result of Canadian or European tourism in Cuba or Canadian or European joint economic ventures in the island. Cuba's Armed Forces Ministry runs the state-owned and joint venture resorts. Tourist money that it receives only allows for the continuation of Cuba's repressive apparatus. Unrestricted U.S. travel to Cuba will do little to promote democratic change and much to bolster the regime by providing it with scarce hard currency. As the President has indicated, we will not consider lifting of sanctions absent significant political and economic reforms in the island.

Question 5:

We, in the Senate, have been struggling to pass an energy bill. Can you comment on what impact passage of that bill could have on the economic future of this country?

Answer 5:

Overall, higher energy prices decrease consumer purchasing power and subtract from the bottom line for business. They are a barrier to the efficient functioning of the U.S. economy.

Energy prices have been an important source of instability in our economy for several decades. For instance, oil prices soared $11 per barrel or nearly 60 percent to $30 a barrel in 2000, contributing to the economic slowdown. Prices eased back in 2001 and 2002, as economic activity slowed but then rose $5 (almost 20 percent) to $31 per barrel last year and so far this year are up another $4 on average to about $35 a barrel.

Since more than half of our petroleum products are imported, these higher prices represent more money in foreign bank accounts and a drag on US real GDP growth. Our estimates suggest that each $10 increase in the price of crude oil subtracts about one-half percentage point from real GDP growth.

Natural gas prices have also risen sharply, averaging $5.50 per MMBtu last year and roughly $5.75 so far this year – more than double the average from 1991 to 1999. Because of increased demand for the clean burning fuel, limited resources, and inadequate capacity to import liquefied natural gas, these prices are likely to remain high. This past winter, homes that heated with natural gas experienced a12 percent hike in their winter heating bill on top of a 33 percent jump the previous year.

Chemical producers who rely on natural gas for feed stock are said to be moving operations to countries where gas prices are lower.

Given the considerable hardships imposed by higher energy prices throughout the economy, I applaud every effort to pass a sound energy bill that increases U.S. supplies and decreases U.S. dependence on foreign energy sources.

Question 6:

I am very intrigued by the proposals to revamp the tax-advantaged savings accounts for retirement and education and have a few questions about those proposals: the Treasury Department mentioned last year that one reason that coverage rates under employer retirement plans have not grown above 50% is the complexity and compliance costs associated with the current plans. Could you elaborate on ways that the newly proposed plans would cut down on complexity and compliance costs? Could you comment on whether the treasury department has any estimates on whether these changes could increase coverage rates – both by encouraging more companies to offer such plans and encouraging employee participating rates? Also, with regard to the proposed LSA's, has the Administration completed any estimates of how they expect overall savings rates to be influenced by enacting their proposal?

Answer 6:

ERSAs: The Administration's proposal to consolidate the various types of employer-sponsored retirement savings plans into a single Employer Retirement Savings Account (ERSA) would be considerably simpler to administer for most employers. The most common form of employee savings plan, the 401(k) plan, is subject to two rather complex tests that ensure that the plan does not disproportionately benefit highly compensated employees. One of these tests relates to employee deferrals, while the other test relates to employer matching and after-tax employee contributions. In 1996, Congress established safe harbor designs that employers could adopt that would avoid having to administer these tests. The safe harbors were a great step toward simplicity for those employers that could adopt them.

The Administration's ERSA proposal would greatly simplify the nondiscrimination tests by combining them into a single test. If the average percentage of compensation that is contributed to the plan on behalf of nonhighly compensated employees is greater than six percent, then the test would be satisfied. If the average percentage of compensation that is contributed on behalf of nonhighly compensated employees is six percent or less, then the average percentage of compensation that is deferred by highly compensated employees could not be more than twice the average percentage of compensation deferred by nonhighly compensated employees. In addition, the Administration's ERSA proposal would simplify the existing safe harbors and would provide a special custodial arrangement that would simplify the reporting and fiduciary rules for employers with 10 or fewer employees.

Any increase in employer sponsorship is likely to come from small firms, which are currently much less likely to offer a plan. Many factors contribute to the lower rate of retirement plan coverage for small employers, including the composition of small firms' workforce. However, the administrative costs associated with employer plans plays a role. Some of the costs of establishing and administering a retirement plan are fixed costs, and large firms are able to spread these costs over a larger number of workers. A 1996 report estimated that the administrative costs of a DC plan as a percent of payroll were 0.16 percent when 10,000 employees were covered, but were 1.44 percent when 15 employees were covered. Any

reduction in the costs associated with establishing and maintaining a retirement plan would likely encourage more firms to adopt a plan.

Of the firms participating in the 2002 Small Employer Retirement Survey (SERS) conducted by the Employee Benefit Research Institute, 16 percent of those firms that did not offer a savings plan reported that high administrative and compliance costs were the most important reason for not offering a plan. Many more firms responded that the high administrative costs are, if not the most important reason, a major reason for not offering a plan.

The SERS also asked firms to assess how much more likely firms would be to offer a retirement plan if certain changes occurred. According to the study, if policy makers could create a plan with low administrative costs that did not require employer contributions, 69 percent of firms would be more likely to offer a plan. The availability of easy-to-understand information or a plan with reduced administrative requirements would make 56 percent and 53 percent of firms, respectively, more likely to offer a plan and 19 percent and 17 percent of firms, respectively, would be much more likely to offer a plan.

To give an indication of the potential magnitude of the effect of increasing coverage among small employers, if only 5 percent of small firm employees currently uncovered by a plan were to gain coverage, an additional 1 million employees would have coverage and the participation rate at small firms would increase from 26.7 percent to 29.1 percent. Larger employers are also likely to adopt plans because of the simplifications.

LSAs: The Administration's Lifetime Savings Account (LSA) proposal, along with the proposed Retirements Savings Accounts (RSAs), will result in taxpayers no longer having to sort through the maze of savings options and allocate savings accordingly. There will be one account for retirement savings and one account for savings for any other purpose, including augmenting retirement savings, health care, covering emergencies, and education.

The lack of restrictions on the use of LSA withdrawals substantially increases the likelihood that lower-income taxpayers will participate. Low-income taxpayers have traditionally been less likely to participate in IRAs and other tax-preferred savings accounts, because they have fewer resources to devote to savings. With fewer dollars to save, such taxpayers would be more likely to face a penalty if they needed the funds in an emergency and had saved in an IRA. LSAs give individuals tax-free earnings from their first dollar of savings, and withdrawals can be made at any time for any purpose with no tax or penalty.

The Treasury Department has not produced an estimate of the effect of LSAs on overall savings. Because the academic literature offers a wide range of estimates on the effect of tax incentives on savings, any single estimate would have a good deal of uncertainty. However, we believe the bulk of the evidence supports that view that tax incentives increase personal savings.

We also believe that the design of LSAs will encourage savings. As already mentioned, LSA participation will likely be high because LSAs are easy to understand and because withdrawals can be made at any time for any reason. The universal availability of LSA should also increase participation. Taxpayers can begin saving in LSAs at the beginning of the year rather than

THE PRESIDENT'S HOMELAND SECURITY BUDGET

WEDNESDAY, FEBRUARY 25, 2004

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:08 a.m., in room SD–106, Dirksen Senate Office Building, Hon. Don Nickles (chairman of the committee) presiding.

Present: Senators Nickles, Gregg, Allard, Burns, Sessions, Bunning, Crapo, Conrad, Murray, Wyden, Feingold, Nelson, Stabenow, and Corzine.

Staff present: Hazen Marshall, majority staff director; and David Ortega, senior analyst for homeland security, justice and community development.

For the minoriyt: Mary Ann Naylor, staff director; and Mike Jones, analyst for justice, homeland security, community and regional development, Sarah Kuehl, analyst for social security, transportation.

OPENING STATEMENT OF CHAIRMAN NICKLES

Chairman NICKLES. Mr. Secretary, I would like to welcome you to our committee. We are delighted to have the Secretary of Homeland Security, Tom Ridge, before us today. I believe this is your first appearance before our Budget Committee, so we welcome you. I apologize for being a minute or two late. I went up to the sixth floor out of habit, but anyway I am delighted to have you before us.

Mr. Secretary, you have enormous responsibility, and I compliment the President for selecting you. I compliment your willingness to serve our country in this very important task of being Secretary of Homeland Security.

Since the year 2001, the Congress and the President increased discretionary appropriations for homeland security from basically $10 billion in 2001 to the President's request of $30 billion for 2005. We have created a new Department of Homeland Security in which you, as Secretary, oversee a total budget of over $40 billion, which include mandatory spending and fee-funded programs.

As you know, Mr. Secretary, creating new agencies and new appropriations subcommittees can be challenging for budgeteers. We like to compare spending levels from year-to-year, and when you start moving around the pieces, it can get very confusing. I want to make sure, since we have thrown in a lot of new money, that

we are spending the money wisely. I have seen some reports where that is not the case in some areas.

I am concerned that Congress is creating programs under the banner of Homeland Security which, in some cases, some cities, some States are using as more or less general revenue sharing. I do not think we can afford that. I do not think we can afford to, frankly, rehabilitate fire departments throughout the country, and I do not think that is the purpose of your department.

So we look forward the your discussion with us today. I think it is vitally important for us, as members of this committee and Members of Congress, to use adequate and I would say good oversight to make sure these funds are well-spent. And I intend to do that, and I look forward to working with all members of the committee.

The President requests today a large increase for your domain—a 10-percent increase. When we look at most of the Federal budget, it is pretty close to a freeze, that is very significant. I think you have to compete with all other priority programs, and there will be enormous competition. As we really try to be more frugal in this era of high deficits, you are going to have to justify that $3-billion increase and convince me, and I think other members, that it should go to your department instead of to other departments.

And so anyway we are delighted to have you with us today.

First, I will call upon my friend and colleague, Senator Conrad.

OPENING STATEMENT OF SENATOR CONRAD

Senator CONRAD. Thank you, Mr. Chairman, and welcome, Mr. Secretary, to the Budget Committee.

I want to, first of all, commend the chairman for holding this hearing. We discussed a schedule of hearings, and we agreed that one of the most important hearings we could have would be on homeland security because, as the chairman has noted, the spending has increased dramatically, certainly the threat has increased dramatically, and much of that spending is in response to that threat. We all recognize that, and we support as strong a homeland security as we can provide.

On the other hand, as the chairman mentioned, we have a responsibility to make certain that taxpayer funds are used wisely, and well, and for the purposes intended. And I must say I have been increasingly concerned about reports that I have heard from individual departments that spending initiatives that were pending previously, that were not approved once they were given the label of homeland security, whether or not they really fit that description, sailed through.

And we have an obligation, as do you, to make certain that things do not just sail through because a label has been put on them, that they really strengthen our homeland security. And I know that has got to be an extraordinary challenge to you, bringing together all of these different agencies and several hundred thousand employees or approaching several hundred thousand employees to try to make certain the money is used wisely and well.

Let me just go to put in perspective some of the issues that I see with respect to the issue before us.

First is to kind of put in context where we are. This committee, and the administration, and our colleagues in the rest of the Con-

gress are faced with deficits that are at record levels—$521 billion. I believe at the end of this year it will actually be somewhat less than that, but nonetheless, a record budget deficit, by far the biggest we have ever had.

In looking ahead, the President has said he is going to cut the deficit in half. I do not see that. I do not see that under the President's plan. The only way that is achieved is by leaving out things. But when you add back the defense cost, when you add back addressing the alternative minimum tax, which the President's budget only does for 1 year, when you add back the extension of the tax cuts, what I see on an operating basis going forward is extremely large deficits, by far the biggest we have ever had, and all of it at the worst-possible time, right before the baby boomers retire.

One of the big problems we have is on the revenue side of the equation. We have to be tough on the spending side. We also have to look at the revenue side of the equation because the revenue for this next year, the year we are in, is projected to be the lowest as a percentage of gross domestic product since 1950.

When I look at the long-term or at least the 5-year trend on homeland security, it matches what the chairman indicated—$9.4 billion in 2001 and going up to $28.1 billion for 2005. So we have seen a dramatic ramp-up. All of us understand why.

In terms of this year, the budget year 2005, the administration has called for a 10-percent increase, but I have tried to analyze that 10 percent, and what I see leads me to a somewhat different conclusion because much of that is Bio Shield advance funding for future years—2006 or 2008. When I take that out, I see about a 4-percent increase, just to put in perspective what I think an appropriate analysis would be.

And then when I look at the specifics, one thing that strikes me are cuts in these areas: State formula grants for first responders, the firefighter grants, the urban area security. In those areas, $990 million cut in State formula grants, almost $250 million in firefighter grants, and then an area not under your direct control, over at the Justice Department, the COPS program and other law enforcement grants, $911 million, for a cut of a $1.4 billion, approaching $1.5 billion.

Bush Budget Cuts First Responder Funding
(Budget Authority in millions of dollars)

	Bush Funding Above/Below 2004 Level
Department of Homeland Security	
State Formula Grants	-$990
Firefighter Grants	-$246
Urban Area Security and Other	$682
Department of Justice	
COPS and Other Law Enforcement Grants	-$911
Total First Responder Cuts	**-$1,465**

Source: OMB
Note: DOJ grants include COPS, Byrne formula grants, Local Law Enforcement Block Grants, and a proposed Justice Assistance Grants program.

And then I look at the cost of the Bush tax cut in 2005 for those earning over $337,000 a year, and the cost for the tax cuts for people earning over $337,000 a year in 2005 is $45 billion—30 times the amount of the cuts for first responders and for cops on the street. I know there are some who do not think of cops on the streets as first responders, but I can tell you my cops feel that way. And dramatic cuts in the COPS program are certainly not well-received in my constituency.

Finally, on the issue of port security, those grants being cut by 63 percent, and those are issues I want to go into in some more detail when we get to the questioning phase, Mr. Secretary. I hope this information is useful as we go into this questioning phase.

Thank you, Mr. Chairman.

Chairman NICKLES. Mr. Secretary, welcome to the committee. You are free to make any opening remarks you wish.

STATEMENT OF HON. TOM RIDGE, SECRETARY, DEPARTMENT OF HOMELAND SECURITY

Secretary RIDGE. Thank you, Mr. Chairman and Senator Conrad. You have been very kind to accommodate a scheduling conflict I had later on this morning. So, in order to give the membership of the committee the complete opportunity to address whatever questions they have, I would like to just ask unanimous consent that the statement be included in part of the record and get at it.

Chairman NICKLES. Certainly.

Mr. Secretary, Senator Conrad alluded to the fact, and Senator Collins has already written a letter, that dealt with the reduction in the program, the State Homeland Security Grant program from $1.7 billion to $700 million. Would you care to expand upon that?

Secretary RIDGE. Yes, I would.

First of all, the President's budget reflects the same level of commitment in terms of his requests in his budget, the budget docu-

ment of 2004. What you are talking about with regard to the State Homeland Security Grant program is a shifting of some of those resources, a substantial amount, over $700 million into the Urban Area Security Initiative, where we feel that it is appropriate to take in not only population, but population density, threat, critical infrastructure and the like.

So, if you go back and take a look and compare it with the 2004 numbers, the overall request for the President has been sustained, and increases in other parts of the homeland security budget have been advanced. It is a shifting of resources because there is a shifting of priorities. I think it is a strategic decision, while we want to continue to support the development infrastructure around the country, continue to support States and their development of their own security strategies, that we shift some of those dollars where we think the greatest threat and the greatest possibility of catastrophic loss might be.

Chairman NICKLES. Mr. Secretary, I happen to concur with that, but let me also say I do not want to waste money in the big cities either.

Secretary RIDGE. I understand.

Chairman NICKLES. And D.C. would be a program that one would say that is a high-threat area, probably one of the highest, with New York, and maybe Los Angeles and others. The District of Columbia funded leather jackets, assessed environmental problems on property prime for development. In Maryland, the money was buying Prince George's county prosecutors an office security system; Virginia, a small volunteer fire department spent $350,000 on a custom-made fire boat; in State and local Governments in the District, Columbia Hospital Association had a formula that guaranteed every city hospital a share of an $8-million grant. That meant the Psychiatric Institute of Washington, a small private hospital, received money to buy security cameras for its wards.

I could just go on. I am just looking at a lot of money that is in a big city that is going to maybe be under the discretion—see, D.C., the agency used an additional $300,000, this is according to the Washington Post, and maybe they might be inaccurate sometime. I do not want to say it is gospel, but according to a Washington Post article, let me put it that way, and that was debated on November the 23rd, said that $300,000 was used for a computerized car towing system, which incidently I learned, my daughter learned the hard way. There is a lot of corruption in the D.C. car towing system—corruption. And I will repeat that because I am still mad about it. But I do not know that your department or the Federal taxpayers should be funding that. And I could go on. There is $100,000 to go to the mayor's politically popular Summer Jobs program, but that does not make me more secure.

So my point is I think you are on the right track and saying taking away or reducing the amount of money for the State grants that is going to every State by a population formula, I guess, and moving it into areas that you deem—I am guessing with your discretion—in the urban areas that are a higher threat, I happen to agree with that. But this is an urban area of high threat, and they waste a lot of money. And I am going to be just as vigilant on your $700 million under that urban grant program as I am on the State

program. And when I find that we are wasting money, I am not inclined to grant increases.

And I just want you to know I want to be your ally, but I can also be your enemy if I find out that these funds are being wasted. And a lot of these funds, it looked like we Congress rushed to throw money at it, and the cities were all lobbying. They are here this week. The League of Cities and the Governors are all out saying, give us more money, we want more money, and then when you find out they are spending it in ways to buy leather jackets and so on, it infuriates me, and I wanted you to be aware of that.

Secretary RIDGE. Senator, I do not think we would ever have any disagreement about the need to make sure that for every dollar that we are investing in security, we should get at least a dollar's worth of return in security. Clearly, some of the expenditures that you have highlighted are of questionable relationship to that outcome.

I will tell you, this year, for the first year, because we have only been in operation for a year as of Monday, we have asked the States to submit homeland security plans built from the grassroots up. We have also asked, with the Urban Area Security Initiative, that we get more complete prior expression of where those dollars are going so that as a formal function of our Department, we can start, one, limiting where these dollars can be expended, as we have a responsibility for building that national infrastructure across the country.

So I am not going to try to explain how relevant some of those expenditures are to homeland security because I do not think I can. But I can tell you that there is not only a shared responsibility for us to oversee where those dollars go, but there is also a shared accountability and not just at the Federal level, but also at the State and local level to ensure that the dollars are being spent as Congress intended. And I assure you we will followup on that as rigorously as we possibly can.

This year, for the first year, we will have plans. We are already screening the statewide plans. And while we do not want to be prescriptive, because one size does not fit all, we do want to frame where these dollars can go so we have a much better understanding of the integrated nature of the mutual aid systems that we are trying to build around the country.

Chairman NICKLES. Well, these funds, correct me if I am wrong, these funds really are not supposed to be just a subsidy for local police and fire; is that correct?

Secretary RIDGE. That is correct.

Chairman NICKLES. Because I think a lot of cities have financial problems or challenges, and they would love to have us help them out, whether it is for assets or whether it is for other little things that are in the——

Congress has not abided by the President's request in the past. In other words, we funded part of this. I believe you wanted most of the first responders' money to go through FEMA and your department now. In the past, Congress had $1.6 billion of unrequested funding that was in the Department of Justice; is that correct? To make sure I am kind of on the right page.

Secretary RIDGE. Well, what we hope to do, Senator, is actually take the programs that had been, some of the programs that had been at FEMA. The basic source of these dollars were the Office of Domestic Preparedness. It used to be in Justice. We have it, and we want to combine our Office of Domestic Preparedness and our State and local office and then bring the relevant grants in from FEMA and from TSA so we can develop a one-stop shop for the State and locals, so we can better integrate the use of these resources, so we have much more rigorous oversight, and so we can evaluate whether or not we are getting a security return on those investments.

Secretary RIDGE. For our purposes though, we need to combine those funds together to get your budget.

One other thing, and that deals with the issue of the—well, maybe I will take it up later. I am going to ask all of our colleagues, the Secretary has a meeting, and he needs to leave. So I am going to try and be short, and I will ask all of our colleagues to try and keep their comments or questions to about 7 minutes, and I think we can get there—7 or 8 minutes, and we should be fine.

So, with that, I will turn it over to Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

Let me just pursue, if I could, some of the items that the chairman was mentioning because I think this really does deserve scrutiny and your opportunity for response.

In the article that the chairman was referencing, it indicates that "Two years after Congress approved a massive infusion of cash to help gird the Washington area against terrorism, much of the $324 million remains unspent or is funding projects with questionable connections to homeland security." That is on the negative side of the ledger.

On the positive they say, "Police, firefighters and public health have undergone disaster training, are better equipped to handle conventional attacks, weapons of mass destruction. They have more gear to protect them, more ambulances and fire trucks, more heavy equipment to diffuse bombs or locate victims buried beneath rubble. Local governments have at their disposal new blueprints on how to respond to a terrorist attack." All of these things are very positive I think we would all agree.

But they say, on the other hand, "Some police officers are still waiting for basic protective gear. Public health labs, swamped by the anthrax attacks of 2001, have no more capacity today. Most local Governments have no efficient way to give instructions to residents shut off from radio and television, and there is no comprehensive plan to unite families separated in a disaster."

Can we just take that paragraph, Mr. Secretary, and give you a chance to respond to that. Obviously, Washington, D.C., and you have talked about moving funds around to deal with the priority threat areas, and I think all of us would say that should be done. But here they are saying Washington, it has already been subjected to attack or the area, that some police officers are still waiting for basic protective gear. What can you tell us about that?

Secretary RIDGE. The only thing I believe I could share with you is that among the priorities that the city of Washington set was ob-

viously the purchase of some protective gear, as well as other emergency equipment during the first year of the funding. We are finding that throughout not only Washington, D.C., Senator, but around the country, that these Governors, and police chiefs, and fire chiefs understand that they are not going to be able to build themselves the kind of security unit or acquire new uniforms across the board and new equipment across the board, and so they are incrementally and sequentially making different purchases to buildup over a period of years the kind of capacity that they need.

It reflects a decision by the mayor and the police chief as to what their priorities were. So, if they purchased some protective gear and other needs, we are not going to quarrel with that. We are just going to be mindful of their building up an adequate amount of protective gear and equipment over a period of time, and they are not going to be able to do this in a year.

Senator CONRAD. Do you believe that it is adequate in the District?

Secretary RIDGE. Well, again, I think the—I cannot tell you specifically the kind of protective gear that any particular police department has purchased. I can tell you that many of them have initially gone to protective gear and communications equipment, but I doubt if any of them have purchased the protective gear for everyone in their police forces. It is going to take some time, and the question becomes whether or not every individual police officer in every single police department has to have the same kind of protective gear. I do not believe that is necessary.

Senator CONRAD. Let me just, if I could, Mr. Chairman, maybe I could ask that I just—I will give you a series of questions now, and if you could provide answers in writing, so that we not take the full time of the committee.

My No. 1 question would be do the police in Washington, D.C., and surrounding communities have the protective gear that they need? No. 1.

No. 2, do they have a system of communications that allows them to communicate an interoperable way? I held a hearing on this out in my home State, Mr. Chairman, and that was the No. 1 issue of first responders is a lack of interoperable communications.

Third question, do the public health labs have sufficient capacity to deal with a bio or chemical attack?

Next question, do local Governments, in the high-target areas, have an efficient way to give instructions to residents shut off from radio and television, such as a reverse 9/11 system? And maybe, Mr. Secretary, you could address that one right now before the committee.

To your knowledge, do these local Governments, in these high-vulnerability areas, have a way to give instructions to residents shut off from radio and television?

Secretary RIDGE. I believe that the National Capital Region, which is a specific entity that you created in the legislation that created the Homeland Security Department, has worked to have that kind of system put in place.

Senator CONRAD. Is it in place?

Secretary RIDGE. Well, they are certainly working on it. I believe that Mayor Williams discussed it publicly. Arlington County has a

similar system. So I think, again, I cannot tell you today that it is completely in place across the National Capital Region. I can tell you it is a priority of the National Capital Region, and they have been working on it vigorously since the NCR was created.

Senator CONRAD. Can I just ask that you, for the record, let us know what is the status. You know, the one thing that really struck me on that fateful day was the lack of communications. I mean here in Congress there was no communications. I think we saw that there really is a lack of a plan. I do not hold you responsible for that. I am just saying that is the reality that I saw play out on that day and massive confusion in this city. I mean, people were at jobs, did not know where their loved ones were. There was no ability to talk on a cell phone because the cell phone systems were overwhelmed.

Finally, this article asserts there is no comprehensive plan to unite families separated in a disaster. To your knowledge, is that still the case that there is no comprehensive plan to unite families in the case of a disaster?

Secretary RIDGE. Senator, this raises the question of responsibility of Government, and communities and families to do some certain things together. There is plenty of information out there about the need to have a communication plan and a contingency plan. There are individual efforts that have been undertaken by the National Capital Region to get families to think of how they would contact one another and then reassemble in the case of an incident.

I know the National Capital Region is going to expand nearly $5 million that the Congress has appropriated. So they have this massive public education effort to alert families that they need to develop these individual plans themselves—very family specific plans.

I do not think it would be possible for any level of Government to design a family specific plan. That is something that they need to do themselves, but I do know that the National Capital Region is putting quite a bit of energy and quite a few dollars that Congress appropriated toward that end.

Senator CONRAD. If you could give us a report on what the status of that is.

Secretary RIDGE. Yes, sir.

Senator CONRAD. Thank you, Mr. Chairman.

Chairman NICKLES. Senator Conrad, thank you very much.

I next call upon Senator Gregg. For the information of our colleagues, the vote has started. We will continue throughout. We will continue with the hearing.

Senator Gregg.

Senator GREGG [presiding]. Thank you, Mr. Chairman. And let me join with yourself and with Senator Conrad, and I think the questions that Senator Conrad asked and that you asked, Mr. Chairman, are very appropriate, and I know the Department will want to answer them.

Actually, to some extent, there is a certain deja vu all over again because I have gone through these hearings now, since I had jurisdiction of the issue of first responders for a number of years in my appropriations committee, and since we tried to set up a one-stop-shop attempt. Unfortunately, due to the bureaucracy involved, we were never able to put up one-stop-shop. And I hope now that was

the concept of the Homeland Security Department, that we would accomplish that. I appreciate the Secretary pursuing that course, and I am sure it will be accomplished now that we have a central area.

And the issue of first responders, since basically this was a program created by myself and Senator Hollings, was never to replace or give the police officers, and fire departments, and health people basically replacement parts. It is not a "blue light" program. It is not supposed to be like the LEA was in the seventies. It is supposed to be a threat-based organization. It grew out, as I have mentioned before, from the original Nunn-Domenici Act, which targeted the top 162 cities in the country, and it was supposed to bring those cities up-to-speed, and we decided to try to take it beyond that.

I congratulate the Department for going to a threat-based system, and I understand that you are reorienting dollars to accomplish that. It is the right approach. It is going to make a lot of chiefs, fire chiefs, police chiefs, and Governors and mayors unhappy, but they have to understand that if they have a region that is not a high-priority threat, then they are just not going to get as much money as regions that do.

Second, the State plan. We had an understanding there would be State plans in place before we gave out any of this money, and that was a precondition. I know you are now redeveloping the State plan, but again that is a little bit of deja vu all over again. But those State plans are critical to being sure that this money is not ending up buying blue lights, that it is going—and so I hope you will oversight those aggressively.

I want to congratulate the Department for some things that it has done. One of the reasons I wanted the Department created was because, again, I had oversight over Immigration, but I did not have oversight over Customs, and I had oversight over Border Patrol, but I did not have oversight over Coast Guard, and I found that it was just chaos trying to get these departments to communicate with each other.

I have spent a lot of time since the Department has been up and running talking to the line folks, the Customs agents, the Immigration folks and asked them, "Well, how is it working? Are you guys talking to each other yet?" And initially there was a lot of resistance. There was a sense of, "I do not want to learn that guy's job, and he is never going to do my job as well as I can do it."

That has changed. That whole atmosphere has changed out there. There is a real positive atmosphere from the Immigration, the Customs people, the Border Patrol people. I sense a real dedication to trying to learn each other's job, making this integrated. It is anecdotal to me, but it is good news, and I congratulate the Department for the effort there.

What I want to ask is this Bio Shield issue. As Senator Conrad pointed out, most of this money is going to prefund Bio Shield, most of the new money. I am very concerned we are not making progress on this, that we are open to a biological and chemical attack. We have not been able to pass the Bio Shield bill out of the Senate. I got it out of our committee a long time ago. It should

have been through the Senate. It should have been passed. It should have been down to you.

How much do you need the Bio Shield authorization to do this right, and even though you have not gotten the authorization, are you able to use the dollars to get us oriented for the purposes of first detecting and then handling biological and chemical attacks, which is clearly our biggest threat?

Secretary RIDGE. Senator, as one who spent 12 years on authorization committees but never managed to get to an appropriation committee, I do not want to say that not having the appropriation would impair our ability to restrict our ability to use those dollars. I will let the Congress work that out.

We are comfortable that the $2 billion-plus that you have provided us can be used under the circumstances designed by the legislation. That is, if we see that there is a specific threat, a biological threat, for which we do not have an antidote or a vaccine, and we know very clearly that there is not going to be a commercial market for this product, you have given us the resources to go in immediately and engage the private sector in researching the antidote or the vaccine.

So, again, we will let the Congress work their will on whether or not we are going to get an authorization bill, but we believe that the appropriation gives us the opportunity to use those funds immediately when we do.

Senator GREGG. On another issue, I was a little concerned about the Department's request in the area of TOPOFF. It seems to me that TOPOFF has been an extremely constructive experience. It has now really gotten very mature.

Senator CONRAD. Could the Senator explain what that is.

Senator GREGG. TOPOFF is basically exercises of attacks, going through what is basically a military exercise. We stage a simulated attack on a city. It is biological, chemical or conventional or maybe even nuclear, and then it is a full scale, engage everybody in the community in a time line, very complicated, but very professionally done, much the way the Strategic Air Command used to stage their exercises relative to war.

But I am a little concerned that the funding does not appear to be as aggressive as it needs to be in this area in order to stand up the next round of TOPOFF exercises.

Secretary RIDGE. Senator, we think you have given us the resources to do that. I am actually going to have a briefing here in the next couple of days as we prepare for TOPOFF 3. Senator Conrad, the last TOPOFF 2 exercise included simultaneous events. One was a radiological event in Seattle, the other was a biological event in Chicago. When you bring to bear the Federal, State and local resources and all of the prime time players, we actually even had a, we call it VNN, a Virtual News Network, so we could work on crisis communication during this period. You learn a lot. You learn what you are doing right. You find gaps in the system, and you learn where you need to strengthen.

Senator GREGG. What we learned was that the mayor of Seattle was a lot more efficient than the Federal Government in responding.

Secretary RIDGE. They did a good job, Senator. They did a good job.

[Laughter.]

Secretary RIDGE. So there are a lot of lessons to learn, both good and bad, and I think the Congress has been very generous with funding in that regard. Plus, not only the broad national exercises, but we literally run hundreds of both formal, on-the-ground, boots-on-the-ground exercises or table-top exercises. That is one of the primary responsibilities of the Office of Domestic Preparedness, and one of the eligible costs associated with the dollars that Congress appropriates to our department.

Senator GREGG. Senator Corzine?

Senator CORZINE. Welcome Governor, and let me start with a compliment based on my reading of how the Department is working with the folks in my home State, and I feel like there is good dialog and coordination. That is the good news. Let me ask some——

Senator GREGG. Senator Corzine, could I note that I am going to have to leave to go vote. Could you recess the meeting after you finish and the other folks will be coming back?

Senator CORZINE [presiding]. Sure. Absolutely. I would be happy to recess.

I am going to ask a couple of questions: one about chemical plant security, one about screening issues at airports, and then a little bit about port security and do that relatively quickly.

Chemical plant security is a major issue in my State. We have a number of plants that have more than a million folks that are in the fall-out zone of a potential explosion, and it is an issue that you have actually spoke very, I thought, eloquently about, talking about voluntary efforts that alone are not sufficient in a letter that you sent to the Washington Post, October 6, 2002.

Do you feel the legislation that is working its way through Congress, which does not bring about mandatory review of security plans and review of technological elements of chemical plants is adequate to meet a standard of certainty for the communities that surround these plants?

Secretary RIDGE. Senator, first of all, I would hope that, while there may not be mandatory review, we certainly are empowered to—the Department of Homeland Security is empowered with its discretion to go out and review the security plans at any chemical site. We have worked very hard over the past year visiting some of the potentially more problematic sites. Some of them have been in New Jersey.

We have produced a document dealing with the common vulnerabilities of chemical facilities and potential indicators of terrorist activity. We have established a protection, training, and planning program. We are trying to develop a baseline for chemical facilities. So whatever the legislation might be, I do think it is very, very important that the Department of Homeland Security, particularly the Infrastructure Protection Unit, have the ability to go out and review the security plans.

And likewise, I think one of the most important allies to determine whether or not that chemical site has met the local needs is that we get some, that the local first responders were included in

that assessment. Because actually they are going to be the ones that are going to have to deal with the incident if it occurs.

So mandate—I think it is imperative that we have the ability to go out and review the security plans.

Senator CORZINE. I would hope that you would have some kind of accountability for the plans. I think that the idea that you could go out is a good thing, but whether we are actually following through, I believe, based on at least my own anecdotal spot checks and others and broad bases, not all of what is being said is going to be done is being done, and I find it quite threatening in a community where there are multiple millions in a number of the incidents in New Jersey, but it is true across the country.

Secretary RIDGE. Senator, we would be prepared to work with you on the language. What we have done, tried to do within these chemical facilities, is take a look at again the toxicity of the contents, proximity to population, and we have begun to set some priorities. And I think that clearly we will never have enough manpower to get out and visit and work with every chemical site around the country. We are going to have to rely on our first responders and the local law enforcement community to do that, but there are some that would offer great potential catastrophic consequences, and I would like to work with you on the language and make sure we get out and review those.

Senator CORZINE. As you have I think appropriately identified threat-based elements with how you are designating your priorities in the Department, I think that is true here, and we need a prioritization basis on how you look at these.

I think some of the things that I see coming through Congress not necessarily meeting the themes or the standards that I think I hear, and I have heard from you as you have commented on this, and I recognize that you recognize it is an important element. I see it working on the ground through our State efforts, but I would encourage you and the administration to do whatever you can to get a bill through with some meaningful bite with regard to prioritization and then mandates at least with regard to some of those issues, and I look forward to working with you.

Let me ask about the state of screening by a TSA at airports. I am quite obviously being parochial in one sense in that Newark airport is one of the seven airports that did not meet the baggage screening deadline at the 1st of the year. I think there were seven.

A lot of this is attributed, at least from the interviews that I have been able to put together with the folks on the ground, this is a heavy turnover in TSA and among screeners. I think average is 14 percent. I think it is 17 percent in Newark, and it goes up to 35 or 36 percent. By any managerial metric, those are high turnover rates and do not lead to the best of professionalism and efforts in carrying through.

Is this a problem that is being recognized? Are there plans to address it? And particularly how soon do we think that these seven airports—I happen to have a special interest in Newark—that we can get this into a position that we can begin to give the public assurance that the safety of the airways is intact?

Secretary RIDGE. Senator, I would like permission to get back to you specifically with a request to our anticipated deadline for the

Newark airport and for those seven. I do not have that information with me, but I would be pleased to work back to you.

Yes, we have experienced similar problems at some of the other airports, Senator. A lot of it has to do with convenience, transportation, getting to the airports, the cost of either the inconvenience associated with taking public transportation—many of them have to—the cost of parking their vehicles. There are certain themes that we are seeing in some of our major airports around the country that we are going to try to address financially with different kinds of incentives to keep people working.

We invest a great deal in them to train, but if we have this constant turnover, it is not, to your point, it does not provide the stability and the continuity we need. So we are aware of the challenge. A lot of it has to do I think with access, transportation, and we are reviewing a system of financial incentives to help alleviate some of the problems that these people are running into in order to get out there to serve the public.

Senator CORZINE. I think there are real issues here I the overall structure, and any time you start a new program as broad as this is, that it can be the kinds of issues you cite. It does not happen to be the case at Newark because there is great public transportation there. It is a huge turnover.

I would love to work with you on the specifics in that particular situation, but I think it is a national problem. And I will just ask for the record, since I need to go vote, on port security, I am curious what current percentage of containers that we are actually screening, if that is something that is available for the public view, and is there a metric of resources expended to increase the number, and is there a goal where we think we can, since you probably can't screen every single container that ever comes to the shores, how can we get ourselves into a position to have the greatest confidence on our screening abilities? What is the percentage? Where do we stand with regard to our budget requirements to get to that?

And since I have to go vote, I will take that on——

Secretary RIDGE. I would be pleased to, Senator. Just to assure you that we are layering in our review, our inspection of these container ships, beginning with a very precise targeting of these containers before they are unloaded in Singapore, and Hong Kong and the like. It is a rule-based system. We do it at the National Targeting Center here, and right now I think we are at 98 or 99 percent of the containers initially go through that process before they are even put on the ship. It is a very important and very complex application of the information we have acquired from the Coast Guard and the Customs over the years, and I would be very pleased to lay out in detail to you the different layers of defense as it relates to cargo container security.

Sorry to keep you, Senator. Thank you.

Chairman NICKLES [presiding]. Senator Corzine, thank you very much. That was an excellent question.

Senator Burns.

Senator BURNS. Thank you very much.

I have just a couple of points. You might want to write these down, and you may have to respond to them, Mr. Secretary, in private or whatever.

I notice you have in here an increase of about $892 million or a 20-percent increase in improving aviation security. Could you tell me is that employees? Is that a capital investment? Where is that money going? Because every time I go down there, I have never seen so damn many people in my life. They are all over the place, and I am not real sure we need it.

Secretary RIDGE. Senator, that additional $800 million is basically personnel costs. The 2004 budget, as we ramped up pursuant to the mandates from Congress, we did not need, because we were not fully ramped up—let me put it another way. We had an FTE requirement that was not fully met in 2004, and we needed additional dollars to meet it in 2005. So those are personnel costs, to your point, paying for labor, and paying for the baggage and passenger screeners.

You should also know simultaneously we are now going back, having met the mandate of Congress, getting the technology deployed, hiring the screeners, on an airport-by-airport basis to see if the present configuration of people and technology is appropriate at each and every airport. So there will be some adjustments in the future. Some airports may have fewer, some airports may have more screeners. But we really need now to take a look an airport-by-airport basis to determine whether or not we have the right number of people there. And the more technology we can deploy, in the long term, probably the fewer people we will need.

Senator BURNS. Passenger IDs, any of these people on people who have a record of being frequent flyers, are they going to identify those people in some way or another, facilitate moving some of those people through these airports a lot quicker?

Secretary RIDGE. Senator, as you know, we are working on two initiatives right now within the Department. One is the computer-assisted passenger prescreening program. It is a pilot program that we hope, with the approval of Congress and basically we need the stamp of approval from GAO, that we can run that program. It would help us prescreen and probably eliminate a substantial of the secondary screening.

There is another initiative that we are looking at called a Trusted Traveler Program, where people are prepared to give us, in advance, basic information about themselves, and so we can confirm their identity, verify who they are, and they do what they claim they do, to expedite their movement through the airport as well.

So those two initiatives we are undertaking this year.

Senator BURNS. In another area. Up in our State, when those grants come down to help first responders, fire departments, this type thing, there was a, if your EMTs or your first responders was not a part of the fire department, they did not get any funds. Is that a rule in your shop or is that a local State regulation?

Secretary RIDGE. I think that is a restriction—I would have to double check, Senator—but I believe that is a restriction imposed by legislation. If it is the Assistant to Firefighters Grant program, I think it limits access to those dollars to firefighters.

Clearly, the emergency management personnel that you are talking about, if they are part of a State or local scheme, can qualify for any money. But for the Assistance to the Firefighters Grant, I believe Congress limited that just to fire departments.

Senator BURNS. You have different situations, like in the State of Montana, we have such small towns, you know, sometimes they are not together, and most times they are volunteer systems in that respect.

One other question. In the area of bio defense, we have spent a lot of money in the procurement of vaccines and drugs that would be needed in case of a bio attack. Do those drugs have shelf lives, and what is our cost of replenishing those or turning those over from time to time?

Secretary RIDGE. The drugs do have a shelf life. Health and Human Services, one of their responsibilities over the strategic national stockpile is to monitor and replace them if they have exceeded their shelf life. I cannot give you the specific annual figure to replace the vaccines or the other pharmaceuticals, but I will get it for you.

Senator BURNS. And border, I understand we are going to restock a whole little town in Montana about people coming to Montana or that is going to work that border. I do have a complaint, though, and I hear this more than anything else.

As you know, bureaucracies have habits of building fiefdoms, and we are getting a lot of complaints on just out and out harassment at these borders. And I know most, I should probably take that up with department heads, and I plan to do that, but I did want to bring it up during this hearing because I am concerned about that.

The free flow, Mr. Secretary, is this. We have people who farm both sides of that border up there. They have farms in Canada, they have farms in the United States, and now all at once we are just—really, it is just a hassle to traverse that border now, where it has always been open before, and these are people that are everyday people, and most of them live in the area. But they say these people are just getting out of hand, and they are outrageous, and they are discourteous, and if you make them mad, they will leave your equipment sitting there. They might hold you for a half a day. I heard of farmer had to hold his equipment half a day because he made the guy mad, and I fail to understand this.

Secretary RIDGE. Well, Senator, I would like to work with you on that. We have had some challenges along the borders because of that.

Senator BURNS. I will bet you have.

Secretary RIDGE. And our job obviously is to, No. 1 priority is security, but there is a commercial activity at the border. Some of it is visible with trucks, and cargos, and others. It is just good farmers who happen to have a parcel of land on both sides. So we would certainly like to work with you on that, and I am fairly confident we can come up with a satisfactory solution. You identify the problem, Senator, and we will correct it.

Senator BURNS. Thank you.

Chairman NICKLES. Senator Burns, thank you very much.

Mr. Secretary, I told you earlier I would try to get you out—11:30 is when you—do you have a little flexibility there?

Secretary RIDGE. A quarter of.

Chairman NICKLES. We will be OK.

Senator Wyden? Thank you.

Senator WYDEN. Thank you, Mr. Chairman.

Mr. Secretary, as you and I have talked about before, I feel very strongly that it is possible to fight terrorism without gutting civil liberties. Yesterday, the associated press ran a story that indicated that some of the remnants of Admiral Poindexter's program are still continuing. I want to start with a couple of questions about that.

My first question is can you make clear to us that none of those Poindexter programs are used to spy on law-abiding Americans on American soil? That is what the law requires.

Secretary RIDGE. Senator, I am going to respectfully refer that inquiry to DOD, where Admiral Poindexter was engaged in that enterprise. I can assure you that nothing that we are doing in the Department of Homeland Security has been designed to collect information or to spy on American citizens. Frankly, every initiative that we consider, from the outset, there is both concern and consideration about the impact on civil liberties and privacy.

The Congress very appropriately created within the Department a Privacy Office and an Office of Civil Liberties, and those couple of really talented lawyers and very good staffs are engaged at the very outset not only internally within the Department, but frankly with the groups and organizations around the country that legitimately are concerned about the universal protection of privacy and freedom.

Senator WYDEN. Is your office involved, in any way, with data mining on the part of Government agencies? Because it seems to me that the Congress is just in the dark with respect to data mining. And we are paying for it, and my guess is you all are involved with other agencies in data mining today. And I would like to know, A, if that is the case; B, how many programs are going on involving data mining; and, C, how much money is being spent on data mining; and, D, whether there are any privacy rules with respect to how this data mining is going forward?

What can you tell us about your office and data mining this morning?

Secretary RIDGE. Well, Senator, I would like a little clarification from you, and I would be happy to have a private conversation with you, even a public exchange, if we framed the issue.

We target containers coming into the United States. We buildup a data base that includes information about companies, and shippers, and we do refer to that. I do not know whether you consider that to be part of a data-mining process, but we do refer to information that we have compiled in Customs and the Coast Guard about companies and shippers.

We do, as part of a program to move commerce through the borders, insist on going in to check the backgrounds of truck drivers coming across our borders from Canada to Mexico in order to get them access, quicker access to and from the States.

We are contemplating a computer-assisted passenger screening program. This is probably perhaps where the greatest concern might be, where we would take the name, the address, the phone number, and the date of birth and other passenger name records that would be associated with that passenger. And, again, the Congress has set some thresholds and asked the GAO to examine the CAPPS program to ensure that the privacy protections that Con-

gress is concerned about are met. We are still working and developing that pilot program, which we cannot implement without the GAO's imprimatur.

So I would be happy to take up any of these or any related questions with you at any time. But we are getting access to personal information, and occasionally some proprietary information, but the most expansive reach would be the CAPPS program where we are trying to enhance security, reduce inconvenience, and frankly get access to some commercial information that commercial vendors might.

Senator WYDEN. Why don't you furnish to me, for the record, what programs involving data mining your agency is involved with because I think it is very clear that everything from airline ticket purchases, to visas, to driver's licenses, a whole host of information is being examined by Government agencies every single day, and the Government, and certainly the Congress, is in the dark with respect to what is going on in data mining. There are no privacy rules. It seems to me the public has a right to know exactly what is going on here.

Two other questions, very briefly. Section 313 of the legislastion creating the homeland security department calls for the creation of the Centralized Technology Clearinghouse. This is something I was very involved with. And the point of the clearinghouse was to make sure that our entrepreneurs and our small businesses would not have to traipse all over Washington, D.C., in order to get their technologies reviewed. We are not clear what the status is of the clearinghouse that is mandated by Section 313. Could you give us some sense of where that is because there are a lot of entrepreneurs and small businesses with ideas out there, and they wanted a one stop kind of process. What is the status of the clearinghouse?

Secretary RIDGE. We understand and recognize it is a priority for the Congress. It is not as complete as I think you want it to be. With regard to getting access to information concerning procurement, we are in the process of streamlining that. In terms of it getting access to our Science and Technology Unit, to review the technology to see if it has application either within the Federal Government or elsewhere. Those are two features of that, as I read Section 313, that you wanted us to do. We are not completely done with either one yet; one, procuring information; two, assessing whether or not the technology is as good as it says it is and will perform as advertised.

Senator WYDEN. I hope that you all can move quickly on that because it seems to me that this is something we hear again and again from small business people, that they traipse all over Washington, D.C., trying to get answers.

One last question, if I might. Section 224 of the law was something that I was particularly interested in because it established something called NetGuard, which was essentially volunteers in science and technology. We saw after 9/11, for example, a lot of companies literally went to New York City in an effort to try to help them get their communications link-ups back and going, and they simply could not get in.

What is the status of section 224? This is something, like the clearinghouse, it is a very low-cost operation. NetGuard is volunteers. This is not something with Government employees. What is the status?

Secretary RIDGE. Senator, I will have to get back to you on that one.

Senator WYDEN. Fair enough.

Thank you, Mr. Chairman.

Chairman NICKLES. Senator Wyden, thank you very much.

Next, is Senator Sessions.

Senator SESSIONS. Thank you, Mr. Chairman.

Mr. Secretary, it is great to have you with us. You have had one of the greatest challenges anybody could have to try to assimilate all of these agencies and departments into one cohesive branch. I think you are doing a good job, and I salute you for it, but it is not easy. Anybody that has worked in the Federal Government, as I did, and worked with a lot of agencies, a United States attorney, and you know they are all quite different, have institutional prerogatives. When they decide to work together, they sign what amounts to treaties, you know, Memoranda of Understanding and things, that really I think indicate just how difficult it is to get people to work together.

In that regard, I strongly believe, based on my experience at that level, partnerships between law enforcement at the local level, partnerships between State and local and Federal works. I have heard some concern in the field that there is not enough really partnering with the Federal Government in cooperative work.

It is something, in my experience, you have to push constantly from the top, and it will eventually filter down, but without sustained leadership and pushing, it may not happen. I know you have indicated your desire to see this happen, but I wonder if you are satisfied at the level of cooperation and, if not, will you continue to push for that?

Secretary RIDGE. Senator, I am very satisfied with the level of cooperation We have literally seven hundred thousand-plus volunteers in State and local law enforcement that want to be part of the Homeland Security team, and if given actionable information will take action to help us.

Our challenge within the Department is to build an information network so that we can give them timely information. Just yesterday, we announced an initiative. Our goal is to complete it by the end of the year, and that is basically to design an Internet-based information-sharing system that once completed will go through all 50 States and initially to the 50 largest urban areas. But, clearly, trunk lines can be spun off of that, so we can pass on down to the States and local law enforcement sensitive, but unclassified, information, and then as we complete our classification system, where needed, and when appropriate, even pass down secret information. It will be an Internet-based system.

As I said before, our goal is to get it up and operational, and it is also not only going to connect us vertically, but the Operations Center in Washington, D.C., then can compare notes with the Operation Center in New York City. So there will be points of comparison, where they may pick up bits and pieces of information

that need to be shared. They may find some trends with regard to surveillance activity and share those. So, again, it is an Internet-based system. It is one of many that we are going to do in addition to secure phones, and video conferencing and the like, but our goal is to have that completely operational by the end of this year.

Senator SESSIONS. I think that would be an historic step and would be very important. At the same time, I think you also need to push your local officials in areas to have regular meetings with the local law enforcement. Make sure they feel that they know how to access this and feel that partnership effort.

Secretary RIDGE. If I might, Senator, one of the things I failed to note, and for everyone's benefit, this was a system actually designed by State and local police, and shortly after 9/11 we became familiar with it. And it just seemed to be the easiest way to transmit information.

During the holiday season, we actually used this system to connect with New York City and Los Angeles, California. So you'd get virtual real-time information exchanged. We saw a couple of States using it. New York and California get a lot of credit. We said this should be one of the main poles in the informational tent, and it was really brought to us by State and local law enforcement. As you point out, if we give them information, they can act on it.

Senator SESSIONS. Mr. Secretary, we have a substantial problem with securing our borders with regard to immigration. We have large numbers of people here illegally. I understand that this bill calls for I believe $23 million for enhanced worksite——

Secretary RIDGE. Enforcement.

Senator SESSIONS [continuing]. Enforcement.

Secretary RIDGE. Yes, sir.

Senator SESSIONS. Are you satisfied that can make a significant difference in that problem?

Secretary RIDGE. Well, Senator, I think it is a doubling of the personnel and teams that we have within the Department. We will give you a status report here in maybe 6 months to tell you whether or not, after we get those dollars, and see if we need additional support.

But I think, as a precursor to dealing with the President's initiative concerning immigration, we will know that none of these laws are going to be effective unless we have the resources to enforce them. So we do have a doubling of those dollars to assist us in 2005, and we think it is adequate to meet our laws under the existing laws because we are doing so many other things in addition to that at the borders to reduce the illegal flow of immigrants.

Senator SESSIONS. Well, we are making some progress.

Secretary RIDGE. Yes, sir, I think we are.

Senator SESSIONS. There is no doubt about that. I have been a critic of, as you know, the legal system and its effectiveness in some of the things we have done. I think we probably need more than that in that account.

And, second, you have a $100-million increase for purposes of dealing with detention and removal of illegals. As I remember the numbers, I think there are 400,000 absconders, people who have been arrested for violations of immigration law, were released on

bail, and they just never return. There are 400,000 out there. They also are not getting into the National Crime Information Center.

I am sure this $100 million will help, but I hope that you will give high priority to guaranteeing, before we have any reform of the law, that our legal system is capable of dealing effectively with these problems.

Would you make any comments about that expenditure and what you hope to achieve with it.

Secretary RIDGE. Senator, you highlighted a challenge that we have with regard to the enforcement of the law, and that is dealing with those who fail to show up for that final determination hearing or there is a hearing, but we have no place to detain them. So the $100 million will significantly increase the capacity—not completely—but it is a significant increase in our detention capability, so once detained we can make arrangements to deport them.

Senator SESSIONS. When people are convicted of felonies, they really should not be released. They are required by law to be deported, and I understand that has not been happening on a regular basis, and we need to make progress there.

Thank you, Mr. Chairman.

Chairman NICKLES. Senator Sessions, thank you very much, spoken as a Senator and also a former U.S. attorney.

Senator Stabenow.

Senator STABENOW. Thank you, and welcome, Secretary Ridge, it is good to see you again.

Secretary RIDGE. Hello, Senator. It is good to see you.

Senator STABENOW. I first want to thank you for coming to Michigan and for the progress we have made at the border. It has been my pleasure to be a part of hosting you and a bipartisan delegation and have you come and see not only the challenge in Detroit, which is the largest Northern border crossing, as you know, but also in Port Huron, a smaller community where there are multiple risks and threats, and we look forward to continuing to work with you to meet those multiple needs, both for small communities as well as larger communities.

I also understand you will be in Detroit on Friday to the Economic Club, so we welcome you again.

Secretary RIDGE. Thank you.

Senator STABENOW. There is no doubt in my mind that this is one of the most serious issues, if not the most serious issue, that we face as it relates to the budget, and this is not a partisan issue. We all care about safety and want to make sure we are safe, but we have different choices, and that is really what the budget process is all about.

And one of my deep concerns is that after having 11 different meetings around Michigan with first responders, I can say emphatically that if I were to answer Senator Conrad's questions about do we have protective gear, do we have interoperability on communications, do we have what we need in my State, the answer would be no, no, no. And that is of deep concern to me.

And so when I look at choices in the budget, and I would ask, first, you to respond with your former Governor hat on, as being a distinguished Governor and having to work under Federal laws and budgets in the past, when we look at the fact that the Presi-

dent's budget cuts the COPS program by $712 million, and the fire grant program by $250 million, and then provides some other increases, but when we look at the fact that, in totality for a Governor or a local community, you do not compartmentalize everything. You do not say to this police officer, you will only answer the call if we know it is terrorism, and you will answer the call if we know that it is a domestic problem.

The practical reality is that law enforcement has to address a wide variety of issues. They get a call on a suspicious package, they do not know whether or not that is terrorism or whether that is something else, and yet they have to respond.

So the local police chief, the mayor, the Governor looks at it in totality of what they need to be ready for threats no matter where they come from, which is one of my concerns about our attempts to divide this up in some way. Where the rubber meets the road, and you are dialing 911, that is just now how they look at it, in a practical sense.

So I am concerned, I mean, as a former Governor, if you were receiving a $5-million increase in homeland security, but then a $5-million cut in other areas, would you feel you were really moving ahead?

Secretary RIDGE. Well, Senator, even the new math wouldn't get me to that conclusion if you took $5 million out of this pot they used to give me and gave me $5 million in that pot, so I can understand that. But I want to share with you that I think it is, at least from Homeland Security's point of view, the President has sustained his commitment, which was a considerable increase in 2004. What we are talking about, Senator, is the difference between—and again you did say it was a matter of priorities—but the President's request, by and large, for first responders this year is at 2004 request level.

In the budget process and in the legislative process, the Congress shifted some resources and took the dollar amounts for the State homeland security grants a little bit higher, took the assistance to the firefighters' grants higher. But I think we have to be very clear. The President has basically sustained his request from 2004 to 2005, and the priorities were shifted a little bit by Congress.

And I think the President has come up in 2005, and here we have shifted—it is the same amount—but we have shifted the resources to where we think strategically there would be, at least for this time, it would be a better investment.

Senator STABENOW. And I appreciate that. My concern, which is a larger concern, really addressed—that we are responsible for as well—is whether or not we are meeting 2004 levels and whether it is the same as 2005. Those levels were underfunding of what our communities needed.

And the broader issue, and I have more of a statement, is that when we look at what former Republican Senator Warren Rudman and the commission, a distinguished group of people, looked at in terms of the broad needs that we have on first responders, they indicated that it would take $15 billion more a year to truly make sure the equipment was there, the communications was there, the bioterrorism training was there, the staff was there.

This is more just a comment from the perspective of our Budget Committee, but when we look at this next year—and I am borrowing Senator Conrad's chart—and we look at the fact that it is a matter of choices. For people who are earning over $337,000 a year, this next year they get $45 billion back in their pockets in terms of a tax cut. If we just gave them two-thirds of that, if we said we, as Americans, need to sacrifice together, and we are all going to be better off if we are able to fund everything that is needed in homeland security, and we just said you can have two-thirds of that, but we are keeping a third of it to fund first responders, I believe that would be a better choice to keep us safe.

One other question, Mr. Secretary, and I will not ask you to respond to that. That is an issue for us to debate in terms of priorities.

Secretary RIDGE. I understand.

Senator STABENOW. On the local front in Michigan, when you were in Michigan last, we talked about a specific issue to Michigan which is the fact that Toronto closed all of their landfills and is now trucking all of their trash literally into Michigan. We have a, we showed you through a helicopter, the trucks coming across the bridge.

Secretary RIDGE. Right.

Senator STABENOW. Over 180 trucks a day. Even though we have better equipment at the border, and I was pleased to sponsor the amendment to create that and to work with folks at the border who have done an excellent job, we still cannot see inside of every truck. Every truck is not completely inspected.

Your Department has initiated an effort to look at these trash trucks from a security standpoint. I wonder if you can share, at this point in time, any update on what you are finding or when you will be able to give us some feedback on that. This is a critical issue in Michigan for us and a real issue of national security because we do not know what is inside those trucks, and we are very concerned about our ability to keep people safe.

Secretary RIDGE. Well, Senator, No. 1, thank you for your hospitality during that visit. I did learn quite a bit. The visit to Port Huron specifically was very eye-opening in relationship to a community with massive infrastructure and not very good access to any of the dollars that are out there, except through the State's share, and I look forward to working with you and your colleagues to see if we can remedy that as we work with the regulations around the Urban Area Security Initiative.

I did raise the issue with my counterpart in Canada, after our meeting, and clearly it was just the raising of the issue, but no resolution. It was raised again when I returned, based on my conversation with you, with Customs and Border Patrol. But what, if anything, they have done since that time we visited, I do not know, and I would be pleased to get back to you and report. All right?

Senator STABENOW. Thank you.

Chairman NICKLES. Senator Stabenow, thank you very much.

Before I call on Senator Allard, Mr. Secretary, I need to excuse myself. Senator Crapo will conclude chairing the hearing. I just want to thank you for your presentation before our committee today, and also I look forward to working with you. You have taken

on a big challenge reorganizing a whole lot of the Federal Government. I think doing a good job, making our country safer, it is almost an impossible task, and I just compliment you and your team for the work that you are doing and look forward to working with you in the future.

I apologize that I need to step out, but I think we just have three or four more Senators, so you should be done shortly.

Chairman NICKLES. Senator Allard.

Secretary RIDGE. Thank you, Senator.

Senator ALLARD. Thank you, Mr. Chairman.

Mr. Secretary, welcome.

Secretary RIDGE. Senator.

Senator ALLARD. I always enjoy what you have to say.

The administration, I want to move right into one, a question here that has to do with the local nature and local problems that we are having in Colorado and several other States first, and then I have some other questions I want to talk to you a little bit about—the Information Analysis and Infrastructure Protection program that you have in place.

The administration suggested a significant funding decrease for chemical demilitarization in the budget for the Department of Defense. We have a facility in Pueblo, Colorado, that will be profoundly affected, and understanding that you are not here today representing the Department of Defense, I would just ask simply does a delay in the disposal of chemical weapons and byproducts, essentially warehousing these hazardous materials, post a risk to homeland security?

Secretary RIDGE. Senator, I would, without knowing the specific details of the change reflected in the DOD's budget, I would say to you that the delay, in and of itself, I do not necessarily think would create a higher level of risk as long as there is no diminution of security around the facility. I do think that one organization that has been very good over the years at protecting their forest structure and everything associated with him has been the Department of Defense. But delay in final disposal, no, assuming that the security measures have been sustained.

Senator ALLARD. And I think that is the big "if," because I know around the facility we have in Colorado, I am not, at least the locals are not convinced, we have much in the way of security measures, and it seems that the sooner we can get this——

Secretary RIDGE. Is it through a private contractor?

Senator ALLARD. They are in the process—yes, a local contractor has been let out, but security is minimal, and I think you always have to worry any time you have an accumulation of chemicals in one location whether it could ever become a target, whether it is a homegrown terrorist or foreign terrorist or whatever, and it seems to me that there could be some risk there.

Secretary RIDGE. Yes. I am sorry I cannot be more specific, Senator, since I am not familiar with the particular venue or the contents at the facility.

Senator ALLARD. Well, thanks for your interest in it at least.

In January, the President, in 2003, in the State of the Union address, he had instructed the leaders of the FBI, and the CIA, the Homeland Security, and then the Department of Defense to develop

a Terrorist Threat Integration Center to emerge and analyze all threat information in a single location.

And there is a section there in the Homeland Security Act that provided that your Office of Information Analysis and Infrastructure Protection is to assess, receive and analyze law enforcement information, intelligence information and other information from agencies of the Federal Government, State and local Government agencies and private sector entities to integrate such information.

Who is in charge of detecting and warning of these threats to the homeland? Is it you or is it the Terrorist Threat Information Center?

Secretary RIDGE. The warning responsibility is given to our Department. The analytical responsibility is shared. We have analysts in the Threat Integration Center. While we do not collect information, because we are considered a full partner in the intelligence community, we can go back to the Threat Integration Center and ask whatever agency responsible for generating the information to answer questions that we might have from our analytical point of view about that particular piece of information.

So, again, it is a collaborative exercise. We have analysts in it from the CIA, FBI, Homeland Security and others that paint a strategic threat picture. It is a real value added to our own independent analysis, and on a daily basis we do analytical work together. We, from time to time, go back and ask for additional information if, as part of their strategic analysis, there is something that catches our eye as it relates to our responsibility to secure critical infrastructure.

Senator ALLARD. This has been spread through the various agencies and whatnot. I would think that you would have some concern about duplication of effort. How do you limit your duplication of effort?

Secretary RIDGE. Well, Senator, I think having a couple of different groups or organizations bringing their various experiences to the analytical side of combatting terrorism is a good thing. Some people call it duplication, others call it competitive analysis. But I do think it actually is a better situation to have analysts in different departments may have a slightly different point of view on a particular piece of threat reporting, and it will be really forced, because of that competitive analysis, if there is a difference of opinion, for them to look deeper and more critically at that reporting stream.

I think, by and large, there has been, in my experience so far with Homeland Security and the Threat Integration Center, there has been harmony in terms of the relationship, and frankly not too many differences of opinion as to what it all means. But when there is a difference of opinion, it just sharpens the clarity, and focus and gets a very robust discussion going on, and I think that is healthy.

Senator ALLARD. I am just curious, we just stood up the Northern Command in the Department of Defense. It seems to me that there ought to be some communication between Northern Command and Homeland Security. Is there some avenues of communication that have been set up between individuals in those two departments?

Secretary RIDGE. Well, we can communicate with the Northern Command, but as an old soldier, there is a chain of command that we use in order to do it. But we——

Senator ALLARD. So you feel comfortable with anything that they may be doing, anything that you might be doing and that is being coordinated.

Secretary RIDGE. Yes. Well, you know, they just had a very, very significant multi-day, multi-incident exercise, and we were very much involved in the planning process and participating in that exercise. I am confident, in the months and years head, we will get locked up even closer.

Senator ALLARD. There is a computer system being set up. It is called the Homeland Security Information Network. You are familiar with that.

Secretary RIDGE. Right.

Senator ALLARD. It is supposed to provide critical information to all 50 States and major urban areas. Can you update the committee on the program requirements and estimated costs on that.

Secretary RIDGE. Senator, the cost, frankly, is minimal. I do not have a specific dollar amount, but since it is Internet-based, you have the infrastructure there. The costs will be associated with developing a classification system and some firewalls so that we can share, when appropriate, some classified, secret information. But it is actually a system that was developed by New York and California, by the State and local law enforcement community and a little assistance from I think the Defense Intelligence Agency, and it is the way that they have been communicating between their State and local officials.

In one of our travels, some of our folks took a look at it and said, You have the backbone here. Let us see if we can devise what they used to call what they used to call was a Joint Regional Information Exchange System, JRIES. Let us take it nationwide. Let us draft it and tie it into, at first, to the 50 largest urban areas in America so that we have virtual contact with the States and the large urban communities.

We used it during the holidays, when we raised, elevated the threat level, with New York City—our Operations Center was hooked up with the New York City Police Department and the Los Angeles Police Department by virtue of the Internet, and they are constantly information on a minute-by-minute basis. So it is a good system. It will take us about an entire year to get it up and running, but at the end of the day, it will give us the capacity to share information to just about every State and local law enforcement official in our major urban areas, and we think that is a good thing.

Senator ALLARD. Thank you.

I see my time has expired, Mr. Chairman.

Senator CRAPO [presiding]. Thank you, Senator Allard.

Next is Senator Feingold.

Senator FEINGOLD. Mr. Chairman, Mr. Secretary, thank you for being here and for your work on behalf of our country.

Let me ask you, first, about something that I have heard from emergency management officials in my State. They are concerned about a proposal in the President's budget to cut funding for the Emergency Management Performance Grants. They are much more

concerned about the proposal to cut the percentage of grant money that they can use for personnel costs from 50 percent to 25 percent.

I am told that this will have a tremendous impact on emergency management officials, especially those in small cities and counties, because salaries are often almost 100 percent of the cost of local and State emergency management programs. And a number of people told me in meetings back home and hearings that many local Governments will simply not be able to afford to have an emergency management official. The Emergency Management Performance Grant program is a respected program that our State and local officials have come to depend on.

Why has the administration proposed reducing the personnel spending cap for the EMPG grants and potentially undermining State and local emergency management capacity?

Secretary RIDGE. Senator, I think it is a decision based upon a shared responsibility for personnel costs and a primary responsibility for the Federal Government to send dollars out for training and exercise programs; that we would reduce the level that we would contribute to defray the salaries and use our portion of the funds so that once these men and women were in place they would have additional dollars to conduct a training and exercise program.

So it was based on a notion that we have a shared responsibility to pay for the salaries. We have a primary responsibility to help provide funding for training and exercises.

Senator FEINGOLD. Well, I understand that. I would just indicate that I think this is going to have such a disproportionate impact on some of our smaller counties and communities, and I hope we can work together to possibly reverse this before the budget is complete.

I would like you to address EMS funding in your budget. Wisconsin EMS officials tell me that they feel sort of overlooked when it comes to first-responder funding. As you know, there has been no dedicated funding source for EMS funding, and the President's budget proposal does not change that.

I am told you will be submitting a report to the Appropriations Committee next week discussing the amount of funding EMS teams are receiving through DHS grants and the barriers facing EMS teams as they try to get these grants.

Could you say a little bit about your findings and how the Department is working to make sure that our EMS services are not overlooked.

Secretary RIDGE. Senator, I cannot tell you today what proportion of dollars that we have distributed to the State and local Governments have found their way down to the EMS personnel. Clearly, they are an invaluable part of our first responder community. We relied upon them heavily in Pennsylvania, as does just about every other State. So I cannot give that specific figure.

It is certainly supporting EMS, not so much the personnel costs, but supporting their equipment acquisitions and their involvement in training exercises is clearly an eligible cost for the homeland security grants and if they are associated with the Urban Security Area Grant money and eligible costs there.

I will be able to tell you, in a short period of time, to you and to Congress, as we read the State and territorial plans that they

have submitted to us, we should be able to get a read as to where they view the EMS infrastructure as a priority for the distribution of the billions and billions of dollars that we have available to them. I just cannot give you the specific figures on that.

As a former Governor, I assure you I think EMS is an integral part of the first responder community, and they would be eligible for distribution of these dollars, whether or not other Governors or mayors, as they have developed their own individual plans, have decided that, for this distribution, they ought to get some of this money. I do not know yet. We just got the plans.

Senator FEINGOLD. Thank you. I was pleased to hear that DHS is working to gather and disseminate first responder best practices information. The first responders from Wisconsin who I have talked to are excited about having a central Best Practices Center. The Council on Foreign Relations Independent Task Force, chaired by Senator Rudman, also found a real need for such a center, saying that having one would "allow all emergency responders to learn from past experiences and improve the quality of their efforts, thereby assuring taxpayers the maximum return on their investment in homeland security."

How are you involving the local first responder community in your efforts to gather and disseminate best practices? And I would like to inform Wisconsin first responders about your initiatives and when they will be in place. When can they realistically expect these programs to be online and available for their use?

Secretary RIDGE. First of all, Senator, we have as part of the Homeland Security Advisory Council, a group of men and women specifically out of the first-responder community from around the country. And we were asked by the States, in anticipation of our request for statewide plans, to give them a template. And so we put together the first responder group, as well as a State and local group, and they were the ones that developed the template.

That is why I am hopeful that I can report back to you that as the States took a look at the template that the Advisory Committee gave them that was, in part, authorized by the first responders and EMS folks, that there will be an EMS provision there.

We are consolidating the State and local Government and the Office of Domestic Preparedness. We sent a letter to Congress here a couple of weeks ago so it can be a one-stop shop. This will be the driving force behind the initiative to get the best practices out. We will probably use many means of communicating back to your first responders in Wisconsin, not the least of which will be the Internet. I cannot give you a specific timeframe, but I will task my people to provide that information because if the first responders of Wisconsin are interested in it, first responders everywhere will be interested. I just cannot give it to you today.

Senator FEINGOLD. Thank you for that.

Other Senators are waiting to ask you questions before you have to leave, so let me just associate myself with the comments of Senator Wyden with regard to data mining, his questions, his emphasis on this. He and I have worked together on this, and we will continue to work with you and others to assure the American people that certain data-mining practices are not used in a way that goes beyond the challenge that you face, which is the terrorist threat.

And this is a matter of the highest priority to me, as it is to Senator Wyden, and we look forward to closely watching this with you.

I thank you, Mr. Chairman.

Secretary RIDGE. Senator, if I might, I would really like to take you up on that offer. I served with Senator Wyden some time ago. I know that is a passionate interest of his, and obviously it is yours as well.

I do think the most immediate pilot program that we would like to initiate I think goes to the heart of everyone's concern about individual privacy and liberty, and that is the CAPPS program. We think we have designed a program that is respectful of individual privacy rights. We know we need GAO's approval; i.e., Congress's approval. So particularly with that initiative I would welcome the opportunity to work with you to address any concerns that you and Senator Wyden or, for that matter, any other Members of Congress might have.

Senator FEINGOLD. I look forward to that.

Secretary RIDGE. Yes, sir. Thank you.

Senator FEINGOLD. Thank you, Mr. Chairman.

Senator CRAPO. Thank you very much.

Secretary Ridge, we realize that your time is limited. We have three Senators who have not questioned you yet, and I believe Senator Conrad would like to have another round of questions as well.

Secretary RIDGE. Sure.

Senator CRAPO. I am the last one on our side, and I will just hold off until we finish up over there. And so we will next go to Senator Nelson.

Senator NELSON. If Senator Murray was here before me, I would certainly defer to her.

Senator MURRAY. No, thank you.

Senator NELSON. Well, thank you. Thank you, Senator. Mr. Chairman, Mr. Secretary.

Secretary RIDGE. Senator.

Senator NELSON. Mr. Secretary, Interpol has testified to Congress last summer about the enormous amount of money that is being made in the knock-off goods trade. We know, for example, in the drug trade, that is a source of funding for terrorist organizations. But the profit on knock-off goods is enormously higher than the profit on the trafficking in drugs.

And I just visited with your folks in the Jacksonville office, where they had just seized an enormous load, in this particular case it was at a flea market, of these goods. And interestingly they import the handbags without the labels. So it is legal to import them or the shoes or the pieces of the watches, and then once they are here, they assemble them and then put the Fendi or Ralph Lauren labels on them, which then it becomes illegal because it is deception, and that is against the law.

And apparently billions of dollars are being made in this kind of trade all over the world. A lot of these items are being manufactured in China, where they can be manufactured very cheaply. So naturally my concern is, particularly with Florida being a place of 14 deep-water ports, where a lot of commerce is coming into this country and where we just had this seizure over the weekend.

I would want to know, from you, what we can do to help you, perhaps first with legislation, increasing the penalties. Because, interestingly, if you get caught dealing in drugs, that is one kind of harsh penalty, but if you get caught dealing in these knock-off items, it is a much lesser penalty. And if we ultimately get the proof that profits from these criminal organizations are going into terrorism, then we better be concerned.

The second item that I would wonder would it be helpful for us, as the legislators and the appropriators, to do is to create some kind of public education fund for you so that, when people go and buy these goods—and they know they are getting knock-off goods. It is not illegal for them to buy them. It is illegal for the guys to sell them—so that they see the potential link there with supporting terrorism, and thus a campaign of public service announcements.

What do you think, Mr. Secretary?

Secretary RIDGE. Well, first of all, Senator, I think my colleague, Secretary Hutchinson, testified that, from our point of view in border and transportation security, as we inherited the old Customs Department, that this is probably one of the fastest-growing areas of criminal activity not just in this country, but around the world. And the potential for it to be linked up, in time, because we have no contemporary evidence that suggests it is tied to terrorist organizations, but certainly the possibility always exists.

So as it comes to enhancing the penalties or some form of public information campaign vis-a-vis the potential consumer, a couple of issues we would certainly look to work with you on. I would defer to Mike Garcia, of Immigration and Customs Enforcement, as to whether or not he thinks, in his experience, the penalties have been adequate, whether they have been a sufficient deterrent and would like to review, get the benefit of his analysis and then get back to you with a more complete opinion.

Senator NELSON. OK. I will talk with Mr. Garcia then, and I have put this in a letter to you right after I met with your folks on Monday, after this big bust.

Secretary RIDGE. Good.

Senator NELSON. And that is there in your office. So if you would get your folks to direct it to Mr. Garcia.

Secretary RIDGE. I will. Thank you.

Senator NELSON. Mr. Secretary, of course, port security is of enormous importance to us in Florida, with us having so many deep-water ports. And I am concerned, a year ago the President had no money for the Port Security Grants. The Congress put in $125 million. This time the President has put in $43 million for a different kind of other than direct grants.

This Senator is going to be working to increase that at least to the level of the $125 million for the grants, but beyond that, if you talk to the Nation Ports Council, as well as our own Florida Ports Council, they think, nationally, that from a security standpoint, that they are lacking about $5 billion. I am going to shoot, over the course of time, for a target of enhancing it by $2 billion. I would like to have your reflection on that, and perhaps this is something we can work together.

I know you have $1.9 billion in the budget, but that includes the Coast Guard, and the Coast Guard has got a bunch of other things

to do, particularly in the waters off of Florida. Let us hope they do not have to start interdicting an exodus out of Haiti, but you know what we have to deal with down there.

Secretary RIDGE. Yes, sir.

Senator NELSON. Not only that, but the drug runners as well.

Secretary RIDGE. Yes, sir.

Senator NELSON. Give me your ideas.

Secretary RIDGE. Well, Senator, I could not help but think, with Senator Murray, after you talked about port security, this is a conversation that the Senator and I have had before with regard to her perspective and yours as the inadequacy of the port funding. And I think it is worthy of the kind of public discussion, in a civil way, because it is of a civic interest to all of us.

I just, as a former Governor, as someone who expended and saw expended both Federal, State and local resources in my ports in Pennsylvania, oftentimes they are publicly owned, you have public employees there, I more or less view them as part of the private sector's distribution chain. It is part of their infrastructure. And while I think we have to make the business case that it is important for any major corporation to protection its own supply chain, I think that we need to have that conversation or debate here in the Congress.

From my point of view, the Congress has appropriated hundreds of millions of dollars not only for grants, but you support the Coast Guard. The Coast Guard provides enormous port security. They are helping them with their security and vulnerability assessments. The Coast Guard puts captains of each port to coordinate the activity between the public and private sector.

We get to a point I think, given the people and the resources we commit to all of these ports, but I think we ought to take a look at the private sector to enhance security at these ports. So, again, they are for-profit entities. It is part of their supply chain, and I think it is reasonable for the taxpayer to expect a major corporation that is importing goods to sell to our citizens that they invest in their supply chain.

Senator NELSON. Well, I am going to help Senator Murray help you, even though you will not say that you need the help, we are going to try to help you to up that port security money.

Thank you.

Secretary RIDGE. Thank you, Senator.

Senator CRAPO. Thank you very much.

Senator Murray?

Senator MURRAY. Well, thank you very much, Mr. Chairman.

Obviously, from Florida to Washington State, we are deeply concerned about the administration's proposal on airport security, and I again am very concerned, listening to what you have to say, and I do think we need to have a dialog, but we need to do it immediately I think.

As a Senator from a State that depends on seaports for its livelihood, we have to have a cohesive port security plan that protects our communities and our economy from potential threats. I know we both agree that the agencies that are involved in securing our ports are doing an admirable job. They are working through a very difficult problem, but if they are not given the proper tools, and re-

sources and guidance to knit together a coordinated approach, all of us are left vulnerable.

You talk about the supply chain, but that is only part of what port security is. Our ports are where a container or something can come in and enter this country in a way that puts everybody's security at risk.

I am deeply concerned about putting our security in the hands of the private sector when I know how much they are struggling today with costs of their own. And if they do not do it, we have left a real weak link in the chain at whatever port just simply does not have the money to do it.

But there is another issue as well, and I have listened to you. You answered my question before when I asked you about this, by saying that the private sectors for goods moving in and out, similar to what you just said, and they should be responsible for picking up. I noticed that on I think it was News Hour with Jim Lehrer you said that the administration should engage the private sector and that it should be their dollars to provide security.

Let me tell you what my problem with that is. We are at a real competitive disadvantage if we start requiring our ports in this country to pay for security. We already have a problem in Tacoma and Seattle with, if our prices are higher, containers are diverted to Vancouver. I know that is the same case in California. I do not know if that occurs in Florida. I assume it would. If the costs of bringing containers into our ports increases, if our private sector has to put that money in there, those containers will not come into this country. Now, that means a tremendous loss of jobs. That means killing jobs right here in the United States.

My State is deeply concerned about this. If there is a Federal mandate that we have port security, and there is a reason that we should have that, it will have to be paid for. If our costs go up, those containers will be diverted. Now, that is an economic factor. It is a security factor as well, and it is a job killer in the State.

So I wanted to engage you in that conversation today. I am glad that the Senator from Florida brought it up. He is correct. It is completely underfunded in this. If we are relying on the private sector to do it, I think we need to know how much you anticipate our port security efforts will cost the private sector.

Secretary RIDGE. Senator, first of all, let me just, at the outset, say that we have a continuing responsibility that, again, as part of the Federal share, to continue to deploy our Customs and Border Patrol people there. We are going to make, through congressional appropriations, additional purchases of the nonintrusive technology, gamma ray and X-ray machines. So that is an ongoing contribution to enhancing port security.

But when it comes to some of the other features of port security, again——

Senator MURRAY. Other features meaning?

Secretary RIDGE. Well, surveillance cameras, fencing, infrastructure that accommodates the intermodal nature of securing the infrastructure that accommodates the railroads or the trucking companies that come in. I mean, there are security profiles and things that I think can be done at relatively low cost. We are in the process of——

Senator MURRAY. Well, the commandant told us that the cost would be $7 billion.

Secretary RIDGE. Seven billion dollars spread over a period of years? If that is the case, and I do not——

Senator MURRAY. I do know that the requests last year to your department for port security were over a billion dollars, and I have worked with a number of these ports. I mean, we had a wake-up call on September 11th, and many of these ports had absolutely no security in them. They are a huge weak link in our security chain, and they know that. They have been trying to step up to it. Congress told them to put together their plans. They have. I am aware that some of it is fencing and security cameras, but if we just say, private companies, you go do that, I know it will not happen.

Secretary RIDGE. Well, first of all, Senator, I need to reiterate, in addition to my preference that the private sector pick up more of the additional expense with security because the taxpayer is already paying for a substantial part of the security, I think the taxpayer owns a lot of the land, has provided some of the initial security, but remember we began the security protocol before the container is even put on the ship.

Senator MURRAY. Well, I heard your answer to Senator Corzine——

Secretary RIDGE. I guess it becomes a question of what is the additional security that you are most concerned with for purposes of our discussion? Is it continued scrutiny of the contents of the containers?

Senator MURRAY. Well, I heard your answer to Senator Corzine, and I think he asked you what percentage of containers were screened, and you said 98 percent.

Secretary RIDGE. Right.

Senator MURRAY. I am assuming that you are talking about the 24-hour-rule for screening manifests.

Secretary RIDGE. Correct.

Senator MURRAY. That does not look at what is in containers. How many containers are screened before they ever enter our ports?

Secretary RIDGE. Actual physical screening, there is no quota, but I think now it is about 5.4 percent.

Senator MURRAY. That is——

Secretary RIDGE. But I would say to the Senator, we could physically screen every container——

Senator MURRAY. We do not want to do that. I think there are really good programs in place to not do that.

Secretary RIDGE. You could do it, but the economic costs associated with the physical screening of every container coming across by railroad car, coming across by truck, coming across by the shipping container, would be a far, far greater impact on the overall national economy than modest improvements at several hundred ports around the country.

Senator MURRAY. And I do not think anybody believes that we need to do the actual physical.

Secretary RIDGE. Right.

Senator MURRAY. But I do think there are ways to provide security at ports where the containers are loaded before they ever get

there and track them here, which is what Operation Safe Commerce was put in place to do. But——

Secretary RIDGE. What we may decide to use, Senator, depending on those lessons, there may or may not be a Federal role. I am not prejudging that one way or the other.

Senator MURRAY. And actually some of that money still has not gotten out to them, so we are way behind the curve on where we need to be in order to learn that.

But let me go back to the basic question here because it is a critical one for our economy. If that $7 billion that the commandant himself told us was going to be necessary, and the vast majority of that is going to be required to be paid for by private companies, they will increase the costs to them at their containers. How do we deal with the competition? That means we will lose jobs in Washington State, I am assuming California, Florida, other ports on the East. I know we will in Washington State. I know our containers will be diverted. It is an economic challenge they face every single day.

Secretary RIDGE. Senator, the assessment of the commandant of the Coast Guard was based on their review I think of most of our major ports, if not all of our major ports. I believe it was the optimum costs associated with the security plans to be dealt with over a period of time. As we buildup security infrastructure, be it at a port, be it at a local community, we are not going to ramp it up all at once, No. 1.

No. 2, we have to be in the business of managing the risk, and when it comes to managing the risk around shipping containers, if that is the concern we have about enhanced security at domestic ports, we begin that process before the container is boarded on the ship.

There is a very sophisticated rulemaking device, based on information we have from intelligence, from data that we have accumulated over the years, so we have a pretty good way of targeting potentially troublesome containers, for a variety of reasons: criminal information we have, threat information we might have, coupled with the information we have secured by Customs and the Coast Guard over the years. That process begins before these are ever loaded.

Senator MURRAY. Are you confident, as Secretary of Homeland Security, that our ports are secure today and that we are safe from having a container come into any one of our major ports?

Secretary RIDGE. Senator, if you are asking me to guarantee you the safety of 20,000 containers coming into the port every day, I will not do that. It can physically be done, but if we are going to talk about the impact on the economy, Senator, I think we need to understand that in an international economy, a domestic economy that is in the trillions of dollars, and so much of it relies on container security, we have to manage the risk, and you manage that risk——

Senator MURRAY. I understand that. But what I am asking is you are saying that, under the plans that our ports have put in place, that the vast majority of that is going to have to come up with the private companies to pay for, are you confident that they will do that, that the plans will be put in place and that we can tell our

citizens who live within blocks of a major port, work in our major ports, that they are secure? And even beyond that, if a container comes in, and the ports are shut down, and stores in Senator Conrad's State no longer have anything on the shelves because we do not have any imports, are you confident that that will occur?

Secretary RIDGE. Senator, I believe that the business of securing America is not exclusively the business of the American taxpayer. I believe the business of securing America, securing ports, securing chemical sites, securing nuclear sites, there is a shared responsibility. It is both in terms of leadership and financial responsibility.

Now, what the division of costs associated with port security is between the public and the private sector, that remains for a very good public discussion, as we are having right now. But if every time we look to a particular sector within our economy and say that we cannot guarantee a fail-safe system, which we can never do any how, but insist that the taxpayer pay the entire measure for securing the private sector, that is just a philosophical difference as to how we go about integrating the resources and accepting the shared responsibility of securing the country.

What balance is in there, Senator, remains to be seen. We certainly are going to have a continuing responsibility to buy nonintrusive technology, to continue to ramp up, and we have asked you for additional money for the Targeting Center. There will be other very significant Federal funds invested in securing these containers.

You continue to give more money to the Coast Guard, I mean, there is a long list of things that the taxpayer is providing for to provide security, but I do think it will be helpful for us, once we get these vulnerability assessments completed and we take a look at the precise nature of these security plans, to see what is appropriate Federal costs and what should be borne by the private sector.

Senator MURRAY. What do you expect the time line to be able to tell our private companies what their costs are going to be on this?

Secretary RIDGE. First of all, Senator, I do not think they are operating in isolation because the captains of each and every port, more often than not, obviously, a member of the Coast Guard—you know, they sit down, and they have worked with these men and women in these companies for quite some time. And the level of security around these ports, not all, but most of them, was pretty good around some of them, nonexistent around others, but every day I think around the country, particularly at the major ports, they are doing more to integrate their security efforts, Federal and public.

And it just remains, I cannot tell you today what those costs will be, but I think in time we will have a pretty good idea. And then we have to decide, as a country—both public and private sector—at what level do we take security at any of these venues?

Senator MURRAY. I understand all of that. I know my time is——

Secretary RIDGE. How high is the fence? How many cameras?

Senator MURRAY. I just have to tell you, where I get really nervous with your argument is that if we rely on the private sector to do it, and they either do not have a money or there is a competitive disadvantage that they do not or for whatever reason, they are op-

erating in thin margins that they do not, who will end up paying for a tragedy is all of us.

Secretary RIDGE. But, Senator, I am still trying to understand, I am still trying to understand is your concern with regard to the security of the port from domestic infiltration across into the port or is your concern the potential vulnerability around the container? I mean, there are different kinds of security concerns around a port, and I think that is where, very appropriately, the discussion would be who has what responsibility for what security concerns.

Senator MURRAY. Well, I think both, but I do think the potential for something coming in a container on a ship into one of our ports, and you are the Secretary, and you know the information better than I do, is out there. It has always been part of what we need to understand, and accept and do something about, and that is a huge concern for me.

Secretary RIDGE. Again, Senator, I thing the approach we are taking, laying in the targeting, the physical inspection of some of these containers before they get on the ship, we do board some of these high-interest vessels before——

Senator MURRAY. The 5 percent that you said are looked at before they——

Secretary RIDGE. The 5.4, that's right. There is no quota. Whenever we find a high-interest container, we run it through the machine, and if there is something that reveals itself when it is run through the technology, we go in and open up the container. And it is about managing the risk.

Senator MURRAY. Well, I agree with the Senator from Florida. I think we need to make sure we have the funds available and put in place a strong security system, and I look forward to working with you.

Thank you, Mr. Secretary.

Secretary RIDGE. Senator, I do too. Thank you.

Senator CRAPO. Thank you.

Mr. Secretary, the Department of Homeland Security has an important role in defending our homeland against bioterrorist attacks, including those involving anthrax, and smallpox and other toxins. And I note in your testimony that you have allocated some of the time and attention of your remarks here today to that.

Could you please expand a little bit on that and tell this committee first how the fiscal year 2004 Department of Homeland Security funding is being allocated to meet those threats and then, second, how you will utilize any funding in fiscal year 2005 that we may appropriate for deterring or responding to such bioterrorism threats.

Secretary RIDGE. First of all, Senator, our responsibility with regard to bioterrorism is joint with the Department of Health and Human Services. I think, as you recall, when we first sought to create a Department of Homeland Security, the legislation we initially sent to the Hill, we had requested the entire portfolio of bioterrorism defense responsibility, but I think Congress said that you have Health and Human Services, you have the NIH, you have the Centers for Disease Control, they will have primary responsibility, but there are roles that you play.

One of the roles we play is to direct some of the research and development on technology that would help us sense a bio attack, bio sensors and chemical sensors, and so a considerable portion of the research and development dollars you have given to S&T is going out to the bio sensors.

We have also built on the Bio Watch program we have located around the country. EPA has air quality monitoring stations at various sites around the country. Last year, we expanded those sites to include some modest technology that enables us to pick up potentially some bio or chemical agents, but it is still a very labor-intensive process, and so some of the dollars that you have given us are going into technology that will actually capture whatever that agent is in the air, analyze it right at that point so we do not have to manually take the filter out and take it to a lab to get done. So we have that responsibility.

We have a shared responsibility when it comes to Bio Shield. That is the program where both the Secretary of Health and Human Services and Homeland Security, based on threat, can access the dollars that Congress provided. If the threat indicates a biological threat, we view it as credible. We look at our stockpile of vaccines and antidotes, make a determination that we do not have anything in this country to combat that threat. Congress has appropriated $2.5 billion for us to access that.

So, again, there are a variety of different ways. We interact both with Health and Human Services or act independently on our own to deal with a bioterrorist incident.

Senator CRAPO. All right. Thank you. I have several other questions, but I think I am going to submit them to you in writing because I have just been informed that you are really over time.

Secretary RIDGE. I appreciate it. I have to be with your colleagues on the other side of the Hill.

Senator CRAPO. Senator Conrad.

Senator CONRAD. Yes, I would just be very brief.

Again, it has been good to have you here, Mr. Secretary.

Let me tell you my honest assessment is that with all of the work that has been done, the resources that have been devoted, we are still ill prepared to deal especially with a chemical and biological—chemical or biological attack on this Nation's urban centers. I have tried to evaluate, based on my staff's analysis, the feedback we have ten from these experiments, if you will, in major cities. We look at the experience in Denver, and what we saw was really chaos; that the health providers basically left their hospitals. Everybody headed for the hills.

I worry very much what would happen if there were a chemical and biological attack on the Nation's capital, if there were a chemical, biological attack on New York City, if there were a chemical or biological attack on our Nation's stadiums. I worry very much about that. I can imagine if they flew over a small plane with a chemical and biological agent and sprayed the crowd, the chaos and panic that would ensue. And I do not think we are yet as prepared as we need to be for those threats and that eventually.

I noted that there are places where the money is being spent that just make no sense. We talked about the thousands of dollars for leather jackets, and $500,000 for a digital camera for mug

shots, and Dale Carnegie courses for sanitation supervisors. This is not money that you authorized. This is money that went to local units of Government, but this is what they did: Maryland cutting State spending for local health care outreach centers and then using Federal funds to fill in, basically substituting Federal funds for State funds, an $800,000 mobile command bus that they said would be the talk of the East Coast.

You know, these are things that do not make lot of sense to me. And the conclusion that I want to leave you with is that more money will be frittered away without a clear national plan spelling out what first responders need to be able to do in an emergency and more stringent guidelines on how the money should be spent. That is not my conclusion. That is the conclusion from this detailed article that was in the Washington Post that I know you paid careful attention to.

Can you just tell us what it is you are doing to make sure that this money does get spent wisely and effectively and what you are doing to lay out a clear national plan, spelling out what these first responders need to be able to do.

Secretary RIDGE. Senator, during the past several months, in addition to worrying and directing congressionally appropriated dollars out to first responders, we have been working and created a national response plan and a national incident management system that has been accepted and will be used as the framework within which we can set guidelines and standards for our first responders. There are certain protocols that we will expect to be done in the event of a chemical incident, a biological incident and the like. So we have the framework of how we are going to train and exercise our first responders that show up to save lives in an incident.

In addition to that, this is the first year that we are going to have the statewide plans, which hopefully were built on the template that the Department sent out to the Governors. We asked the Governors to take the lead.

I think you are going to find, from 2005 forward, that we are going to be far more prescriptive in where these dollars would go so that we can monitor, on an annual basis, that we are able to say that that infrastructure that we all believe we need to buildup, sometimes it is a complete infrastructure in a major urban area, sometimes it is a mutual aid infrastructure around a wider, less-populated area. So we know that we have the training exercises and the equipment, consistent with the protocols that we have developed in the incident management system, to respond to a terrorist attack.

So, again, I do think that we are far better prepared than we were a year ago. I do think we have a long way to go to get where we want to be, and our goal every single day, Senator, is to make sure we rise to a new level of readiness and preparation. I think we reached that goal, but we will now be in a position, having developed these statewide plans, and we have already alerted the Governors and the mayors to be a little bit more—we will be more prescriptive as to the menu that you can call on to spend Federal money.

Senator CONRAD. Well, I think that is just very important. Again, I would say to you the one place that I think we are still deficient

is the preparation for a chemical or biological attack in one of our major urban areas or one of our stadiums. I hope there is just an intense focus on preparation, and I think the need to exercise, to train in a way that is a realistic replication of what might occur is critically important.

Secretary RIDGE. Thank you, Senator.

Senator CRAPO. Mr. Secretary, we thank you for your time and apologize that we have kept you over. This is very important information, and we will submit to you some additional questions that we did not get to ask. But, again, thank you very much for your time, and you can get on your way.

Secretary RIDGE. Thank you very much.

[The prepared statement of Secretary Ridge follows:]

Statement of Secretary Tom Ridge before the United States Senate Committee on the Budget

February 25, 2004

Introduction:

Chairman Nickles, Senator Conrad and Members of the Committee:

I am honored and pleased to appear before the Committee to present President Bush's FY 2005 budget for the Department of Homeland Security. Before beginning to outline our FY 2005 budget request, I want to thank you for the strong support you showed for the Department in the FY 2004 budget and for the fact that that appropriation was passed in time for it to be signed by the President on October 1, 2003 – the first day of the fiscal year.

The $40.2 billion request represents a ten percent increase in resources available to the Department over the comparable FY 2004 budget and reflects the Administration's strong and continued commitment to the security of our homeland. The fiscal year 2005 budget is a $3.6 billion increase over fiscal year 2004, and it includes increased funding for new and expanded programs in border and port security, transportation security, immigration enforcement and services, biodefense, incident preparedness and response, and the implementation of a new human resources system that will reward outstanding performance. The budget also continues our momentum toward integrating intelligence, operations and systems in a way that increases our nation's security.

The Department of Homeland Security has made great organizational strides during the first year of operations. Nearly 180,000 employees and a budget of $31.2 billion were brought under DHS less than a year ago. The Department established a headquarters operation and successfully began operations on March 1, 2003 – bringing together the legacy agencies and programs that now make up DHS. Customs, border and immigration activities have been reformulated into new agencies that will increase the effectiveness of our dedicated employees. DHS continues to create new ways to share information and intelligence within the Department and between levels of governments, and horizontally across agencies and jurisdictions. Already, over 350 different management processes have been consolidated to 130, and DHS has begun consolidating 2,500 support contracts into roughly 600.

While DHS invested considerable time to make the many organizational improvements that will improve our effectiveness, much was also accomplished programmatically. The fiscal year 2003 Performance and Accountability Report provides a comprehensive discussion of our accomplishments of the past year. We believe that in the twelve months since the creation of the Department, we have made substantial progress. Through the hard work of our dedicated and talented employees, America is more secure and better prepared than we were one year ago.

We have achieved many results since our creation, including:

- improving the collection, analysis and sharing of critical intelligence with key federal, state and local entities;
- allocating or awarding over $8 billion to state and local first responders to help them prevent and prepare to respond to acts of terrorism and other potential disasters;
- strengthening border security through the "One face at the border" initiative, which will cross-train officers to perform three formerly separate inspections—immigration, customs and agriculture. This will allow us to target our resources toward higher risk travelers;
- instituting innovative new systems like US-VISIT to identify and track foreign visitors and students and to screen for possible terrorist or criminal involvement;
- safeguarding air travel from the terrorist threat by hardening cockpit doors, instituting 100 percent checked baggage screening; and training more than 50,000 federal passenger and baggage screeners;
- increasing safeguards on maritime transportation and port infrastructure;
- expanding research and development in the defense of our homeland, through the creation of programs such as the Homeland Security Advanced Research Projects Agency (HSARPA) which has already engaged hundreds of private companies and universities in developing new cutting-edge technologies;
- launching an ambitious, collaborative effort involving input from employees at all levels, unions, academia, and outside experts to design a modern human resources system that is mission-centered, fair, effective and flexible;
- initiating a five-year budget and planning process and commencing the development of an integrated business and financial management system (Project eMerge^2) to consolidate the 50 different budget execution systems, 43 different general ledgers, and 30 different procurement systems inherited by DHS; and
- successfully transferring more than $50 billion in assets, $36 billion in liabilities and more than 180,000 employees to the Department.

FY 2005 Budget Request

The Fiscal Year 2005 budget for the Department of Homeland Security builds upon the significant investments to date to our safeguard against terrorism, while also sustaining the many important departmental activities not directly related to our fight against terrorism. The President's budget clearly demonstrates the continuing priority placed on the Department of Homeland Security in providing total resources for FY 2005 of $40.2 billion. This is an increase of 10% above the comparable FY 2004 resource level, $9 billion (29 percent) over the 2003 level and $20.4 billion (103 percent) over the 2001 level.

Strengthening Border and Port Security

Securing our border and transportation systems continues to be an enormous challenge. Ports-of-entry into the United States stretch across 7,500 miles of land border between the United States and Mexico and Canada, 95,000 miles of shoreline and navigable rivers, and an exclusive economic zone of 3.4 million square miles. Each year more than 500 million people, 130 million motor vehicles, 2.5 million railcars, and 5.7 million cargo containers must be processed at the border. Conditions and venues vary considerably, from air and sea ports-of-entry in metropolitan New York City with dozens of employees to a two-person land entry point in North Dakota.

During FY 2005, we will continue to strengthen our border and port security. Our budget seeks over $400 million in new funding to maintain and enhance border and port security activities, including the expansion of pre-screening cargo containers in high-risk areas and the detection of individuals attempting to illegally enter the United States. Our budget also includes an 8 percent increase for the Coast Guard to upgrade port security efforts, implement the Maritime Transportation Security Act, and enhance other activities.

Specifically, our budget includes an increase of $25 million for U.S. Customs and Border Protection's Container Security Initiative (CSI) which focuses on pre-screening cargo before it reaches our shores. We are also seeking an increase of $15.2 million for Customs Trade Partnership Against Terrorism (C-TPAT). C-TPAT focuses on partnerships all along the entire supply chain, from the factory floor, to foreign vendors, to land borders and seaports. To date, nearly 3,000 importers, 600 carriers, and 1,000 brokers and freight forwarders are participating in C-TPAT, surpassing the Department's original goal of participation of the top 1,000 importers. In order to further protect the homeland against radiological threats, the budget seeks $50 million for next generation radiation detection monitors.

As well as continuing development for secure trade programs, the President's budget also seeks an increase of $20.6 million to support improvements for the National Targeting Center and multiple targeting systems that focus on people and/or goods. These systems use information from diverse sources to provide automated risk assessments for arriving international air passengers, shipments of goods to our country, and land border passenger traffic.

The United States Visitor and Immigrant Status Indicator Technology (US-VISIT) program's goals are to enhance the security of our citizens and our visitors; facilitate legitimate travel and trade across our borders; ensure the integrity of our immigration system; and respect the privacy of our welcomed visitors. US-VISIT represents a major milestone in our efforts to reform our borders. DHS deployed the first increment of US-VISIT on time, on budget, and has met the mandates established by Congress as well as including biometrics ahead of schedule. The budget seeks a total of $340 million in FY 2005, an increase of $12 million over the FY 2004 level. Through FY 2005, over $1 billion will be used to support this initiative.

Our budget also seeks an increase of $64.2 million to enhance land-based detection and monitoring of movement between the ports, and $10 million to plan, procure, deploy and operate unmanned aerial vehicles. In addition, the budget request for U.S. Immigration and Customs Enforcement (ICE) includes an increase of $28 million to increase the flight hours of P-3 aircraft. The P-3 has already proven itself to be a key asset in the battle against terrorism as demonstrated in the days immediately following the September 11, 2001 attacks when P-3s flew airspace security missions over Atlanta and Miami.

The Coast Guard funding increase includes over $100 million to implement the Maritime Transportation Security Act, to support the Coast Guard's ability to develop, review and approve vessel and port security plans, ensure that foreign vessels meet security standards, improve underwater detection capabilities, and increase intelligence capacity. The budget also maintains the Coast Guard's ongoing Integrated Deepwater System initiative, funding the program at $678 million, an increase of $10 million over the FY 2004 funding level.

Enhancing Biodefense

The President's FY 2005 budget reflects $2.5 billion for Project BioShield that will be available in FY 2005 to encourage the development and pre-purchase of necessary medical countermeasures against weapons of mass destruction. Project BioShield allows the Federal Government to pre-purchase critically needed vaccines and medications for biodefense as soon as experts agree that they are safe and effective enough to be added to the Strategic National Stockpile. The Administration is moving forward in purchasing the most important countermeasures and high on the list are next-generation vaccines for both smallpox and anthrax.

The Department's efforts to improve biosurveillance will involve the Information Analysis and Infrastructure Protection (IAIP) and Science and Technology (S&T) directorates. In S&T, the budget requests $65 million increase to enhance current environmental monitoring activities, bringing the total FY 2005 investment in this area to $118 million. One key component of this initiative will be an expansion and deployment of the next generation of technologies related to the BioWatch Program, a biosurveillance warning system. In IAIP, $11 million increase is included to integrate, in real-time, biosurveillance data collected from sensors throughout the country and fuse this data with information from health and agricultural surveillance and other terrorist-threat information from the law enforcement and intelligence communities.

The National Disaster Medical System (NDMS) is responsible for managing and coordinating the Federal medical response to major emergencies and federally declared disasters. For 2005, FEMA's budget includes $20 million for planning and exercises associated with medical surge capabilities. In addition, the budget transfers funding ($400 million) for the Strategic National Stockpile to the Department of Health and Human Services to better align the program with that agency's medical expertise.

Improving Aviation Security

We have made great strides to improve the safety of the aviation system from acts of terrorism. For example, we have made significant investments in baggage screening technology – over $2 billion to purchase and install Explosive Detection System machines (EDS) and Explosive Trace Detection machines (ETD) to the nation's airports from FY 2003 to FY 2005; hardened cockpit doors; deployed 45,000 federal passenger and baggage screeners at the Nation's airports; and trained pilots to be Federal Flight Deck Officers. The President's FY 2005 budget seeks to enhance our efforts in this regard and would provide an increase of $892 million, a 20 percent increase over the comparable FY 2004 level, for the Transportation Security Administration (TSA). Additional funding for TSA supports aviation security, including efforts to maintain and improve screener performance through the deployment of technology.

The Department implemented a substantially improved air cargo security and screening program last year, and the President's budget sustains funding to continue program deployment and screening technology research. In addition, the FY 2005 budget seeks a total of $61 million to accelerate development of more effective technologies to counter the threat of portable anti-aircraft missiles.

Enhancing Immigration Security and Enforcement

Comprehensive immigration security and enforcement extends beyond efforts at and between the ports-of-entry into the United States. It extends overseas, to keep unwelcome persons from reaching our ports, and to removing persons now illegally residing in the United States. The Administration is committed to stronger workplace enforcement in support of the President's temporary worker proposal announced January 7, 2004.

The requested increases include $186 million for U.S. Immigration and Customs Enforcement (ICE) - whose appropriated budget overall increases by about 10 percent - to fund improvements in immigration enforcement both domestically and overseas, including more than doubling of current worksite enforcement efforts and approximately $100 million increase for the detention and removal of illegal aliens. Detention and Removal of illegal aliens present in the United States is critical to the enforcement of our immigration laws and the requested funding will expand ongoing fugitive apprehension efforts, the removal from the United States of jailed illegal aliens, and additional detention and removal capacity.

Our proposal for ICE also includes an increase $78 million for immigration enforcement. As part of the President's proposed new temporary worker program to match willing foreign

workers with willing U.S. employers, enforcement of immigration laws against companies that break the law and hire illegal workers will increase. The FY 2005 President's Budget includes an additional $23 million for enhanced worksite enforcement. This more than doubles existing funds devoted to worksite enforcement and allows ICE to hire more Special Agents devoted to this effort. With these resources, ICE will be able to facilitate the implementation of the President's temporary worker program initiative by establishing a traditional worksite enforcement program that offers credible deterrence to the hiring of unauthorized workers. Without such a deterrent, employers will have no incentive to maintain a legal workforce.

Our budget also seeks $14 million to support our international enforcement efforts related to immigration, including enabling ICE to provide visa security by working cooperatively with U.S. consular offices to review visa applications.

We are a welcoming nation, and the hard work and strength of our immigrants have made our Nation prosperous. Within the Department, the U.S. Citizenship and Immigration Service (CIS) has improved the administration of immigration benefits to the more than seven million annual applicants. For FY 2005, the President's budget seeks an additional $60 million, for a total of $140 million, to achieve a six-month processing for all immigration applications by 2006, while maintaining security.

Increasing Preparedness and Response Capability

Though the primary mission is to protect the Nation from terrorism, the Department's responsibilities are diverse. The ships that interdict threats to our homeland are also used to help mariners when they are in distress and protect our marine resources from polluters and illegal fishing. While we must be prepared to respond to terrorist attacks, we are more often called upon to respond to natural disasters

To support the Department's efforts to respond, the President's Budget includes an increase of $10 million, for a total of $35 million in FY 2005, for the Homeland Security Operations Center (HSOC). Pursuant to the Initial National Response Plan, the HSOC integrates and provides overall steady state threat monitoring and situational awareness and domestic incident management on a 24/7 basis. The HSOC maintains and provides situational awareness on homeland security matters for the Secretary of Homeland Security, the White House Homeland Security Council and the federal community. In addition, the HSOC provides the Department's critical interface to all federal, state, local & private sector entities to deter, detect, respond and recover from threats and incidents.

The National Incident Management System (NIMS) is designed to ensure that all levels of government work more efficiently and effectively together to prepare for, respond to, and recover from domestic emergencies and disasters, regardless of cause. For FY 2005, the Department requests $7 million to ensure that the major NIMS concepts involving incident command, coordination, communication, information management, resource management, etc., are incorporated into and reflected in FEMA's national disaster operational capability. This

funding will provide for plan development, training, exercises and resource typing at the Federal, State, and local levels

Supporting State and Local First Responders

The Department has initiated consolidation of the two principal offices responsible for administering the grants awarding process for emergency responders and State/local coordination, the Office of State and Local Government Coordination and the Office of Domestic Preparedness. This consolidation provides an opportunity to tie all DHS terrorism preparedness programs together into a cohesive overall national preparedness program designed to support implementation of State Homeland Security Strategies.

The FY 2005 budget continues to support the Nation's first responders and seeks a total of $3.6 billion to support first-responder terrorism preparedness grants with better targeting to high-threat areas facing the greatest risk and vulnerability. For FY 2005, funding for the Urban Area Security Initiative (UASI) doubles from $727 million to $1.45 billion. Since March 1, 2003, DHS awarded or allotted over $8 billion to support state and local preparedness. Between FY 2001 and the FY 2005 budget request, over $14 billion in assistance will be made available for programs now under DHS. Our request for FY 2005 is slightly higher than funding sought for these programs in FY 2004.

Investing in Human Capital and Building Departmental Infrastructure

Our employees are our single greatest asset and we are committed to investing in the development and motivation of our workforce. To support our efforts in creating a model personnel system, the President's FY 2005 budget seeks $133.5 million for the implementation of a new DHS human resources system that is mission-centered, fair, and flexible by rewarding top performers. The FY 2005 budget specifically provides additional resources that will be used for training supervisory personnel to administer a performance-based pay system and to create the information technology framework for the new system. Our new system will ensure that DHS can manage and deploy its resources to best address homeland security threats and support information technology tools for workforce management.

We also seek additional funds to invest in the Department's core infrastructure. Our budget request seeks a total of $56 million, an increase of $17 million to support a new resource management system. This funding will support the design, development, and implementation for a single Department-wide financial management system. It will provide decision-makers with critical business information, e.g., budget, accounting, procurement, grants, assets, travel, in near "real-time" and eliminate stovepipes within existing systems and processes.

An increase of $45.1 million is also sought to continue expanding the DHS presence at the Nebraska Avenue Complex (NAC). These resources will enable DHS to perform tenant improvements to the facility and relocate U.S. Navy operations, pursuant to congressional authorization, from the NAC to leased facilities.

Conclusion:

We have a dedicated and skilled team in DHS who understand that what they are doing is important. We have the support of our partners in government and the public and private sectors. I thank the Congress for its support, which has been critical to bringing us to this point.

Our homeland is safer than it was a year ago, but we live in dangerous times and cannot count on times to change. That is why the Department of Homeland Security was created, and why we are moving forward. I am grateful to be here today to talk about the work we are doing to make America a safer home for us, for our children and generations to come.

Thank you for inviting me to appear before me today, and I look forward to answering your questions.

Senator CONRAD. Thank you, Mr. Secretary.
Secretary RIDGE. Thank you, Senator.
Senator CRAPO. This hearing is adjourned.
[Whereupon, at 12:15 p.m., the committee was adjourned.]

Statement of U.S. Senator Russ Feingold
At the Senate Budget Committee Hearing on the Homeland Security Budget

February 25, 2004

Thank you, Mr. Chairman. I want to thank you and the Ranking Member for holding this important hearing and I want to join my colleagues in thanking Secretary Ridge for testifying before the Budget Committee today and for answering our questions.

Secretary Ridge, you have taken on the massive task of merging 22 agencies with 180,000 employees into a cohesive department dedicated to securing the homeland. I thank you for working to improve our nation's security but I am sure that you would agree that we have a long way to go and many issues to resolve.

In reviewing the President's fiscal year 2005 budget proposal, I was immediately struck by the dramatic cuts in first responder funding in the DHS budget as well as in other parts of the President's budget. One of the most dramatic cuts was to the State Homeland Security Grant Program, which the President's budget cuts by $1 billion, a cut of almost 60 percent. The Fire Act Grants also face dramatic cuts from $750 million in fiscal year 2004 to $500 million in the President's new budget, a 33 percent cut.

The Department of Justice budget also includes dramatic cuts to crucial first responder programs such as Byrne Grants and the COPS program. I know that you have no control over these last two programs, Secretary Ridge, but I bring them up to highlight the vast cuts local first responders are facing throughout the budget, not just in DHS. It seems to me that, even as we in Congress talk about increasing the size of the military's endstrength, we are being asked to slash the number of first responders - our frontline troops at home. This makes no sense to me at all.

Secretary Ridge, I understand that the Administration's position on first responder funding is that the $3.6 billion is an appropriate level and that the money added by Congress for fiscal year 2004 was not necessary. According to one of the budget documents, the added first responder funds for 2004 were - quote - "not targeted towards homeland security capabilities and do not represent DHS-wide priorities." Given what I have heard from Wisconsin first responders and based on independent expert analysis, I must respectfully disagree with that assessment.

There are other areas where I have some concerns, including with the

implementation of the new DHS personnel system and its impact on worker rights.

However, I do want to thank the Secretary for coming here today and for his hard work. I look forward to working with him in our challenging fight against terrorism.

Statement of Senator Jim Bunning
Budget Committee
February 25, 2004

Mr. Chairman, thank you for holding this hearing. Mr. Secretary, thank you for coming up here to talk to us today.

I am quite concerned about several programs run by your department. First, I am deeply troubled by the progress of the armed pilots program. Congress first gave the Administration the authority to arm commercial pilots shortly after the September 11, 2001, terrorist attacks. After more than a year of inaction by the Administration, Congress again acted and mandated that the program be established in the bill that created your department. Last year I successfully added cargo pilots to that program.

To date approximately one percent of pilots have been armed. Tens of thousands of pilots have stated their willingness to sign up, but many have not because of problems they see in how the program is being handled by your department. I believe that there is no better last line of defense against terrorist hijackings than tens of thousands of armed pilots. This program has great potential to increase the security of our homeland at a relatively small cost.

I support rigorous training for these pilots that includes realistic simulations in an airplane environment. Your department has the authority to open multiple training sites but has not done so. Instead, you are using one training site in a remote part of New Mexico. Making training more available at convenient locations would encourage more pilots to sign up.

I am also very troubled by some of the procedures implemented in the program. It is downright irresponsible to make off-duty pilots check their loaded firearms in baggage while they are flying. That violates safety rules and prevents the trained pilot from being able to stop a hijacking.

Other pilots have been rejected from the program but given no reason. Some are former law enforcement or military. Pilots who are in the program have been harassed by law enforcement and federal officials. Many also believe that signing up puts their career in danger because of threats to pass information to the FAA or their airline.

I am not saying we should just give any pilot a gun without training, but changes need to take place. We already trust these men and women with the controls of an aircraft that could be used as a giant missile and I do not think it is too much to trust them with a gun to defend that aircraft and the American people.

I am also bothered by the Administration's plan to grant amnesty to illegal aliens. The sketchy proposal sent to Congress by the Administration rewards illegal aliens with lawful status regardless of what the program is called. I will fight against rewarding illegal behavior and will fight any funding to let that happen.

Also, federal grants for homeland security programs have been a great benefit to the states. The proposed cuts in these grants must be justified. I know there are many dollars out there that have not yet been spent, and it is unwise to put money in the budget that will not be spent. But it is also unwise to cut homeland security funds just to trim the budget. We will be looking closely at your justification for these cuts.

Finally, Mr. Secretary, thank you for your hard work. You have a demanding job and probably do not sleep well at night. Your department has made our nation a safer place and I encourage you to keep up the good work. I will work with you to fix what needs to be fixed and continue to support what you are doing right.

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Jim Bunning

Questions Submitted for the Record by Senator Jim Bunning

Armed Cargo Pilots

1. **Question: Mr. Secretary, I worked very hard last year to add cargo pilots to the armed pilots program. I am very interested in the progress of this addition to the program and am watching closely. I would like to know when the first cargo pilots will be trained and please give us a brief update on implementation of my bill.**

   Answer: We are working aggressively to incorporate cargo pilots into the Federal Flight Deck Officer (FFDO) program as soon as possible, as TSA briefed your office on April 7, 2004. Our prototype training class for cargo pilots is scheduled to begin on April 26, 2004, at the Federal Law Enforcement Training Center campus in Artesia, New Mexico. Participants who successfully complete the class will graduate and be deputized on May 1, 2004. The on-line application system was modified to accommodated cargo pilots on February 5, 2004. TSA completed a review of the existing FFDO training curriculum and made modifications to the cargo FFDO course to reflect cargo FFDO needs. Curriculum changes included development of cargo aircraft specific scenarios for the judgment pistol shooting simulator portion of the training program. Necessary changes to the standard operating procedure (SOP) are currently undergoing review.

Armed Pilots Program

2. **Question: According to press reports there are only between 1,000 and 1,500 pilots armed today. It is well over a year since the law establishing the program was enacted. I have also been told by many pilots that your unpublished screening criteria and threats to turn over your psychological evaluations of pilots to their airlines have kept them from applying. Why does it seem that the department is discouraging pilots from joining a program strongly supported by Congress and how can you justify arming so pilots?**

   Answer: The number of armed pilots is not information we publicly disclose for security reasons, but the numbers cited above from press reports are not accurate. I would be glad to provide such information to you or your staff in an appropriate setting. The number of new applicants for the program has been relatively steady for some time now. Those pilots completing the application process are scheduled for training at the earliest possible date, depending upon the pilot's availability.

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Jim Bunning

TSA does not discourage pilots from volunteering for the FFDO program. In fact, we ask graduates to encourage their colleagues to volunteer. Considering the high satisfaction ratings that graduating FFDOs give the program, word-of-mouth will be an increasingly strong asset as the program continues.

Specifically, TSA does not threaten to turn over results of FFDO applicant psychological assessment results to their airlines. However, in certain situations involving a major safety concern, TSA will notify the Federal Aviation Administration (FAA) Federal Air Surgeon about the discovery. To ensure the protection of the privacy of the individual involved, any information is first submitted to the FAA anonymously to determine if review by the FAA may be warranted. Additional information regarding the identity of the individual is only provided in those cases where the Federal Air Surgeon determines that further inquiry by the FAA is appropriate. Upon receiving this information, the Federal Air Surgeon conducts a review and takes action as appropriate. This process is necessary to address potential safety and security risks relating to pilots who fail to self-report or otherwise have conditions or issues that are relevant to their medical or pilot certification. TSA uses the FAA notification process only when absolutely necessary.

For example, if TSA became aware during the FFDO selection process that a pilot was abusing alcohol to a point that might interfere with his or her effectiveness as a pilot, the FAA Federal Air Surgeon would be provided that information to determine if any follow-up was needed.

To date, no adverse action has been taken against any volunteer for the FFDO program as a result of participation in the application process. FAA has expressed concern about the increasing prevalence of alcohol abuse by pilots and has specifically indicated to TSA that these cases should be brought to the FAA's attention when appropriate. Fewer than a dozen such referrals have been made to date, and none of these referrals resulted in further action by FAA.

How Long Does it Take to Train Pilots

3. Question: Can you tell us on average how long it is taking from the time a pilot applies to the armed pilots program until he is trained and armed?

   Answer: Typically, the time from submission of the completed application to being eligible to schedule oneself for training is 60 days. This timeframe is considerably shorter than the time necessary for a traditional law enforcement

selection process. As a result of an essentially paperless process, volunteers can move through each step quickly with virtually no bureaucracy.

We have implemented a highly efficient application and assessment process designed for the convenience of the volunteer. The pilot is notified of his or her eligibility within 24 hours of completing the initial application and can use the Internet to schedule testing at one of over 50 centers nationwide. Candidates receive another notification within 24-hours after completing the testing and can then schedule their interview with one of 35 psychologists across the nation. Background investigations are initiated once the interview is completed and the volunteer is recommended for the program. After the background investigation is adjudicated, the pilot is so notified and his or her name is placed on the list of eligible volunteers to be scheduled for training.

The biggest driver of total time the process takes is the speed with which volunteers schedule themselves for each step. The candidate controls the scheduling, limited primarily by his or her personal and professional schedule and priorities.

Lockboxes

4. Question: According to a Time magazine article, an off duty pilot's lockbox containing a gun disappeared while being stored in the baggage area of a plane. All indications are that it was stolen. What has been done to make sure this does not happen again and are you reconsidering the decision to make pilots carry their guns in locked boxes and give them to baggage handlers?

   Answer: TSA takes this incident very seriously and is pursuing an investigation. The lost lockbox referred to in the Time article is the first and only lost FFDO firearm. It must be considered in light of the hundreds of FFDO missions flown each day and the number of incidents where weapons are lost or stolen in law enforcement activities throughout the government.

   The FFDO program office works closely with carriers to ensure that training is provided to crewmembers and baggage handlers to ensure proper handling and storage of lockboxes. In some instances, lockboxes have been identified as not placed in the precise location expected, but with the exception of the one reported incident, the lockbox has always been quickly retrieved without endangering the traveling public.

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Jim Bunning

5. Question: Can you explain how this policy does not violate, or cause airlines to violate, your own department's rules against storing loaded firearms in the cargo compartment of airplanes?

   Answer: The FFDO firearm storage policy does not conflict with existing TSA rules. The FFDO Standard Operating Procedures (SOP) exempts an FFDO from 49 CFR 1540.111(c) and 1544.203(f), which generally prohibit a passenger from transporting, and an airline from permitting any person to transport, a loaded firearm in checked baggage. The SOP was issued to airlines as an amendment to the Aircraft Operator Standard Security Program. Thus, neither the FFDOs nor the airlines are in violation of the rules governing transport of a loaded firearm in checked baggage.

Budget for Armed Pilots Program

6. Question: According to the TSA, they have budgeted $25 million for the armed pilots program. That is the same amount as last year. Are you going to spend all the money from last year?

   Answer: During FY2004, TSA expects to spend the full $25 million earmarked for the FFDO program.

7. Question: Since you recently doubled the class size for training pilots, do you think this year's budget will be enough to handle the additional pilots?

   Answer: the FAA Reauthorization Act of 2004 expanded the pool of eligible pilots to include cargo pilots and other flight deck crewmembers. The $25 million earmark for the FFDO program in FY2004 will cover the cost of double classes through the end of this fiscal year.

Guns for Armed Pilots Program

8. Question: What measures have you taken to make sure enough guns are available to purchase to arm all pilots who apply for the armed pilots program, and would you be able to buy enough to arm tens of thousands of pilots this year if the program were accelerated?

   Answer: Under the original weapons contract for the FFDO program, we have an additional 3 option years that can be exercised. The Department is reviewing offers for a contract to meet all DHS firearms needs, and additional pistols for arming pilots could be purchased under that contract.

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Jim Bunning

Plans to Open New Training Facilities

9. **Question: You have authority in current law to use multiple training facilities to train pilots. You can also contract private training sites to conduct pilot training. Do you have any plans to expand the number of training sites for arming pilots, and if not, why not?**

   Answer: Based on the current rate of applications, there is sufficient training capacity at the FLETC campus in Artesia, New Mexico, to meet projected training needs for the remainder of fiscal year 2004 and through 2005. FLETC has additional training capacity available should the need arise. Currently we have no plans to expand the number of basic training sites for pilots but are certainly prepared to do so should the need arise.

   We feel that conducting basic armed pilot training in a Federal law enforcement training environment makes the best sense when possible. FFDOs are statutorily designated as Federal law enforcement officers and all Federal law enforcement officers receive their initial training at a Federal facility. Artesia also houses the Federal Air Marshal (FAM) basic training program and possesses facilities and equipment uniquely suited to law enforcement training for the commercial aircraft environment. This same opinion was recently expressed by a representative from the Airline Pilots Association in testimony before the House Committee on Small Business, Subcommittee on Rural Enterprise, Agriculture, and Technology.

   For FFDO re-qualification, TSA is using a mix of private and State owned facilities. Currently, six out of ten facilities under contract around the country for re-qualification training are privately owned. As the number of armed pilots continues to increase, we will need additional re-qualification locations. TSA plans to certify six new sites at existing facilities beginning in June 2004.

Armed Pilots on International Flights

10. **Question: I'm also going to ask Secretary Powell this question at tomorrow's Budget Committee hearing. The law creating the armed pilots program allows them to operate on international flights. According to an op-ed in Monday's Roll Call none are being allowed to do so. Why not, and is your department**

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Jim Bunning

working with the State Department to make that happen? Is the State Department cooperating, or are they the problem?

Answer: The U.S. Department of State continues to explore with foreign governments the possibility of expanding the FFDO program to U.S. flights flying internationally, and keeps TSA apprised of developments.

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Jon S. Corzine

Questions for the Record Submitted by Senator Jon S. Corzine

Baggage Screeners

1. **Question: Mr. Secretary, at Wednesday's hearing on the Department of Homeland Security's FY05 budget request, I asked about the problems facing Newark Liberty International Airport in meeting the deadline Congress established for the electronic testing of all baggage. What is the Administration doing to ensure that all checked baggage is subjected to electronic screening at these airports?**

   Answer: Since December 31, 2002, TSA has screened all checked bags electronically or using congressionally approved mitigation strategies. As TSA has reported monthly in classified reports to the Congress, there are a handful of airports where we have not yet achieved 100% electronic screening. The approved mitigation strategies in place at each one of these airports allow us to perform 100% baggage screening until all electronic systems are deployed and operational. We are working to achieve compliance as quickly as possible. TSA has signed letters of intent (LOI) with some of the remaining airports, setting the stage for the federal government to provide 75 percent of the funding needed to accommodate in-line baggage screening systems. TSA will use funding already available, along with the additional budget authority requested in FY 2005 and expected for the following fiscal years, to achieve 100% electronic screening capability.

2. **Question: I am particularly concerned that turnover for screeners is so high. The turnover rate has been reported to be 17 percent in Newark, and as high as 36 percent in other airports. What is the Administration doing to retain screeners? Are there any special plans to improve recruitment and retention of part-time screeners?**

   Answer: TSA's data for calendar year 2003 reveals that its overall screener attrition rate was 25% – 15% voluntary attrition and 10% involuntary. At Newark, the voluntary attrition rate was about 16%, and its total (voluntary and involuntary) attrition rate was about 22%. TSA's data also shows that while some Cat X airports had attrition rates as high as 36% in certain months, none of these airports had total attrition rates greater than 30% for calendar year 2003.

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Jon S. Corzine

In contrast, prior to the 9/11 terrorist attacks and the advent of TSA, screener workforces often experienced attrition rates exceeding 100%.

Much of the TSA screener attrition during calendar year 2003 can be attributed to TSA's efforts to restructure the workforce to comply with Congressionally-directed levels of 45,000 full time employees (FTE). As a result of this work, TSA reduced the size of the screener workforce by 6,000 screeners by the end of September 2003. Naturally, when putting into place strategies to lower the workforce, the attrition rate will increase. In addition to involuntary departures as a direct result of the reduction in workforce (RIF), many screeners left voluntarily for other opportunities rather than risk being subject to the RIF. Now that TSA has rightsized its workforce, attrition rates appear to be stabilizing. Data for December 2003 and January 2004 indicate that attrition rates are dropping and may reach levels comparable to the pre-reduction in force (RIF) levels.

Emerging from the RIF period, we are undertaking new efforts to recruit and retain screeners. . Our emphasis on Model Workplace practices is a major component of our plans to create a more stable working environment for our screeners. We have involved local Federal Security Directors (FSDs) in recruitment for their airports and are expanding their role even further to give them primary responsibility (with appropriate support from our contractor) for local recruitment. We are also encouraging the FSDs and the scheduling officers at the airports to work with their part-time employees to develop schedules that work for both the airport and the employees.

In December 2003, we began a pilot test at Dulles Airport of three incentives designed to make screener jobs more attractive and to keep screeners on the job for an extended period of time. First, we are subsidizing the parking of screeners at the airport. At Dulles Airport in particular, this benefit is a tremendous help to screeners on an hourly wage. Second, we have implemented a retention bonus for new hires of $1,000, half of which will be paid after 6 months of service as a screener and the other half after one year. Third, we have implemented a referral bonus of $150 for current screeners who recommend new applicants who are subsequently hired. We will assess how well these measures work in accomplishing retention and hiring goals before considering moving forward to other locations.

When other airports experience particular difficulties in recruiting and retaining screeners, we will look at these other options to the extent that are appropriate for the circumstances of the airport.

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Jon S. Corzine

3. **Question:** Given current shortages, what will the Administration do to address the shortage of screeners at Newark and the other airports in the short term? The "high season" for air travel (March through Labor Day) starts in a couple of weeks. How can we be certain that there will be enough screeners?

   Answer: TSA is aware of the shortages in Newark and other airports. We are currently working to assess trends in certain locations and developing plans to address and mitigate fluxes in the screener workforce. We are developing a Summer Airport Strategy to plan for the increased passenger flows that are expected during the "high season." We are making every effort to plan for and mitigate delays, with consideration given to specific regions normally impacted during the spring and summer seasons.

Chemical Plant Security

1. **Question:** On the broader issue of chemical plant security, will the Administration commit to a goal of getting a bill enacted into law this year? If not, then when?

   Answer: DHS IAIP closely coordinates and consults with the Homeland Security Council on important issues such as chemical plant security. DHS IAIP refers you to the Administration with respect to prospective proposed legislation.

2. **Question:** Legislation sponsored by Senator Inhofe and reported by the Environment and Public Works Committee requires owners of chemical plants to submit security plans to DHS, but does not require DHS to review those plans. Do you agree that it is not sufficient to have plans submitted to the government, if those plans can then be left to sit on a back room shelf, collecting dust? Shouldn't any legislation guarantee that the Department will review and approve these plans?

   Answer: DHS has been partnering with chemical industry to make sure chemical plants have robust security plans. This approach which also includes full engagement with state and local officials as well as the private sector in local communities, where security, preparation, and prevention occur, and has already resulted in increased the safety and security of

millions of Americans living within possible impact areas of these highest-risk sites.

Working with state and local leadership, state and local law enforcement authorities, chemical industry associations, and private sector management of chemical sites, DHS has developed:

- **guidelines for chemical facility common vulnerability assessments;**
- **a template for protection plans for areas adjacent to chemical facilities; and**
- **a report on potential indicators of terrorist activities related to chemical sites.**

These guidelines have been published (For Official Use Only) and distributed throughout the chemical sector, to law enforcement authorities, and to each state's Homeland Security Advisor. These actions are part of the strategic plan developed to incorporate and support local public safety officials in critical infrastructure protection as part of the National Strategy for Homeland Security.

Port Security

Question: Do you share my concern that only 2 percent of all cargo entering U.S. ports is examined? What steps will the Administration take to increase this security at ports?

Answer: Customs and Border Protection (CBP) screens the data and information for all cargo containers arriving in the United States each year, and closely scrutinizes and examines all shipments identified as high risk. Two years ago, 7.6% of all containers entering the United States – by land, sea, or rail – were inspected by Customs. That figure is now over 12% and still rising. But the CBP goal is not to search 2 percent, 10 percent, or even 50 percent of the cargo. CBP thoroughly screens and ultimately examines 100 percent of the shipments that pose a risk to our country.

CBP has developed a multi-layered process to target high-risk shipments while simultaneously facilitating legitimate trade and cargo. Examination of sea containers is a part of this process.

A multi-layered approach is:

- **Electronic manifest information**
- **Partnerships**

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Jon S. Corzine

- Automated Targeting System (ATS)
- The human factor
- Non-Intrusive Inspection Technology

Different modalities present different potential risks. When specific intelligence is available we will act upon it and the impact on general commerce is negligible. Without specific intelligence we use all available data to assess the potential risk of the import cargo. Based on this risk, the decision to slow down or expedite specific commerce is made. Through the use of programs such as the Customs-Trade Partnership Against Terrorism (C-TPAT), Free and Secure Trade (FAST), and other programs that foster cooperative anti-terrorism efforts with our trade partners we are able to minimize the impact on legitimate commerce.

Under the C-TPAT initiative, CBP is working with importers, carriers, brokers, and other industry sectors to develop a seamless, security-conscious environment throughout the entire commercial process. C-TPAT provides a forum in which the business community and CBP exchange information designed to increase the security of the entire commercial process while continuing to facilitate the flow of legitimate trade and traffic. C-TPAT underscores the importance of employing best business practices and enhanced security measures to eliminate the trade's vulnerability to terrorist actions.

Our goal and outcome are to steadily increase our base container inspection capabilities yearly. We are exploring our resource needs constantly. Obviously as the risk fluctuates so does the impact on our resources, and likewise on our assessments and resource needs. Our major goals require elevating our use of physical and research technology. Physical technology such as more gamma-imaging systems enhances our screening capabilities whereas research technology improves our risk scoring abilities.

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Mike Crapo

Questions for the Record Submitted by Senator Mike Crapo

Question: I appreciate and support the recognition in the FY 2005 budget for the increased need for funding to detain and remove illegal aliens. However, I have concerns about the proposal to eliminate the State Criminal Alien Assistance Program (SCAAP). The SCAAP has been quite successful in providing assistance to states and localities that face incurred correctional officer salary costs for incarcerating undocumented criminal aliens for at least four consecutive days. Because the responsibility of protecting our nation's borders lies with the Federal Government, it is reasonable that state and local taxpayers should not have to foot the bill when the Federal Government fails to adequately protect its borders. This important program provides a resource for states and counties that face additional legal costs due to enforcement of federal immigration laws.

By eliminating the SCAAP, what does the Administration plan to do to address the important issue of states and localities incurring substantial costs because of their enforcement of a federal issue without receiving some sort of reimbursement from the Federal Government for those costs? Many counties in my state of Idaho have received SCAAP funds and its elimination would leave these counties with an unfair fiscal burder for them to cover. I look forward to hearing from you about what the Administration proposes to do to address this important issue.

Answer: For FY 2005, the Administration proposes significant investments in border control and immigration enforcement efforts. For U.S. Customs and Border Protection (CBP), the President proposes in enhance Border Patrol Surveillance and Sensor Technology by $64 million for the continued expansion of the Remote Video System along the southern and northern borders thereby increasing the effectiveness of Border Patrol Agents. The expanded system will provide for significantly enhanced detection and monitoring capability between the ports of entry and increase officer safety. In addition, the FY 2005 Budget seeks $10 million to develop, procure, deploy, and operate a system of unmanned aerial vehicles to support the Border Patrol and other components of CBP.

In addition, the FY 2005 President's Budget proposes enhancements for numerous immigration enforcement efforts of the U.S. Immigration and Customs Enforcement. Funds sought will support enhanced compliance teams, detention and removal efforts, and international enforcement efforts related to immigration and visa security. These efforts will enhance our border security and bolster our ability to enforce our Nation's immigration laws.

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Mike Crapo

The SCAAP program is managed by the Department of Justice's Office of Justice Programs and was funded in FY 2004 at approximately $300 million. The Department of Homeland Security does not manage the SCAAP program and is not in a position to provide any additional data on it.

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Nickles

Questions Submitted for the Record by Senator Nickles

1. **Question: On December 21, 2001, the former INS suspended adoptions from Cambodia by American citizens. It has now been over two years since the suspension was put in place. What has been done to resolve the concerns with Cambodian adoptions and what needs to be done before adoptions by Americans can resume in Cambodia? Is there a plan in place to reopen adoptions in Cambodia? Will the suspension be lifted?**

   Answer: As you are aware, following the suspension, the INS (and now Citizenship and Immigration Services, USCIS), administered a program under the Cambodian Adoption Task Force to enable adoptions that had already been in process at the time of the suspension. I am pleased to inform you that almost all of the applications subject to the task force criteria have been processed.

   The next step in renewing adoptions from Cambodia is in negotiating a suitable program that will ensure that abuses like those that prompted the suspension will not happen again. A joint State/USCIS team recently visited Phnom Penh to discuss with Cambodian officials and others what steps might be taken to establish a suitable program. We will continue to work with the Department of State and the Cambodian Government to establish an adoption process that will protect the interest of the Cambodian people and prospective adoptive parents.

   Although we cannot force the Cambodian government to correct the problems with its process or to rid its adoption system of unacceptable practices, we can and will make sure that our processes do not cause American families to unknowingly find themselves in the emotionally-wrenching position in which some families have found or now find themselves. I hope you will understand and agree that until the Government of Cambodia puts in place a transparent, regularized, and consistent adoption process, the processing of Cambodian orphan petitions for immigration to the United States must remain suspended. This is necessary to protect the rights of all parties, most importantly, the children.

2. **Question: On November 23, 2003, I introduced a bipartisan bill entitled the InterCountry Adoption Reform Act of ICARE. The bill proposes to consolidate the former INS adoption functions into a new office within the Department of State named the Officer of International Adoptions. This**

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Nickles

Office will be solely dedicated to handling all aspects of the foreign adoption process. ICARE also streamlines the current foreign adoption process for families while continuing to maintain safeguards and protections for birth families and children. Please provide me your Department's comments on this proposed legislation.

Answer: On Tuesday, March 9, representatives of the USCIS met with members of your staff to discuss the InterCountry Adoption Reform Act. Your staff explained the intent of the legislation and noted the intent to transfer USCIS positions to the Department of State in order to stand up the proposed Office of Intercountry Adoptions. The proposed legislation will likely have implications for implementation of the Intercountry Adoption Act which implements, in turn, the Hague Convention on Protection of Children and Co-operation in Respect of Intercountry Adoption. The Department plans to meet soon with our colleagues in the Department of State to develop Administration comments to your proposed legislation.

Trains Passing Through Washington, D.C.

Questions:
A recent article by Jonathan Turley described dangers associated with tanker trains passing through Washington, D.C. Every day these trains pass under the Capitol complex. Many of these trains haul huge cars carrying industrial chemicals.

1. **Has the Department looked at trains as potential terrorist targets?**
2. **Are the tanker cars carrying industrial chemicals a potential terrorist target?**

Answer: Yes. Al Qaeda and other terrorist groups' apparent interest in rail attacks are a cause for concern. The secure transportation of hazardous materials has been a priority for DHS/TSA since our inception. The recent subway bombings in Madrid and Moscow were a terrible reminder to us all that terrorists do not limit themselves to attacking aviation targets. In fact, DHS has worked with the private sector to suspend shipment of certain hazardous materials during high threat events, such as the State of the Union address in January 2004.

DHS is leading a multi-agency task force in the Washington, D.C. metropolitan area to conduct a comprehensive security review, which includes a vulnerability assessment of the rail infrastructure. This review will be used to create a plan to address any vulnerability uncovered. We are working with all affected

U.S. Senate, Committee on the Budget
Hearing: The President's Homeland Security Budget
Wednesday, February 25, 2004
Secretary Tom Ridge

QFRs Submitted by Senator Nickles

stakeholders, including the local first responder community, local government, and railroad owners and users (VRE, Amtrak, MARC). Federal government participants in the Washington, DC security review will also partner with interested stakeholders to conduct similar efforts in two to three other cities before making the vulnerability assessment template available to the nation.

DHS is working with the Department of Transportation (DOT) to address the security of hazardous material shipments by rail through the comprehensive review of the rail supply chain. TSA and the Research and Special Programs Administration (RSPA) are also engaged in an initiative to evaluate toxic inhalation hazardous material shipments by rail. In addition, TSA and DOT have brought together experts from the response community and railroad community to participate in workshops on various rail security topics, including the role of placards and their security and safety impacts on the shipment of hazardous material by rail.

3. Question: Should we be concerned about tank cars passing near the Capitol?

Attachment: Excerpts from an article by Jonathan Turley entitled The Little Terrorist Engine That Could, which appeared in The Hill on January 28,2 004.

Answer: Clearly, as the home to all three branches of the Federal government, as well as numerous Federal buildings, foreign embassies, multinational institutions, and national monuments, the Nation's capital and the surrounding region offer a plethora of high value, symbolic targets for those who would do us harm. DHS works to identify threats, craft security measures, and ensure implementation of a host of mitigation strategies. As mentioned above, the security review in D.C. will be used to create a plan that will take these things into consideration and to address any vulnerability that is uncovered.

THE PRESIDENT'S BUDGET REQUEST FOR FISCAL YEAR 2005

THURSDAY, FEBRUARY 26, 2004

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in room SD–106, Dirksen Senate Office Building, Hon. Don Nickles (chairman of the committee) presiding.

Present: Senators Nickles, Domenici, Gregg, Enzi, Bunning, Crapo, Ensign, Conrad, Nelson, Stabenow, and Corzine.

Staff present: Hazen Marshall, majority staff director; and Roy Phillips, senior policy analyst for defense and international affairs.

For the minority: Mary Ann Naylor, staff director; and Rock Cheung, junior analyst for science and international affairs, webmaster.

OPENING STATEMENT OF CHAIRMAN NICKLES

Chairman NICKLES. Mr. Secretary, we are delighted to have you come before the Senate Budget Committee again. We appreciate your appearances both last year and this year. You have done an outstanding job. I compliment you on your leadership. As Secretary of State through a very challenging time in a lot of areas in the world, you have been an outstanding leader representing this government, this administration, and I compliment you for it.

You are here today to present the administration's budget on international affairs. This budget at this particular time, is a very big challenge. We have enormous deficits. We are calling almost for a freeze. The administration has proposed almost a freeze in all spending other than defense and homeland security, and international affairs. Your increases consume almost all the growth revenue in non-defense. It is a big increase. And so we look forward to your defending that increase.

There are big increases for the Millennium Challenge and also for the very big battle of combating AIDS. I happen to be a supporter of the Millennium Challenge, but I am also trying to put a budget together, and I realize how difficult and challenging that can be.

I welcome you before the committee. I appreciate your willingness to cooperate with us. Before I call on you for opening comments, I will ask my colleague and friend, Senator Conrad, for opening remarks.

OPENING STATEMENT OF SENATOR CONRAD

Senator CONRAD. Thank you, Mr. Chairman, and again, thank you for convening this hearing.

Thank you, Mr. Secretary, for once again coming up to testify on the budget proposal that is before us.

I think it may be most appropriate to start with the headline from this morning's paper, which should sober us all with respect to where this is all heading, that is, these massive deficits that now Chairman Greenspan has said will require cuts in Social Security in order to, in part, respond to where this is all headed.

Yesterday, Chairman Greenspan called for those cuts in Social Security. This is something I have been concerned about and have been warning about for 3 years, that the budget policies of the President are inevitably and inexorably taking us in this direction.

Fed Chairman Greenspan's Concerns About the Twin Deficits

"Given the already substantial accumulation of dollar-denominated debt, foreign investors, both private and official, may become less willing to absorb ever-growing claims on U.S. residents."

- Federal Reserve Chairman Alan Greenspan February 11, 2004

We have record budget deficits now, and the President proposes further cutting the revenue base and adding to spending. That can only make the deficits worse, more serious, and put more pressure on recommendations like the one the Chairman made yesterday to cut Social Security benefits.

When I look at the President's budget proposal for this year and compare it to previous years in International, what I see is a disturbing pattern that the budget proposed by the President is not the real budget—not the real budget for international affairs, not the real budget in other areas as well, because time after time the President has come back to us and asked us for significant increases in what he proposed in his initial budget. That is certainly true in international affairs where he came back and asked for $1.3 billion more after he submitted in budget in 2002, asked for $8 billion more in 2003, and then last year came back and asked for $21.6 billion more than his initial budget request.

Now, Mr. Secretary, I would very much like to hear from you whether we can expect another large supplemental for international affairs in 2005.

In the President's budget proposal for 2005, international affairs is receiving the largest percentage increase of any area, a 16-percent increase in budget authority. In comparison, the President proposes to increase homeland security by 5 percent, defense by 4 percent, and cut all other domestic spending by 4 percent when measured against CBO's baseline.

As you know, Mr. Secretary, and every member of this committee knows, our budget deficit is skyrocketing. We have a deficit that is forecast at $521 billion this year. I personally believe it will not be that high, but, nonetheless, it will clearly be a record, much higher than any previous deficit, at least $100 billion more than any that we have seen before.

And the President has told us, well, don't worry, the deficits are going to be cut in half over the next 5 years. I don't believe that. I don't think that is an accurate report to the American people on our fiscal condition. I don't think it comes close. The President says we are going to have a deficit of $237 billion in the fifth year. But the only way he gets there is he just leaves out things. He leaves out any defense expenditure, additional defense expenditure for the war on terror past September 30th. He leaves out dealing with the alternative minimum tax. And, most significantly, he leaves out the money he is going to have to pay back to Social Security and Medicare that he is taking from the trust funds.

So I believe we have to tackle this in a very aggressive way, and we have to go after the spending side of the equation. We also have to look to the revenue side of the equation because the revenue side of the equation is where the biggest gap has opened. This year, CBO is telling us that revenue will fall to 15.7 percent of GDP, the lowest since 1950.

Mr. Secretary, I would like to bring you back to something you said 2 years ago when testifying before this committee. I asked you then how the Nation could afford the President's proposed increase in the international affairs budget, and I asked you if we should cut spending in other areas or raise revenues to pay for it. And this was your answer: "I think where we are right now is that for the foreseeable future, for the next several years, we may well have to increase the debt, as your chart shows, in order to deal with these priorities."

Secretary Powell on Increasing Debt to Pay for International Affairs Funding

"I think where we are right now is that for the foreseeable future, for the next several years, we may well have to increase the debt, as your chart shows, in order to deal with these priorities."

—Secretary of State Colin Powell
Testimony before Senate Budget Committee
February 12, 2002

I think in light of what Chairman Greenspan said yesterday that it is appropriate to ask you: Is that still the right answer? Can we afford to continue on this course of borrowing and borrowing and borrowing, borrowing from Social Security, borrowing from the Medicare Trust Fund, borrowing from the Japanese and the Chinese and the South Koreans, borrowing from the so-called Caribbean banking centers, hundreds of billions of dollars to float this boat, whether that can possibly continue?

Mr. Secretary, I noted in a recent Newsweek column from Fareed Zakaria, a foreign affairs commentator who has often been a supporter of the President's international policies—and I will conclude on this note: "The greatest threat to America's primacy in the world comes not from its overseas commitments, explains Niall Ferguson. It is the result of America's chronically unbalanced domestic finances. The mounting Federal budget deficits that now stretch out as far as the eye can see will mean, if history is any guide, sharp cutbacks in American military and foreign affairs spending. We will see a forced retreat of America's foreign policy

similar to the years after the Vietnam War, only the cuts are likely to be much, much deeper and the resulting chaos far greater."

Bush Deficits are Threat to America's Superpower Status

"The greatest threat to America's primacy in the world comes not from its overseas commitments, explains the historian Niall Ferguson...: 'It is the result of America's chronically unbalanced domestic finances.' The mounting federal budget deficits that now stretch out as far as the eye can see will mean – if history is any guide – sharp cutbacks in American military and foreign-affairs spending. We will see a forced retreat of America's foreign policy similar to the years after the Vietnam War – only the cuts are likely to be much, much deeper and the resulting chaos far greater."

– Fareed Zakaria
"Guns, Butter And the Deficit"
Newsweek, February 16, 2004

Now, my first question to you will be: Is that going to be the legacy of this administration? And how can that outcome be avoided?

I thank you again, Mr. Secretary, for being here.

Chairman NICKLES. Secretary Powell, we welcome you to the committee. Please give any opening remarks you wish.

STATEMENT OF HON. COLIN L. POWELL, SECRETARY, U.S. DEPARTMENT OF STATE

Secretary POWELL. Thank you very much, Mr. Chairman. I do have a prepared statement which I offer for the record.

Chairman NICKLES. Thank you.

Secretary POWELL. I will summarize that statement and then be ready for your questions.

Before I begin, Mr. Chairman, let me say that we started today on a very sad note with the news that President Boris Trajkovski of Macedonia was in a plane crash which may have taken his life and others aboard the plane. He was a great friend of the United

States. I have spoken to the new Acting President and expressed the sympathy and condolences on behalf of the President and all of the American people. When I became Secretary of State in January of 2001, one of the first issues I had to deal with was a crisis in Macedonia. The place was coming apart, with a new President who was in great difficulty and anguish as to how to deal with the problems he was facing, and that was Boris Trajkovski. And I became a very good friend of his over the years and he a good friend of mine. And we worked through the problems in Macedonia to the point now where Macedonia is on a stable footing, the European Union is going to be replacing NATO with respect to providing additional support. We have much to be proud of as to what we have accomplished in Macedonia with our European friends and with the Macedonian people and the Macedonia leaders, especially with President Trajkovski. So he will be greatly missed, and we wish the Macedonian people all the best in this time of tragedy.

Mr. Chairman, let me also take this opportunity to say to you how much I have deeply appreciated your support in the years that you have been in the Senate and as a member of this committee and chairman of this committee. You have been a good friend to the Department. We have done many things together over many years, Senator, and I just wanted to take this opportunity to thank you on behalf of all the men and women of the State Department for the support that you have provided to us.

And I would like to say to the entire committee how much I have appreciated the support you have given to the Department in the 3 years of my stewardship. I made certain promises to the committee when I came in about what we would do to fix management and similar sorts of issues, leadership issues, infrastructure issues within the Department and you have supported our efforts, and I think you can see the payoff in what we are doing with respect to our Diplomatic Readiness Initiative, how more and more people are coming into the Department. We fixed the problems of the previous 10 years when people were not being recruited. Information technology has been improved. Morale has improved. And it could not have been done without the support of this committee and the entire Congress, and I express my appreciation for that as well.

Mr. Chairman and members of the committee, I want to thank you for the opportunity to testify on the State Department's portion of the President's budget request for fiscal year 2005. The 2005 international affairs budget request for the Department of State, USAID, and other foreign affairs agencies, as was noted by Senator Conrad, totals $31.5 billion, broken down as follows: foreign operations, $21.3 billion; State ops, $8.4 billion; P.L. 480 food aid, $1.2 billion; international broadcasting, $569 million; and the U.S. Institute for Peace, $22 million.

President Bush's top foreign policy priority remains winning the war on terrorism. And winning on the battlefield with our superb military forces is just one step in this process and one part of this campaign. To eradicate terrorism altogether, the United States must help create stable governments and nations that once supported terrorism, like Iraq and Afghanistan. And we must go after terrorist support mechanisms as well as the terrorists themselves.

We must help alleviate conditions in the world that enable terrorists to bring in new recruits.

To these ends, in fiscal year 2005 our foreign affairs agencies will continue to focus on the reconstruction of Iraq and Afghanistan. We will continue to support our coalition partners to further our counterterrorism, law enforcement, and intelligence operations and cooperation. And we will continue to expand democracy and help generate prosperity, especially in the Middle East.

Mr. Chairman, 48 percent of the President's budget for foreign affairs supports the war on terrorism. For example, $1.2 billion supports Afghanistan reconstruction, security and democracy building. More than $5.7 billion provides assistance to countries around the world that have joined us in the war on terrorism; $3.5 billion indirectly supports the war on terrorism by strengthening our ability to respond to emergencies and conflict situations. And, finally, $190 million is aimed at expanding democracy in the greater Middle East, crucial if we are to attack successfully the motivation to terrorism, the roots of terrorism.

Two of the greatest challenges confronting us today are the reconstruction of Iraq and the reconstruction of Afghanistan, so let me first turn to Iraq.

The Coalition Provisional Authority, under the leadership of Ambassador Bremer, and the Iraqi Governing Council have made great strides in the areas of security, economic stability and growth, and democratization. Iraqi security forces now comprise more than half of the total security forces in the country, and over time that percentage will grow. In addition, the CPA has established, working with the Governing Council, a new Iraqi Army, issued a new currency, which is quite stable, and refurbished and equipped schools and hospitals and town centers and all of the other institutions and infrastructure one needs for a democratic society. And as you know, the CPA is taking steps to return sovereignty to the Iraqi people this summer. We are still committed to a turnover of sovereignty on the 30th of June.

Much work remains to be done. Working with our coalition partners, we will continue to train Iraqi police, border guards, Civil Defense Corps, and the Army in order to ensure the country's security as we effect a timely transition to democratic self-governance and a stable future.

At the same time, we are helping to build critical infrastructure for the people—clean water, electricity, reliable telecommunications, all the systems needed for the basic needs of the people. All of this work goes on. It is going on with greater and greater effect and efficiency over time. It tends not to get the headlines, but the cellular telephone system is coming up, the land-line system is coming up. More and more people are gaining access to clean water. The electricity system is improving, and by the end of the year will be far ahead of anything that existed in the time of Saddam Hussein. Thousands of brave Americans, in uniform and in mufti, are in Iraq now working tirelessly to help the Iraqis succeed in this historic effort. Along side their military colleagues, USAID, State Department, and the Departments of Commerce and Treasury are working to implement infrastructure, democracy

building, education, health, and economic development programs. These efforts are producing real progress in Iraq.

The United Nations Secretary General's Special Advisor, Lakhdar Brahimi, a very distinguished individual, returned from Iraq recently and gave his report to the Secretary General. The Secretary General released the report on Monday of this week, and we have had the report since it went to the Security Council, and we have been studying it. By any measure, the task we are facing is going to be difficult and complicated, but it is achievable. We are going to be moving toward elections as fast as we can in Iraq, but before we can get to elections that are done openly and fairly and allow all people in the society to participate, we want to go to an interim authority, an interim sovereign, until we can get full sovereignty on the basis of a constitution and the election of a legislature, and from that process new leaders who enjoy the full support of the Iraqi people.

Creating a democratic government in Iraq will be an enormous challenge, but Ambassador Bremer, working with the Iraqi Governing Council and now with the United Nations as their full partners, is committed to success. And I think we will be successful. And the State Department is working hard to be prepared to assume a leadership role on the 1st of July, when the CPA will go out of existence and we will have a large embassy requiring new resources to stand up. It will be the largest diplomatic presence we have anywhere in the world.

Afghanistan is another high priority for the administration. The United States is committed to helping build a stable and democratic Afghanistan that is free from terror and no longer harbors threats to our security. After we and our coalition partners defeated the Taliban government, we faced the daunting task of helping the Afghan people rebuild their country. I remember those first few days when President Karzai went in, no telephones—one telephone for the entire government. No money, no accounts, no nothing. No desks, no computers, no nothing. And in a short period of time in the sweep of history, in just a couple of years, we now have a functioning government that is increasingly reaching out to take greater control over the outlying provinces, to bring order throughout the country, a currency that is relatively stable. We are giving more and more technical assistance to Afghanistan so that they can get higher up on the food ladder and on the economic ladder and on the democracy ladder, women are being integrated into the society in every way possible. The lives of women and girls have improved so much over the past 2 years and will continue to in the years to come.

Since 2001, the United States has rehabilitated 205 schools, 140 health clinics, and trained 13 battalions of the Afghan National Army. It is still a dangerous situation. We saw five aid workers were killed yesterday by those remnants of the Taliban and other terrorists in Afghanistan, particularly in the southeast part of the country, that we know our work is not yet completed. And we are working, as you may have noted in the press recently, with our Pakistani friends to do more with respect to bringing that part of the country under control, also working with our NATO allies to increase NATO presence in the country, increase the number of pro-

vincial reconstruction teams working in the country so that the countryside can be made safe for democracy and for development efforts.

We are also pleased that we completed the project to pave the road from Kabul to Kandahar, and that was successfully done. The 30-hour journey is now down to just 5 or 6 hours. It is not just a road and the journey. We are connecting the country once again so it is viable.

While the Afghanistan of today is very different from that of September 2001, there is much left to be done, and we will be participating in a conference in the not-too-distance future with our friends and allies to see what else we need to be doing to help the Afghan people and President Karzai.

The challenges we face in Iraq and Afghanistan are complex, daunting, and dangerous. We must not lose sight of the simple fact that two despotic, awful, terrible, miserable, disgraceful regimes are no longer in power, either in Kabul or in Baghdad. And both the people of Iraq and the people of Afghanistan have a brighter future to look forward to. Lives have been spent in this cause, the brave lives of coalition soldiers and the brave lives of civilians who gave their lives as well. And we mourn for them, but we will never, ever let their families think that they were lost in vain. They were not. It is a noble cause that they have been involved in, in both Afghanistan and Iraq, and it is up to us now to keep that work moving forward and not to shrink from the challenges ahead and to recognize all that we have achieved so far.

It is expensive work. As I said 2 years ago, Senator, we were facing new challenges, and it might require additional debt to get ourselves through this period of challenge. That challenge is still with us. We have had to come in for significant supplemental increases for reconstruction efforts, for our defense efforts, and for our international affairs efforts. And the President is committed to doing everything he can in accordance with the plan that he has submitted to the Congress to bring the deficit under control, cutting it in half within the timeframe that he indicated. And I can assure you that he recognizes that this is an important task for the administration. And so we all have been told to make our requests as reasonable as we can, to seek no increases that are not necessary, to find savings within our budgets, and I think that is what we have tried to do in the State Department submission for 2005.

As I mentioned earlier, the 2005 budget for international affairs provides more than $5.7 billion for assistance to countries around the world that have joined us in the war on terrorism, including Turkey, Jordan, Afghanistan, Colombia, Pakistan, Indonesia, and the Philippines.

While progress has been made attacking terrorist organizations both globally and regionally, much more remains to be done, and the President's budget supports that effort. A few highlights: $700 million for Pakistan to help advance security and economic cooperation and opportunity for Pakistan's citizens, including a multi-year educational support program; $461 million for Jordan; $577 million for Colombia to support President Uribe's unified campaign against drugs and terrorism.

In September 2003, at the United Nations, President Bush said, "All governments that support terror are complicit in a war against civilization. No government should ignore the threat of terror, because to look the other way gives terrorists the chance to regroup and recruit and prepare. And all nations that fight terror, as if the lives of their own people depend on it, will earn the favorable judgment of history." We are helping countries to that judgment.

Two weeks ago, the President spoke at the National Defense University and spoke about another threat that we are facing—the threat of proliferation of weapons of mass destruction technology. The President described how we have worked for years to uncover one particular nefarious network, that of Dr. A.Q. Khan.

Men and women of our own and other intelligence services, especially the United Kingdom, were able to understand that network and provide information about A.Q. Khan to other nations. And we now know that he was providing nuclear technology and information to Libya, Iran, and North Korea.

At the NDU speech that the President gave, he proposed specific measures to take to strengthen the world's efforts against networks such as A.Q. Khan's and others who would proliferate weapons of mass destruction knowledge and technologies around the world. We are hard at work on that. We have seen results.

We can be very proud, Mr. Chairman and members of the committee, of the fact that as a result of U.S. and U.K. efforts, Libya came to a conclusion, as they looked around the world, they saw that the United States and coalition partners were ready to take action against nations such as Iraq. But I think Libya did more than that. They looked and said: "We have spent millions and millions of dollars to acquire the wherewithal to perhaps someday acquire a nuclear weapon. We have spent millions and millions of dollars to produce chemical weapons. We have looked into biological weapons technology. What has it gotten us? It has made us a pariah on the face of the Earth. Nobody will deal with us. Nobody will invest in us. Nobody will come here. What we have seen is nothing but supporters of terrorism and procurers of weapons of mass destruction. What has it done for us? Has it made us safer? No. Made us more secure? No. Fixed our health care system? No. Made us more able to participate in the 21st century economy? No."

And so Colonel Qaddafi decided this was the wrong way to go, and he got in touch with us and our friends from the United Kingdom. An arrangement was worked out, and you know the rest. He is cooperating fully in giving up these programs. Much of the material that he acquired is being sent back out of the country. We have possession of quite a bit of it, and we learned a great deal about A.Q. Khan and the other proliferators in the world. And we hope that this will be a signal to other countries around the world that it is fool's gold, it is ridiculous to invest in these kinds of technologies, because you will not scare the United States of America, you will not scare our coalition partners. All you are doing is denying yourselves the opportunity for a better relationship with the United States and with the rest of the civilized world.

Mr. Chairman, moving on, on Monday of this week, Ambassador Tobias, Randy Tobias, who now heads up our global AIDS effort,

Secretary Thompson, USAID Administrator Andrew Natsios, and I rolled out the strategy for the President's emergency plan for HIV/AIDS relief: $350 million in contracts to some of the NGO's and private organizations who will be carrying out the fight at the grass-roots level. Making that announcement on Monday was a thrilling moment for me and the result of a lot of hard work on the part of Secretary Thompson and Administrator Natsios and Ambassador Tobias and all of my colleagues in the State Department, and so many others.

With this program, the President has once again indicated his commitment to go after one of the great, great threats to civilization, and that is HIV/AIDS. Eight thousand people are dying every day as a result of HIV/AIDS, and we are going to do something about. It is a $15 billion program. It is dedicated to go after the source of this disease. It is also intended to educate people on how to protect themselves from the disease, and for those who have acquired the disease, to provide them with the wherewithal to live a life that is still of a quality nature. It is going to help those who have been made orphans by the disease. It is going to do everything we can to try to get this disease under control and educate the world about the nature of this disease.

But it takes money, and we are very proud of the program that we have put forward to the Congress. We are very proud that the Congress has seen fit to support the first year of this program, and I hope that it will support the program in the years to come.

Another part of the President's agenda for the world has to do with the Millennium Challenge Account, an account where we will take American taxpayer dollars and make those dollars available to developing nations, but in this instance, only those developing nations that are committed to democracy, committed to the rule of law, committed to ending corruption, committed to market reforms and market economic policies. And we are standing up that corporation, and I am Chairman of the Board of Directors, and Mr. Paul Applegarth has just been nominated by the President to lead the corporation. We had our first board meeting not too long ago, at the beginning of this month, and we are ready to go to work. And we appreciate the Congress for the $1 billion it made available in this first year.

Mr. Applegarth and Ambassador Tobias were over at my home the other evening for a little supper. They are both sort of road-running, as we say in the military. They are working here. Their families are still at home in another part of the country. And we just sat and talked. The longer the three of us talked, the more I could see the synergy that will exist between what each of them is doing, because they go together. Developing countries are doomed if they don't do something about HIV/AIDS. And people who are suffering from HIV/AIDS are doomed if their countries are not doing something about poverty alleviation and getting into the 21st century world with the rule of law and with the right kind of development policies.

And so these two programs will reinforce one another and are essential parts of the President's strategy for moving forward. They take money, but it is money well spent. And it shows America's

commitment to the developing world, especially the developing world in Sub-Saharan Africa.

There are so many programs like that in the budget that we are asking you to support. It does reflect an increase. It is one of the most significant increases, as Senator Conrad noted, in the discretionary part of the budget. But, you know, we really are in the front lines of foreign policy with our programs. USAID, the diplomats that are doing such a great job around the world, they are in the front line of foreign policy. They are the ones that are carrying our value system out to the rest of the world. They subject themselves to the kinds of dangers that their military colleagues do. Whether it is Ambassador Jim Foley in Haiti today, who is facing a difficult situation or the other Ambassadors that have passed through my office recently. Our Ambassador to Georgia helped the Georgian people through a crisis last November when the a President stepped down. He helped create circumstances, working the new leadership of Georgia, so that a new democratically elected President could take office. And that President with President Bush the other day. Or our Ambassador in Liberia, who was faced with a very difficult situation last year as people were firing at his embassy, as dead bodies were being placed before the embassy.

But we worked with the Liberians. We worked our way through that. And now Liberia is on a path hopefully to peace and stability. We had a donors' conference at the U.N. a few weeks ago and we raised $500 million for Liberia. It was American political activity, a little bit of American military strength, American support for regional solutions, American support for a political compromise that showed us the way forward.

I could go to country after country around the world where our wonderful diplomats, working alongside so many other great Americans from all of the agencies of government work hard to serve the interests of the American people. And so when you support our budget, you are supporting that kind of effort, and you are bringing reconciliation and peace to places like Libya, Iraq, Georgia, Liberia. We are working hard in Haiti today to try to find a solution to that difficult problem.

Our diplomats are hard at work in Beijing today with the North Koreans, the Chinese, and the South Koreans, the Japanese, and the Russians, and the results of the first 2 days of meetings are positive. There is a positive attitude. There is a promising attitude that is emerging from those meetings, and hopefully we can move in the right direction there.

Diplomacy tends not to be something that happens overnight. You don't see your successes right away. You see day after day after day after day failure, and then suddenly you get a breakthrough. And that kind of dogged, determined work is what the Department is all about. Because of what you did for us over the last several years, we have tens of thousands of American youngsters wanting to be a part of this Department. Thirty thousand people are year now are signing up to join the Foreign Service. They want to be a part of America's team on the front line of foreign policy. And it is because you have said we are going to invest in information technology, we are going to invest in the benefits that you de-

serve for going out and serving your Nation. Well, they are responding, and they are serving their Nation.

So, in conclusion, Mr. Chairman, members of the committee, let me just say keep supporting us because I think you are getting a hell of a return on the investment that the American people place in our international affairs accounts. And I promise you that as long as I am there with my team—Deputy Secretary Armitage and Under Secretary Grant Green and all the others, and Administrator Natsios—we will be good stewards of the people's treasure. I am not spending my money. I am spending American taxpayer money. And I know that we also have to go in debt to finance some of our activities right now. We are all sensitive to that. We are all doing what we can to give you the best return on your investment, and we are all working with the President to get the deficit down and to put the Nation on the kind of balanced financial footing that Senator Conrad spoke to earlier.

Mr. Chairman, I will just stop at this point and be available for your questions.

Chairman NICKLES. Mr. Chairman, thank you for your opening statement. We have several colleagues. Let me make sure that all of our colleagues are aware of the fact that we plan on marking up the budget next Wednesday and Thursday. It is my intention to submit a budget document to markup on Wednesday and I expect to mark it up on Thursday. So you might expect—if we maintain our tradition, Thursday could be a rather long day. Maybe it won't be. Maybe it will be very short. But I wanted to make sure that everybody is aware of that and notified of that.

Mr. Secretary, two or three very quick little comments. And I am going to ask all of our colleagues, the Secretary needs to be out by noon, and if we can all keep our comments close to 7 or 8 minutes, I think we can accommodate that request.

You mentioned the President of Macedonia unfortunately was killed. I happened to know him as well. I haven't heard. Was that an accident?

Secretary POWELL. It appears to have been an accident, flying in mountainous terrain in bad weather.

Chairman NICKLES. That is very difficult terrain. I hate to see that happen because he was really leading that country in the right direction.

Just a couple of other comments. You mentioned now that the U.N. is cooperating with us much more in Iraq. I am concerned. When there was an unfortunate bombing incident right outside their headquarters, the next thing we know, the U.N. was pulling out. We have shown great leadership, and I compliment you, I compliment the President, I compliment Ambassador Bremer and others. I have a staff member that is working over there. A lot of us have—all of us have constituents that are serving over there. But I am always questioning sometimes the UN's resolve, and maybe that is just an editorial comment and I am not asking you to respond to it. But I am concerned.

You mentioned it was a noble cause. It is that and more. I look at what this administration has done in Afghanistan and in Iraq, and I look at it as a liberation. As you mentioned, the women in

Iraq now have freedoms that they did not enjoy before, their country was liberated.

I object to the term "occupation." We are planning on leaving. Correct me if I am wrong.

Secretary POWELL. Absolutely.

Chairman NICKLES. And so we are in the process of trying to expedite turning over total government control to the Iraqi people in a systematic way as soon as possible. It is a liberation. I would encourage your people maybe to use that word.

One other comment. You mentioned Mr. Khan and the fact that he had distributed nuclear secrets. I don't see him being punished, and I am concerned. This individual evidently was spreading nuclear secrets throughout the world to, as you mentioned, North Korea and Iran and Libya. It looks like he is getting off scot-free, and I am interested in your comment on that.

Secretary POWELL. Very quickly, with respect to the United Nations, after the bombing last year that killed Sergio de Mello and so many others, the Secretary General had to take stock of the security situation. They are not soldiers. They don't have a green zone. They have to be out where they can do their work. And they had to withdraw in order to assess security and figure out how they could do their work.

I think we have demonstrated to the U.N. that the situation is improving, and we want to work closely with them on making sure that they can do their work in relatively safe conditions. You can never guarantee safety. Casualties are occurring every day.

The U.N. has started to come back. Mr. Ross Mountain, a New Zealander, is in charge of humanitarian efforts of the U.N. For the most part, they are trying to headquarter these efforts from nearby countries, thereby reducing their vulnerability. But I expect their efforts to grow in the weeks and months ahead.

We were able to arrange security for Mr. Lakhdar Brahimi, when he went in. And we are in constant touch with the Secretary General because after 1 July, we expect an even greater U.N. presence getting ready for the elections at the end of the year or some time next year, whenever they occur.

And so we are working closely with the U.N. They have to have some level of confidence in security before they can put their people into dangerous situations. But they are anxious to play the vital role that the President has anticipated they would play.

With respect to A.Q. Khan, as you know, Senator, he was seen as a national hero in Pakistan, and he occupies a special place in the life of the Pakistani people. President Musharraf is well aware of what Mr. Khan has been doing. I have had many conversations with President Musharraf about this. I think he took a bold step, the right step to uncover it all and not hide from the reality of what A.Q. Khan had done. And he got from Mr. Khan full acknowledgment of what he had done and a lot of information. And then President Musharraf felt it was in the best interest of his country and of his government and of the process of uncovering everything we could about this network for him to give a conditional amnesty to Mr. Khan.

Chairman NICKLES. Did he cooperate?

Secretary POWELL. He was cooperating.

Chairman NICKLES. Did Khan cooperate with Musharraf as far as saying here is what I did, here is where the information was going?

Secretary POWELL. Yes. Dr. Khan cooperated with President Musharraf and with the Pakistani investigators who were pulling all of this up, with assistance from us because we had quite a bit of information we could provide to them. So we are getting a lot of information out of Dr. Khan's openness, and I expect we will get a lot more as well. And it is important to note that the amnesty he was given is a conditional one, meaning he has to meet the conditions of the amnesty, which means full and open disclosure. And we are learning a lot from that.

Chairman NICKLES. Thank you. One other comment. You mentioned about 48 percent of your budget is directed toward fighting terrorism for international security and so on. You also mentioned the terrorist attacks. Some people have said that your speech before the U.N. was hyped, that our going into Iraq was hyped or inflated or misled. I have heard some people say that we are misled into going into Iraq—or lied to, some people use that term.

I looked at a speech that President Clinton gave in 1998, I think it was made to the Pentagon, and he said something like, "Now, let's imagine the future. What if he fails to comply?" And he is talking about Saddam Hussein. "If we fail to act or we take some ambiguous third route, which gives him more opportunities to develop programs of weapons of mass destruction, and he continued to press for release of sanctions, continuing to ignore the solemn commitments he has made. Well, then he will conclude the international community has lost its will, he will conclude that he can go right on and do more to rebuild an arsenal of devastating destruction, and someday, some way, I guarantee you he will use the arsenal."

That was President Clinton. That was made in 1998. That was made in February 1998.

I might mention we had two embassies that were bombed later that summer in Africa, killed a couple hundred people, all employees of the United States, some U.S. citizens.

I am offended when people use words like "deliberately misled." I happen to know you well, and you are my friend. And President Bush is my friend. And this is serious. When people make allegations of being lied to or misled leading up to this war, I am offended by it.

You have been brought into it because of your excellent speech, I might say, before the United Nations a year ago—was that a year ago?

Secretary POWELL. 5 February last year.

Chairman NICKLES. It was about a year ago. Anyway, any comment on that?

Secretary POWELL. Yes. Let me say, Mr. Chairman, that President Clinton's statements and his actions during his Presidency, to include Operation Desert Fox, which involved the bombing of weapons of mass destruction facilities in Iraq in 1998, was based on the best intelligence that he had at that time. And it was a consistent picture that the intelligence community was giving us over time through his administration and into President Bush's administra-

tion which was that Saddam Hussein had never lost the intent to have such weapons, that he kept in place the infrastructure for such weapons. There was no doubt that if he was ever relieved of the pressure of sanctions, he would explode his capability and show it to the world again. He had used them before; he had used them against his own people; he had used them against his neighbors. And we believed, as President Clinton did, we believed that there was a stockpile of these weapons.

When I went before the United Nations last 5 February, I knew very well that I was representing the views of the American Government to the entire world. And I wasn't going to go hype anything or overstate anything. I wasn't going to short-sell anything either. And I spent 4 days and nights out at the CIA with Director Tenet and with Deputy Director McLaughlin and with all their experts going over that presentation. And there wasn't a word in that presentation that wasn't the considered judgment of the intelligence community. Not everybody agreed with every single fact or finding, but it was the considered judgment of the intelligence community, and it represented the judgment of the Director of Central Intelligence. And it was based on the evidence that was available to us, not cooked. The analysts were in the room with us when we made those judgments and wrote that speech.

And so if you look at it in retrospect, it did reflect the considered judgment not only of our intelligence services, but of the United Kingdom and most intelligence services that had looked at it. Any prudent person receiving the intelligence that I did or the President did, Prime Minister Blair, Prime Minister Aznar, Prime Minister Berlusconi, Prime Minister Howard, and so many others did, would have come to the same conclusion. This is a regime that had not given up these programs, had the intent, had the capability, was working on the delivery means, had done it before, was desperately trying to hide it, was desperately trying to get out of the sanctions that had kept it somewhat constrained. And you could reach the conclusion based on what the intelligence community had that there were stockpiles of such weapons.

Now, the stockpiles are the only thing in my mind that is an issue. Dr. Kay, when he went in to start looking for this last year, thought there were stockpiles. He has now come to the conclusion that stockpiles are not there.

Mr. Dulfer, who has gone in to replace him, will continue the work, look at additional sites, look at the documentation, interrogate people to see if more can be found out. But it seems to me that is the area that is in judgment. But nobody made up the information last year. It reflected the best judgment of the best people we have who were going about this trying to find the truth, not to hide the truth or to cook the books.

And so I stand behind what the intelligence community gave us as Director Tenet stands behind what he gave us. As new information comes forward which puts into question old information, let's examine it. If mistakes were made, let's find out what those mistakes were and fix our process going forward.

Chairman NICKLES. Mr. Secretary, thank you very much.

Looking at the number of colleagues, again, I am going to ask all my colleagues to try and keep it pretty close to 7 or 8 minutes. Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

Mr. Secretary, you are a forceful advocate of important work that needs to be done in the war on terrorism and the global fight on AIDS. You are asking here for a 16-percent increase. The question for this committee is how to pay for it. How to pay for it.

Are these increases so important that they should be paid for by cutting spending in other areas or by raising taxes? Because I think the answer of just borrowing more money is really no longer an option. We have record deficits now, and we are not going to have the deficit cut in half, as the President has said. That I think is utterly outside the question when one looks at the hard reality of where this is all headed.

So I would ask you: Are these priorities so important that you would advocate cutting spending in other areas—and if so, where?—or raising taxes to pay for them?

Secretary POWELL. I believe these are important priorities. As the President put his budget together, all of us had to compete our programs. In recognition of the finite resources available to the Nation, the President was strict in his guidance to us. OMB was strict in their application of that guidance, and so our programs competed with other discretionary spending and with the Defense Department's needs.

My figures suggest that we are 7.1 percent above 2004, including the supplemental, 2004 actual to 2005, 7.1 percent. I think it is a reasonable amount for the kinds of challenges we are facing on the war on terrorism, standing up new facilities in Iraq, and all that we are being asked to do on the war against HIV/AIDS and the Millennium Challenge Account.

Now, it is always a question as to am I taking spending from someone else or am I just asking for the debt ceiling to be raised or am I asking for new taxes? I think that is a judgment that the President has to make in consultation with the Congress, and the Congress ultimately answers that question in the manner in which they act on the President's budget. But what we try to do is put forward only those priorities that we felt were essential and were deserving of additional spending in 2005, Senator.

Senator CONRAD. Let me put up this Newsweek article that I quoted from earlier. "The greatest threat to America's primacy in the world comes not from its overseas commitments, explains historian Niall Ferguson. It is the result of America's chronically unbalanced domestic finances. The mounting Federal budget deficits that now stretch out as far as the eye can see will mean, if history is any guide, sharp cutbacks in American military and foreign affairs spending. We will see a forced retreat of America's foreign policy similar to the years after the Vietnam War, only the cuts are likely to be much, much deeper and the resulting chaos far greater."

Bush Deficits are Threat to America's Superpower Status

"The greatest threat to America's primacy in the world comes not from its overseas commitments, explains the historian Niall Ferguson...: 'It is the result of America's chronically unbalanced domestic finances.' The mounting federal budget deficits that now stretch out as far as the eye can see will mean – if history is any guide – sharp cutbacks in American military and foreign-affairs spending. We will see a forced retreat of America's foreign policy similar to the years after the Vietnam War – only the cuts are likely to be much, much deeper and the resulting chaos far greater."

– Fareed Zakaria
"Guns, Butter And the Deficit"
Newsweek, February 16, 2004

Secretary POWELL. Well, I don't know that I can agree with either Professor Ferguson or my good friend who I admire, Fareed Zakaria. America's primacy in the world is unchallenged today, and it will be unchallenged in the future. I think people recognize that America does have some budget difficulties, but they also have confidence in the American political system and the American economic system to deal with this over a period of time—maybe not in a year or two. And it is unfortunate we have gone from a surplus to a deficit situation, but we had emergencies thrust upon us. And we have to work our way through this. And the President made judgments with respect to tax cuts, with respect to his economic plan, with respect to how much deficit we could sustain right now and how to get out of that deficit position. And I don't think it is undercutting our position in the world, and right now we have demonstrated to the world that we will not shrink back from our responsibilities to go after terrorists and we will not shrink back from our obligations in Iraq and Afghanistan.

I don't see anybody coming to my office saying we are worried about you guys losing your primacy in the world. We will remain

the primary actor in the world, the sole superpower—not a superpower that imposes but a superpower that looks for allies and partnerships.

So I don't quite come to the same conclusion that Niall did or Fareed did.

Senator CONRAD. Let me just say to you, I have not come to your office, but I will tell you, I have looked at the long-term projections the President has made, not just the next 5 years but his long-term projections of what happens with his proposed tax cuts and the increased cost as a result of the retirement of the baby-boom generation. We saw yesterday the Chairman of the Federal Reserve tell us those imbalances are so great that we have to cut Social Security.

Now, you know, the explanation that somehow it is all just going to work out is becoming an increasingly hollow explanation. I don't think it squares with the facts that we see before us, either in the immediate term or in the term beyond the 5-year budget window. And that is why people like Mr. Zakaria, who is, I think, in many ways an ally of yours on many issues, and a noted historian are warning us—are warning us—where this all leads. And it leads to incredibly serious choices in the years ahead. It will be very hard to see how international affairs will be exempt from substantial cuts, and even defense.

I would be happy to have you respond to that if you would care to.

Secretary POWELL. Well, I think I have, Senator. I am not competent to judge what needs to be done or not done with respect to Social Security. I do know that the country has vital needs now with respect to international affairs and defense expenditures. I do know that the challenges we are now facing were thrust upon us at the beginning of 2001, and we are responding to it. And it has put a great deal of pressure on our Federal budget, causing the deficit.

And I know that there is debate about the President's tax cuts, but he is confident that the tax cuts will lead to economic growth which will benefit the American people, and he has a plan. And you may disagree with the plan and believe that it is unachievable, but, nevertheless, it is the plan that he was submitted to the Congress that he believes will halve the budget in the period of years that you indicated earlier. And that is a debate that the Congress, of course, will have in the course of the year with the President.

Senator CONRAD. Let me just say in conclusion, I think the notion that the President has floated that this is going to cut the deficit in half is entirely a fiction—entirely a fiction. I mean, I am surprised he didn't say it was going to eliminate the deficit, just leave our some more things. But when you leave out the costs of the war past the end of September, when you leave out the crisis with the alternative minimum tax, when you leave out the $2.4 trillion he is borrowing from the Social Security Trust Fund, every penny of which he has got to pay back—he has no plan to do so—it leads people like the Chairman of the Federal Reserve to conclude that you are going to have to cut Social Security, and much else as well.

So I would say to you I have enormous respect for you. But the policy of just continuing to increase expenditures and borrow the

money I don't think stands up. And we are going to have to do much better.

Chairman NICKLES. Senator Conrad, thank you very much. I hope to have a budget next week that will cut the deficit in half, and it will be real.

Senator Gregg?

Senator GREGG. Thank you, Mr. Chairman, and I will be happy to debate Senator Conrad on his points in the future because I disagree with them. But today we are here with the Secretary of State, who has been a leader in what is one of the—what is the true issue that faces our country, which is that we are at war, and that whether we like it or not, there is a culture out there whose purpose it is to destroy our culture. And they have already shown that they are willing to kill innocent men and women to do it. And if they get their hands on a weapon of mass destruction, they will use it against us, whether it is biological or chemical, and they will kill thousands more Americans. And our purpose must be to defeat them, to find them, to chase them around the globe.

And I admire the fact that this President has been myopic in his efforts to pursue that course, and I admire the fact that he has surrounded himself with people who understand the threat and who are also equally committed to defeating them.

I think if we look at the track record of this administration, it is really rather extraordinary in this fight. If you look at what we have done in Afghanistan, in Iraq, if you look at what is happening in Libya, North Korea is starting to move, it appears, Iran has opened itself up to review of its nuclear programs—these are extraordinary steps in the right direction, and they are steps which are a function of the fact that we have shown strength and commitment.

I can see scenarios where we would have still been debating with the Taliban as to whether or not we would have gone in there under other administrations, and we didn't take that course. So I congratulate the administration and the Secretary of State for their aggressiveness in this fight, because that is what it takes.

It also takes a strong State Department, and I appreciate the Secretary making the point that we as a Congress have stood by the efforts with the DRI program, with the IT program, with the embassy security program, with the visa/passport program, so hopefully the subcommittee that funds them is not a national security risk. But there are some specific concerns I have which are tangential to the larger issues, but which I would like to raise with the Secretary because our time is limited.

The first is Charles Taylor. Not many people focus on Charles Taylor. I have been focusing on him for a long time, ever since his horrific actions and the genocide he created in Sierra Leone.

The tribunal in Sierra Leone has indicted him as their first act. It was a courageous act when the indicted him. It was led by an American prosecutor. I think his name is Thomas, although I am not sure. And now that they have indicted him and Taylor has been forced out of his country, it appears that we cannot get him before the court. And he should come to Sierra Leone and be tried. He should be brought there and tried.

This Congress has put a bounty on the effort to try to get him to Sierra Leone and try him, because if we don't try him in Sierra Leone, no future tribunal that is structured on the issue of genocide, whether it is Rwanda or what is happening in the Congo, is going to have legitimacy. This man cannot be allowed to live under the aegis of a foreign country and be given that protection.

I am just wondering what the State Department's position is on getting him to Sierra Leone to be tried.

Secretary POWELL. We believe he should be tried. We believe that ultimately he will be brought to justice before the tribunal.

We had a challenge last year. We had a rapidly deteriorating situation in Liberia. The people were suffering badly—starvation, we had mobs running around. We had different resistance groups terrorizing the people. And we had to find a solution to all of that that would bring the situation under control and get rid of the leadership that was there, namely, President Charles Taylor.

And after working with our friends in ECOWAS, the Economic Community of Western African States, we came up with a solution that would get Charles Taylor out of power, out of the country, but the only way we could arrange that to happen was to put him in a country where he would not be immediately subject to the tribunal and he would not be moved from that country to the tribunal.

It wasn't a perfect arrangement. We would have preferred another arrangement. But we had to deal with a real emergency at that time. And so it was an arrangement that was entered into by ECOWAS and we supported it. And as a result, Charles Taylor is no longer in power. He is no longer protected by his goons, and the Liberian people are heading toward a better future. He went to Nigeria, the country that was willing to host him as long as we didn't put pressure on Nigeria to immediately turn him over to a court. We made it clear that we believe he is still subject to that tribunal. We made it clear that we believe this is still a matter between him and that tribunal. And we hope and we work for a set of circumstances to come about where it will be possible to turn him over to the court and put him before the court.

Senator GREGG. Well, as you know, the——

Secretary POWELL. But for the moment, I am obliged to respect the political arrangement that was entered into which got him out of the place, out of Monrovia in the first place.

Senator GREGG. I would hope that we have been generous enough to Mr. Taylor. It is time for him to be brought before the court. I think we should not be standing in the way of that, but I think we are.

On another issue, which is really tangential, and which I suspect you have not focused on, and that is the security of the families of our—I know you have focused on the security of our families abroad. This has also been a priority of mine, but I now learn that the State Department has taken a position that if you go to an American school which is not receiving grants from the State Department, that that school will not be able to access the security funds which we put in the budget last year, and which you were kind enough to actually suggest an increase in. Whether you are in an America school that gets grants from the State Department

or not get grants from the State Department, if a school is called an American school, it is a target unfortunately, and the whole purpose of these funds were to protect all Americans, especially families of State Department personnel overseas.

I am wondering why this policy was put in place. It seems to be counter to what the intent—I know it is counter to my intent when I put the money in. It seems to be counter to the logic of the purpose of protecting these families.

Secretary POWELL. I feel a very heavy obligation to protect not only my embassy compounds, but places where families live, where they go for recreation, and especially where they send their children to school. I need to give you an answer for the record.

Senator GREGG. What I would really like you to do is change the policy. It makes no sense on its face.

Secretary POWELL. Sir, I will look at it——

Senator GREGG. After you have looked at it.

Secretary POWELL. Let me look at it before I——

Senator GREGG. I agree.

Secretary POWELL [continuing]. Change it, to find a reason for it first.

Senator GREGG. But please review. Thank you. I congratulate you for the job doing. I think it is extraordinary the progress that has been made, as I mentioned earlier, in these core areas of our national security, especially obviously, Afghanistan and Iraq. North Korea now appears to be moving, and Iran, and Libya, of course, and that is only a function of the fact that you and the President have shown a very strong hand and been willing to play it. Thank you.

Secretary POWELL. Thank you, Senator.

Chairman NICKLES. Mr. Gregg, thank you very much.

Information from our colleagues: we have roll call that is now ongoing I think for about 5 minutes, just FYI.

Senator STABENOW.

Senator STABENOW. Thank you, Mr. Chairman.

Welcome, Mr. Secretary.

Secretary POWELL. Thank you, Senator.

Senator STABENOW. First I would thank you for your service, and also say that I think it is good news that we have men and women wanting to be involved in foreign service, and coming to the Department of State we need the best and the brightest serving in very difficult circumstances.

Two areas of question. First, because we are talking about the budget, I want to focus on the budget and what our priorities and choices are. When we look at this budget right now it is not complete. When we look at it in total we see a hole because there is not one penny for ongoing military or reconstruction efforts in Iraq, and I might just mention that the emergency supplemental we passed last year provided $18 billion to rebuild Iraq, and as a side note, after yesterday's discussion on homeland security, that is four time more than what the President's budget is for first responders, which is of deep concern to me in terms of relative risk to us and what is happening to us in terms of a national threat.

But I am concerned that we are hearing rumors that there will be a supplemental after the election. We are also hearing from many military leaders that this will not serve in terms of the time limit; they need dollars ahead of time. If we are planning to be in Iraq for many years, you have indicated it will be very expensive, certainly very difficult. Why does the budget not include some type of estimates for our operations and rebuilding in Iraq so we can budget intelligently for the future? We may not know exactly what the number is, Mr. Secretary, we know it is not zero.

Secretary POWELL. Senator, the judgment was made that in the course of regular 2004 funding and in the supplemental, we received enough money to carry us through the end of 2004 and well into 2005, so that the best way to handle it was wait until we reached 2005, and then there will be a supplemental request in 2005. But there was not enough known about what that need would be to include it in the 2005 budget submission, and we have more than adequate funding to take us into at least first quarter, in my case, of 2005.

Senator STABENOW. Mr. Secretary, I realize that is the position. I would just say that from our perspective on the committee, I do not believe that is responsible budgeting when we know that our first quarter into the next year we will be asked to come back with a supplemental. We are already borrowing to spend in Iraq, and rebuilding as well as the military, and for us to know that we are going to be going even farther into debt, it seems to me we at least ought to have a placeholder of an amount of money, and that is certainly something I think this committee should be discussing.

Secretary POWELL. In my budget there are some moneys in 2005 for things we really know about to a finite degree now, what it is going to cost us to run our embassy operations in Iraq. Those kinds of things we have put in the 2005 submission.

Senator STABENOW. But you are agreeing that there will be additional dollars needed in 2005?

Secretary POWELL. I am quite sure there will be a need for a supplemental in 2005.

Senator STABENOW. Let me turn to another issue, an extremely serious issue that you have talked about, which is HIV/AIDS. There is no question in my mind that this is one of the, if not the, largest crisis that we have in the world community. When you say 8,000 people are dying every day, including today as we sit here, I cannot imagine a bigger threat to humanity than HIV/AIDS. The President's request to combat HIV/AIDS increased substantially this year to 2.8 billion, and I appreciate that, but I am concerned that the request lags behind the 3 billion that we authorized in legislation last year, which the President signed, and I am wondering if you can explain why we are not meeting the commitment that we made to the world community last year.

Secretary POWELL. We are really still gearing up our programs. The HIV/AIDS Office is now just starting to issue contracts, enter into compacts with delivering agencies for the new moneys coming from the 2004 appropriations. So I think you will see that in the months ahead the rate of commitment of money will increase significantly and the funds will really start to flow out in a very, very rapid and responsible way.

Senator STABENOW. Would you not agree that this is an emergency?

Secretary POWELL. Ma'am, it is.

Senator STABENOW. And there has to be the utmost sense of urgency.

Secretary POWELL. It has the utmost sense of urgency. It is an emergency. It is a priority, and we are working as hard as we can, but we have to do it in a responsible way and make sure we are sending money out to programs that are prepared to receive the money, and we are not wasting the money, and that has taken us time to buildup the capacity to handle the additional moneys and to make sure we are doing it in a good way so that when I come up here next year, I am not criticized for having run bad programs.

Senator STABENOW. Mr. Secretary, I have heard from a number of people and had a number of conversations with members of NGO's that indicate that as fast as we can get them the resources they have the capacity to address this, and I am hopeful that we will do this as quickly as possible.

Finally, this year's request for the Millennium Challenge Account is 2.5 billion, nearly 1 billion short of the commitment outlined by the administration at the onset of the MCAs. I understand it is a new program also. I understand it takes time to ramp up, but we need assurance from the administration that we will meet the $5 billion annual funding goal in year 3 that was promised, and I am very concerned again that things just are not moving as fast as they should be.

Secretary POWELL. The President remains committed to reaching that $5 billion goal, and it is a brand new corporation. The first board of directors meeting I held on the 2nd of February. So inevitably it takes time to create programs, to get the criteria in place. Working with our Ambassadors, we now have their ideas in hand. We are evaluating the countries now. The evaluation system is being put in place, and you will see this program ramp up quickly. It just takes time, frankly, to put in place a system to spend these large amounts of money in a responsible way. But we will be ramping up quickly. I think we will be able to use what we have been given this year, and we will be able to use the $2–1/2 billion for 2005, and the President is still committed to hit the $5 billion a year target that he indicated when he created the program.

Senator STABENOW. Finally, one of the things I noticed in reading former Secretary O'Neill's book—and there were many interesting things in that book—but one of the things that I was appreciative of was his passion about HIV/AIDS after his trips to Africa and his suggestions about water projects, and the fact that only, as an example, half the people in Ghana have water, and what a difference it would make just providing the basics of water to everyone and how this could be done from his analysis, looking at the major reports and some of the contractors that have come in from the U.S. that have been suggesting huge projects of billions of dollars. His assessment was that things could be done for much, much less and much more quickly if we just talked about the basics and about wells and getting water to people in these countries. I am wondering if you have had conversations with him about his pro-

posals? And I should also say I am hopeful he will continue to work on those, because I think he has the right idea.

Secretary POWELL. Paul had a real passion for that, HIV/AIDS and clean water, and he and I spent many hours talking about both subjects. He had an idea about drilling wells rapidly, but we really do have a rather expansive program for wells and for other means of providing water, and we made another substantial commitment when I went to the World Summit on Sustainable Development in South Africa a year, year and a half ago. So we are I think as passionate and as committed as Paul O'Neill was for providing clean water because it goes along with development and it goes along with health, it goes along with combatting HIV/AIDS and other infectious diseases, so it is all part of the package. We may have had disagreements as to how best to provide clean water. It is not just a matter of digging a hole in the ground and up comes the water. You need other parts of that system. You need to be able to maintain and sustain that system over time.

So we were looking at it in a more comprehensive way than Paul was looking at it. I hope he will continue to have an interest in this in private life, continue to work on both HIV/AIDS programs and clean water programs.

Senator STABENOW. Mr. Secretary, I just cannot find the words strong enough to urge you to continue to focus on this as well as all of us needing to do that, because there cannot be a larger crisis right now in the world, and while we focus on military action, which is certainly an important component to leadership, focusing on hearts and minds and the leadership that we can provide as the greatest country in the world on humanitarian efforts, certainly sends an important message about our values as much as other actions.

Secretary POWELL. I could not agree with you more, Senator. Thank you.

Senator DOMENICI [presiding]. Thank you, Senator.

Mr. Secretary, I am not sure that I can finish in the 3-minutes that remains on the vote, so if I come back, please do not consider that I am trying to abuse my time. It is just that I am not going to get 8 minutes in, I do not believe.

First I want to tell you that I have a statement prepared that I want to put in the record. It is a statement of accolades, accolades for you, for our President, for America, with reference to the world, and principally with reference to what it means to be free.

[The prepared statement of Senator Domenici follows:]

Statement of Senator Pete V. Domenici
Committee on the Budget
International Affairs Budget
Secretary of State Colin Powell

- Welcome, Mr. Secretary. Obviously, the portfolio of issues you and your department face continues to grow in size and importance to the future of this country.

- The war on terrorism, counter-proliferation of weapons of mass destruction and fighting the international AIDS epidemic are just a few of the major issues you are working on.

- Let me state **my appreciation** to you for your tireless efforts on these matters. Thank you also for the contributions you have made to this country over the course of your distinguished career.

- There are a number of issues that are of concern to me this year as it relates to international affairs.

- From the budgetary perspective, I am interested to know how we can enhance **security at our borders**.

- My home state of New Mexico shares a common border with Mexico. I remain concerned about the flow of narcotics and terrorists across that border and would welcome a discussion of the Department's plans to address this problem.

- The **proliferation** of weapons of mass destruction also continues to be an issue of utmost importance.

- Clearly, Libya's admission of a secret nuclear program is a major success in our effort to contain these dangerous weapons. However, many **challenges remain**.

- Iran and North Korea remain involved in activities that signal nuclear ambitions. Reports of Pakistan exporting technical assistance to countries seeking a nuclear capability appear almost daily in our newspapers.

- Obviously, our **diplomatic approach** to these problems is critical. From a policy perspective, I am anxious to hear from Secretary Powell on the upcoming negotiations with North Korea and his views of recent developments in Iran.

- Naturally, we are all interested in diplomatic efforts to rebuild **Iraq**.

- Following the **heroic efforts of our troops** to liberate the long-suffering people of this nation, much work has been done to help build democratic society.

- The road has been difficult. Brave American soldiers, United Nations diplomats, and Iraqis themselves have suffered painful losses in the rebuilding process.

- But despite these tragic losses, Americans and Iraqis alike remain committed to our common interest of building a free and stable nation.

- Clearly, this is in the best interest of Iraqis who, until now, have known nothing but tyranny. And it is my firm belief that it remains in the **vital national security interests of the United States** as well.

- In an era where the asymmetric threat of terrorism puts the safety of American citizens at risk, the world cannot afford to allow regimes with a proven record of using WMD to ignore the mandate of the global community.

- I believe Americans are safer today for the actions we took in Iraq.

- I also believe we now have a great opportunity to help Iraq achieve a bright future, and I certainly welcome hearing from the Secretary about our current efforts in Iraq.

- Thank you, Mr. Chairman.

Senator DOMENICI. But I have an issue that I am quite sure you agree is important, and I think it is so important that it requires more than people like you being interested. It requires the utmost action. Let me try to explain it to you in terms of what is happening today.

We are engaged in a war against Iraq on the basis that they have historically been leaders in the use of weapons in mass destruction. Whether they were there on a given day or not will probably not be answered until history is beyond us. But we worried enough about it that we went to war.

Now, Mr. Secretary, the problem I address is the proliferation of weapons of mass destruction and its components and its scientists around the world. When I first got involved in this issue, Mr. Secretary, it was Russia and America, and believe it or not, from that interest and the interest of some very expert people, the first laws were passed with reference to proliferation. Believe it or not, one afternoon in a 15-minute period, the appropriators here started two new nonprofileration programs. We did not take a month or 6 months. One was $200 million to jump start the program to create a plutonium disposition program. I am tempted to stop and go to the other issue in a moment, but let me not do that and create a little further synergy about the issue. On that very same day that that happened, our Appropriations Committee, in conference, approved over 50 million for the United States of America to buy highly enriched uranium from the Soviet Union. That uranium acquisition has worked somewhat. We turned it over to an American corporation that was created by selling a Government corporation. You are aware of that company. Its record has been spotted at best.

But programs like plutonium disposition, you know, they are a kind of a duck on water, and waiting around to drown, and you know how hard it is to drown a duck. That is how hard it ought to be to dispose of a program like plutonium disposition, but we are letting the problem languish to where it may disappear if we do not solve a little disagreement with Russia regarding what we in America would call indemnification. Maybe somebody would describe it as who is going to be liable for what in the event things do not work out.

Let me just say, Mr. Secretary, I have talked to you briefly and I do not expect you to know a lot about this just because I called you on the phone, but I sent you a letter. I have tried my best to speak to the President, and I think a result of both the speech and a letter that had something to do with the President's announcement. People do not know it, but the announcement on nonproliferation, it may go down in history as one of the most significant speeches given if it works.

Mr. Secretary, I want to ask you and urge you, with all the things you are carrying around on your shoulders, to really consider pursuing with vigor the establishment of international institutions to control the spread of weapons of mass destruction, and, Mr. Secretary, I have, since our conversation, talked to the smartest people I could find. The other day you asked me who and I told you, remember, Sig Hecker? Since then I have spoken to Steve Younger, who is going to be a fellow after having been one of America's—leading nuclear bomb makers, and he is going to be a fellow

and research physicist. I asked him about this. He said we have to get somebody to get on with it and get this international thing going.

Now, Mr. Secretary, do you think this is a big problem, proliferation?

Secretary POWELL. I absolutely do, Senator, and that is why the President spoke to the issue at the National Defense University, a speech I think is an historic one, and one in which he laid out a number of things we have to be working on to include improving the ability of the major international organization that deals with nuclear activities and that is the IAEA. And he talked about passing resolutions before the U.N. He talked about passing the additional protocols to the Nonproliferation Treaty and a number of other areas that he is working on.

With respect to the specific issue of liability and indemnification with the Russian Federation, it is a subject of considerable discussion. I have discussed it with my Russian colleagues recently when I was in Moscow, and in subsequent conversations with Foreign Minister Ivanov. And we have engaged the interagency process in recent weeks in a much more aggressive way to find a solution to these continuing, nagging indemnification and liability problems that are holding up not just the particular program you made reference to, but other programs that came out of the G–8.

Senator DOMENICI. Mr. Secretary, I am thrilled to know that you are involved. I can tell you without mentioning names that I believe that people who have been working in your behalf—and I would not mention their names—I do not think they are competent to get this kind of treaty with the Russians. That is my view, not yours. To get that resolved needs your absolute mandate to the State Department that they put the kind of people in that can resolve it. I tell you, it is not that tough, but it has got to have some big people.

I want to wrap this meeting up so that everybody that is here and the media that is here have to understand. We just had a national position, and our ranking member took a big swipe at the fact that America has gotten heavily in debt, and that the Fed Chairman just mentioned Social Security. Well, Mr. Chairman, and fellow Senators, I was chairman for so long in this committee, and I am so thrilled that this very, very competent man, Senator Nickles, is Chairman.

But do you know, 18 years ago in the U.S. Senate we had a vote. Do you remember former Senator Pete Wilson? We wheeled Pete Wilson in in a wheelchair because he had had appendicitis. His was the deciding vote on a proposal by Domenici and Nunn to restrain the COLAs on Social Security, 18 years ago. Why? We knew just what is happening was going to happen. We never did this again because some people think 8 or 10 people lost elections the next time, but from my standpoint I do not think it does a lot of good to talk about this unless somebody is ready to do something about it. But I can tell you, you have some of the greatest programs mankind has ever seen, the greatest humanitarian program was this President's effort of commitment of $2.8 billion for AIDS. Who would have thought it? There are still some people who think Republicans do not care and George Bush is a conservative from

Texas, who cannot believe that he is the one who said we will spend 2.8 billion to address the world's aids crisis.

I tell you, I am not here to criticize how slow it has been because I understand with that much money, if you turn it loose, it will be gone in a year and then they will be back here saying, you forgot this one, this one, the other one, or you put too much here and too much there, and that is a bear of a job. I hope you get it done and I hope you get it done in your typical, methodical and terrific way. The man you put in the directorship is already under criticism because he is not a health man. We do not need a health man. We need a big-time manager, right?

Secretary POWELL. Absolutely, and that is what we have with Ambassador Tobias.

Senator DOMENICI. That is right, terrific. If you put anybody in charge that is going to look at 3, 4, 5 billion and spend it right, you are probably on the right track.

My time is up and I am going to go vote, and I am not sure that I can come back. I have about 8, 9 questions. I will submit them to you.

I do want to close by saying, as strange as it may seem, with this President having 1 year left, and hopefully he will have some more, it is very important that you, where you have the lead in some of these programs, that you really put Secretary Colin Powell behind them. Nobody will move them like you, and you ought to do it. The ones I mentioned are terrific. Weapons of mass destruction are moving around the world today like nothing we could have believed. We have a guy in Pakistan that 10 years ago if you would have found him selling that stuff, you would have hung him in the marketplace. The worst proliferator ever is that fellow from Pakistan. Is that his name, Khan?

Secretary POWELL. Kahn, sir, Dr. Khan.

Senator DOMENICI. Can you imagine admitting that he put weapons of mass destruction in five countries, and we are still running around saying, well, we do not know what to do about him?

Thank you very much.

Secretary POWELL. Thank you, Senator.

Senator BUNNING [presiding]. Since I guess I was the first one back, I will be the first one to be able to followup on Senator Domenici. I would like to comment on an earlier statement by my good friend, the ranking member, about what Chairman Greenspan said and what he did not say. I have his statement before me. He stressed that he preferred cutting Government spending as much as possible before increasing taxes. He also endorsed in the statement the tax cuts that we implemented in the economic reform program, and then he suggested that we might consider cutting promised Social Security, and the exact words, "consider cutting promised Social Security benefits to future retirees." He did not say to cut them. He did not say that that was an option. He said "you might consider it."

Well, I have news for Alan Greenspan, and I have had it before at every hearing—I know I am getting off the track, but I have to say these things. Chairman Greenspan has made so many wrongheaded statements over the period of the last 15 years that I have taken him to task at almost every meeting that he has attended.

Knowing full well that nobody in this Congress of the United States of America is ever going to suggest that we cut Social Security benefits for those who have earned and paid for them.

The fact of the matter is, as Chairman of the Social Security Subcommittee on the Ways and Means Committee, it was never brought up. The only thing that was ever suggested that if we did nothing, nothing to correct the problem, that by 2036 we would have to lower benefits to future beneficiaries after that time by 25 percent. I wanted to clear that up because I think it is very important.

Now to get to some of the things that concern me on your budget. 9 percent increase for the U.N. and affiliated agencies. I bring that only to the point that does that consider any of the military money that we are spending in Bosnia or Kosovo with our troops, or is that excluding the dollars being spent by the DOD on our involvement in Bosnia and Kosovo?

Secretary POWELL. It excludes it. Those are strictly within the military accounts. If it is a peacekeeping mission somewhere under U.N. auspices, then we pay our fair share, 27 percent of that peacekeeping mission, and that would be included in that account.

Senator BUNNING. But we are continuing to pay the 100 percent of our troops, our troop presence——

Secretary POWELL. In Bosnia and Kosovo.

Senator BUNNING [continuing]. In Bosnia for the last 8 years and Kosovo for the last 5 years. So that is not in this budget?

Secretary POWELL. No.

Senator BUNNING. I have a problem with the State Department only to the point that we created a law in the U.S. Congress, and it passed and the President signed it on arming cargo pilots to operate on international flights. It is called the Flight Deck Officers Law.

In an op-ed piece—and I do not recommend this for reading, op-ed piece in Roll Call, because it is not one of my favorite periodicals—none are being allowed to do this because our State Department has not negotiated any agreements with any other nations to allow these armed pilots, whether it be on commercial aircraft or cargo planes to carry these. Can you bring me up to speed as far as where the State Department is in any kind of negotiations with other countries on this specific law that we passed?

Secretary POWELL. No. I would rather provide the answer for the record, Senator. The only thing that I could say is that many of our friends and allies around the world do not have the same view of that approach to security, and therefore if we fly into those countries, there is probably a debate that will take place before we can get in place the necessary policies for our pilots to come in armed. But I would rather get a more precise answer for you for the record.

Senator BUNNING. I appreciate that, because some of our intelligence, as you well know, indicates that that might be a source of national security as far as returning to the United States on cargo planes and on other planes that have been obviously canceled.

Secretary POWELL. I do understand.

Senator BUNNING. I thank you very much for your time, your patience, and my God, the responsibility that you hold as Secretary

of State in this trying time with all of the things that are on your plate, our expansion, our problems in Iraq, our problems in Afghanistan, and many other areas, and the progress that we are making in those areas, and if at all possible, I will support almost everything in this budget, and we will figure out a way to pay for it.

Secretary POWELL. Thank you, Senator.

Senator BUNNING. Thank you.

Chairman NICKLES [presiding]. Senator Bunning, thank you very much.

Senator Corzine?

Senator CORZINE. Thank you, Mr. Chairman.

Welcome, Secretary. It is always great to welcome you, and I want to as well commend you for your service and particularly those who work with you as well in the State Department. The agenda is broad and long, and I feel like we are in strong hands under your leadership there.

I also believe that the reinvesting in the people that you have made such a centerpiece is one of the most important things in the long run for our ability to be able to carry out our foreign policy, both current administration and future, and support it completely. That is the good news.

I have a real problem. It is a little bit along the lines of sometimes a lack of complete information ends up undermining credibility. When we look at the budget this year with regard to what you are speaking to us about today, we are talking about 31.5 billion. And we all know that there is a plug there for reconstruction for additional aid that will accompany both our efforts in Afghanistan and Iraq. It has been there for 2 years, $18 billion last year and two odd years before. I do not understand how we cannot make some estimate, understanding that rational views know that is coming. And you put that into conjunction with other issues about the alternative minimum tax, which is left out or only put in for 1 year or the elements with regard to the cost of some of the programs that were proposed in the state of the union message, like health insurance. It gives people an unease about full disclosure. I think actually the debate the Chairman talked about is less about misleading and lying and more about whether there was full presentation of the various interpretations of intelligence that came as we preceded the war. So I am very troubled about those issues and this is a particularly egregious example, that we will end up almost certainly having a substantial expenditure that is not included in our projections, and it leaves the American people with a false sense of, I think, what we are doing with regard to our budgetary policies, and then some way undermines credibility of people who I think are doing a terrific job and putting themselves at risk and all the other things that are associated with it.

I guess that is my statement. I would ask you to comment on that, but more importantly, would like to hear some of your early interpretations of the writing of your report or the fact-finding report. I think the end of this week, if I am not mistaken, there is supposed to be an implementation of the fundamental law or at least an announcement. Do we think we are going to meet that deadline? There are certainly discussions with regard to whether June 30th is an appropriate timeframe for proper electoral process.

I heard some movement away from maybe an election, although I do not want to put words in your mouth. It was left uncertain. I think nothing is more important with regard to our budgetary indications of whether we are going to have the resources to actually help build an electoral process that is going to have the credibility should the United Nations be presenting this. I really think that an exposition with regard to some of this fact finding—and a very credible person, Ambassador Brahimi, has certainly led the effort in Afghanistan in a way that I think almost everyone would argue has been remarkable.

Secretary POWELL. Thank you. Senator. With respect to the 2005 submission we do have dollars in there for things that we really can scope down and know what the requirement is going to be. There is $46 million requested for State operations in Iraq, including $17 million support cost and $29 million to staffing. That is known now. We can budget for that and we can put it in the budget, which we did. But with respect to other demands that might be placed on the Department, and frankly the larger demands that will be placed upon the Defense Department, it was felt that as a result of the supplemental efforts and the fact that there are other sources of money that will be coming online, revenues for oil sales in Iraq, the donors conference that came up with a lot of money in Madrid a few months ago, that money will start to kick in and help with reconstruction and budget support for the new Iraqi Government.

For those reasons, it was felt that the 2004 regular appropriations, plus the supplemental appropriation, will take us through the early part of 2005. And we will have a better sense then of what additional moneys will be required with another year of experience under our belt. It was felt it was better to wait for that 2005 supplemental to deal with that which we cannot see clearly now. That was the judgment that was made. So we put in, in the Department, that which we could see clearly had a finite way to scope it, and we did not make estimates, nor did others make estimates for expenditures they could not accurately make estimates for now.

Senator CORZINE. Is there no contingency planning though of ranges that are actually thought through with regard to associated planning processes?

Secretary POWELL. I do not know what the Pentagon might have done, but most of the $21 billion was for reconstruction activities and it is not yet clear what that will look like for the latter part of 2005, but we have enough to carry us into 2005 for our operations, both military, State Department and other operations, and that is why the judgment was made to wait until 2005 to see what kind of supplemental would be required for 2005.

With respect to Mr. Brahimi, he is a man of enormous ability, and I haveten to know him very well as a result of what he did in Afghanistan, and he did a terrific job in Iraq. He visited with the parties and he reaffirmed the judgment we had come to that we could not really have the right kind of election between now and say the end of June, and there were certain deficiencies in the caucus process that we were looking at, and he recommended that we look at additional options for the purpose of selecting an interim government for Iraq. We are still driving toward a 30 June date.

We think it is achievable. Ambassador Bremer is hard at work on the administrative law now. 28 February was our deadline. It is getting close. I have not talked to Jerry in the last 24 hours to see whether he thinks he will make it or not, but I think we are getting very close. There are some issues having to do with Kurdish authorities and the regional government of Kurdistan and some other issues that have to be dealt with. They are not easy, but I think we are getting close to conclusion of the work on the administrative law.

The next real piece of work to be done—and we are looking forward to seeing what Ambassador Brahimi and the Secretary General might have to say about this—is what kind of interim government will you put in place? Will it be the governing council, an expanded governing council? Will it be Asura coming up with another group of individuals to take sovereignty? A variety of alternatives are being looked at, not only by us, of course, by the United Nations, but more importantly, by the Iraqis themselves as to how they want to go about it. And that will be the major activity of our governance group in the weeks ahead, what kind of sovereign government should we be supporting for hand over on the 30th of June?

Senator CORZINE. The deadline appears though, you still very certain can be met in some format, just a different format?

Secretary POWELL. Yes, 30 June still is achievable and we are all working toward that 30 June turnover.

Senator CORZINE. I am sure you have read the Brahimi or the interim report or the fact-finding report.

Secretary POWELL. Yes.

Senator CORZINE. One of those things that sticks out very really, very prominently in that report is that security constraints are still a serious issue on the ground, and to some extent did not seem to jive with I thought your opening statement. There is some acknowledgement that security is getting better. They were not allowed to travel outside Baghdad. I am just reading from the report. They were not actually allowed to travel seriously in Baghdad, according to the report. How do you assess the security situation on the ground?

Secretary POWELL. The security situation on the ground is improving but it is still dangerous. We are still losing people. There are still old regime elements and terrorists in Iraq who are doing everything they can to thwart our efforts. The Iraqi security forces are being built up and are being targeted because they are being built up. People understand, the bad guys understand that they want to go after Iraqi security forces, perhaps even more than they want to go after coalition military forces because they are trying to keep this from happening. So we still have a difficult situation. Our commanders I think know what they have to do, and we are putting a lot of effort and energy into building up the Iraqi police force, the civil defense corps, the army, the border police, and all the other security institutions that Iraq will need when it becomes a sovereign nation. Over 200,000 people, close to that number now, are now involved in Iraqi security operations, Iraqis involved in Iraqi security operations. So I think things will improve, but it is dangerous.

Now, the team you are making reference to, they were not able to get as much access as they wanted, or they may have chosen not to go where they wanted because they were not comfortable with the security arrangements. But they got their work done, and we hope that by the time 1 July comes around, when we think there is an even more comprehensive role for the U.N. to play getting ready for elections, we will have put in place security arrangements, working with the United Nations, that will allow them to move more freely. But it is still a dangerous area.

Senator CORZINE. One last followup question. You just implied in your response that it is insurgency, I take it primarily as the fomenter of the violence and lack of security, seem to have a debate going on among different elements of both our intelligence and/or defense establishment about whether what we are primarily seeing on the ground being outside influenced elements who are causing the security problems or insurgents?

Secretary POWELL. We are seeing both. I do not think there is a debate. I think we are seeing both. On any day of the week you can get two opinions as to whether we are seeing more of one and less of the other or what the trends are for each. I think the Intelligence Community generally believes that we are seeing additional terrorists coming into the country and that the former regime elements are coming more under control, but we are seeing both. We are also seeing criminality, just plain criminality, people who want to blow up pipelines, want to steal from the pipelines, people who for one reason or another that has nothing to do with being a former regime element or a terrorist who just came into the country, want to cause trouble. So anyone who says it is all this or all that, that is not a correct assessment in my judgment. It is still a combination.

Chairman NICKLES. Senator Corzine, thank you very much.

A quick question. You have mentioned 200,000 people are being trained. Is that 200,000 Iraqis?

Secretary POWELL. 200,000 Iraqis are performing some kind of security function, whether in the police, in the civil defense groups, border patrol, pipeline security, or the army itself.

Chairman NICKLES. Senator Nelson.

Senator NELSON. Thank you, Mr. Chairman.

Mr. Secretary, thank you again for being so resolute as we continue to look for Captain Scott Spiker. There is a team over there that is looking for him, and although this is outside of your bailiwick, with your credentials of your past life, if you would just keep the pressure up, and I will give this to your staff. It is a letter from the family, which as you know, live in Jacksonville. I just want to urge you, as you are in the inner sanctum, talking about it, keep him on the forefront. They have been. I have been over there. There is a major who was set to rotate back. He is now a lieutenant colonel. He extended to keep up the search. From time to time we get some promising information, but we do not have any results yet. So I am going to give that to your staff.

Secretary POWELL. I will stay on it, Senator. He was lost on my watch.

Senator NELSON. Thank you. You know I want to talk to you about Haiti. When you were with us in our Senate Foreign Rela-

tions Committee 2 weeks ago I asked you the question, is it the policy of the Government for regime change? You said, No, it is the policy of the Government that it is not for regime change. I want to suggest to you that what appears to be the hands-off policy of the U.S. Government with regard to Haiti is in effect going to bring about regime change. Now, we might agree at the end of the day that Aristide is a bad character who has been corrupt and very ineffective, but in effect, when the U.S. Government lays hands off and allows the violence and the bloodshed to increase, that is going to bring about the regime change, and Aristide is going to go. And I know you have probably been overruled by the White House on this to keep a hands-off policy. I would like any of your comment on that, and then I want to encourage you, although you all have not taken my recommendation of putting an international police force in there with the other nations of the western hemisphere, that when he abdicates, it is clearly time for us to get in there and try to settle that thing down, because as you can see, just look at the news, you can see the rickety boats that they are building. They are turning up on Jamaica, they are turning up on the Turks and Caicos. 20 of them turned up on a freighter 5 miles off the Florida coast. This exodus is coming if we do not get in there and stabilize it.

Secretary POWELL. Senator, I have not been overruled by the White House. There is no basis for it because the President and I have discussed this issue almost every day, and we have a common mind. We were together on it 7 o'clock last night in the Oval Office, and he and I discussed it again on the phone at 7 o'clock this morning.

We have been trying to find a political solution to this crisis. I have been in daily contact with the CARICOM leaders, with France, with Canada, with the United Nations. I have been in relatively constant contact over the last week with the authorities in Haiti. I have been in contact with the opposition leaders of the DP. I have talked to them in groups. I have sent Ambassador Noriega down there to talk to them. We have tried to find a political solution. It has not been a successful effort at this point, and we continue to try to see if there is not a way forward.

The issue of sending in a security force, be it a police force or a military force, has come up time and again. In fact, it came up again within the last 24 to 48 hours. What we have said and what my French colleague Dominique de Villepin said yesterday, and it has been somewhat misinterpreted was that the international community stands ready to help put together an international security force, whether it is police of some component gendarmerie or military or whatever. The international community stands ready to put that force together, as my French colleague said yesterday, as part of stabilizing some political resolution to this problem.

What the international community—and there may be some members of the community who feel a little differently—but most of the members of the international community with the capacity to send forces in there have said is that Haiti really needs to find a political resolution to this problem. We do not want to get into an inter-positional situation between opposing forces at this time and coming down on one side or the other.

I spent a great deal of time yesterday on the phone with Foreign Minister de Villepin, spoke to him again this morning, and he made his statement clear yesterday that France is willing to participate in such an effort. So is the United States. So is CARICOM. So is Canada. There may be African nations of the francophone community that are willing to participate in that, but we need to see some kind of political resolution.

We have not succeeded in getting the political opposition, the DP as it is known, to agree to enter into this current proposal with President Aristide. The reasoning is well known. They have stated it clearly. They believe they have been misled in previous discussions with him. At the same time, we are concerned about the humanitarian situation. We are doing everything we can to make sure that food stocks are protected. There are some distribution problems in Haiti, but for the most part there is adequate food, medicine and other necessary stocks.

I am very sensitive to the plight of the Haitian people, and we spent time this morning talking about a spurt in the number of people coming out onto our cutters, and there is a meeting taking place in the interagency community right now I think on how we should respond to that challenge.

President Aristide is aware of all that we have been trying to do. He understands that we have not been able to reach an accommodation with the DP. I know that he is taking a look at the situation. I do not know what judgments he may come to. But we are in a difficult moment in the life of Haiti, the life of Haitian people. It is a great disappointment to me to find ourselves in this position.

I went down 10 years ago with Senator Nunn and with President Carter and talked the generals out in order for President Aristide to come back in, and I regret that over those 10 years we have not seen the kind of progress that we had hoped for. President Clinton invested a couple of years of military presence. The international community spent tons of money trying to put in place a professional police force, and it did not work, and the political process, the democratic political process in Haiti has essentially collapsed, and the international community is ready to get engaged, willing to get engaged. There are debates and discussions taking place in the U.N. today, but anybody who looks at this says, what is it we are getting into? And we have gotten into something that looks like it is a political solution, and that has not yet emerged.

Senator NELSON. Mr. Secretary, I pray that you are successful, and then once the country is stabilized, then I think we have to have fresh thinking about how we help them stay stabilized in the future. I say this in a bipartisan way because I think at the end of the immediate past administration that they started to let Haiti slip out of their sights, as has this administration up to this point. So I pray that you are successful, and then let us get our heads together of how it is going to be stabilized for the long run, and the kind of economic assistance that will give it some hope so that people will not constantly want to flee.

Secretary POWELL. As you know, Senator, we have provided over $800 million from 1995 to the present to Haiti. We are still providing funding to Haiti, $75 million this past year. There is a request in our budget for more. The international financial commu-

nity and the institutions of the international financial community are willing to help more, but they have become frustrated that the money does not seem to produce the kind of results intended. And so there is a reluctance, until the political situation stabilizes itself and there is a legislature and there is a functioning executive branch with some security in the country, and there are institutions that are functioning, there is a reluctance from the international community to just pour money into the place. But we are doing our part with respect to meeting the immediate needs of the Haitian people through NGO and private organizations, and we will continue to do so.

Chairman NICKLES. Senator Nelson, thank you very much.

Mr. Secretary, you have 5 more minutes?

Secretary POWELL. Yes, sir, certainly.

Chairman NICKLES. Just a couple of other issues Senator Conrad and I wanted to bring up. One is on the issue of foreign adoptions. Right now foreign adoptions are basically regulated by the Citizens and Immigration Services and the State Department. I have introduced legislation with Senator Landrieu and a bipartisan group of Senators called the Inter-Country Adoption Reform Act, basically put it under the Department of State, try and consolidate it, get it to where it will work much more efficiently.

Would you review that and give us your thoughts? It would be put in under your shop. I think it would make it work a lot better, simplify the process. I would appreciate your getting back to us on your thoughts and comments.

Secretary POWELL. I will look at it, Senator, right away.

Chairman NICKLES. Also I want to just touch on a couple of other things. The big increases in your budget are for AIDS and for the Millennium Account.

Secretary POWELL. Right.

Chairman NICKLES. Last November, December, I went with Ambassador Tobias and Secretary Thompson on an AIDS African trip. Our work over there is meeting a need that is enormous, enormous, and I compliment you and the President. Ambassador Tobias is just an outstanding representative, taking on a challenge. I look at the job that you have, the job that we have, we all have big jobs around here. That is an enormous challenge as well, and I think we have the right person in there.

The Global Fund assistance that Congress appropriated last year was $546 million. The amount that is in your budget is $200 million. The administration requested a total of $2.8 billion, and last year we appropriated a total of 2.4 billion. So I have not looked at all the differences, but I do know that Congress put in a lot of money in the Global Fund that was not requested, and you are requesting more money in other places. Is the 2.8 consistent on this, meeting that commitment of $15 billion?

Secretary POWELL. Yes, sir.

Chairman NICKLES. I appreciate that. Also I want to just touch on one other thing. The other big piece of that—and you mentioned they are combined, and I would echo that—the Millennium Challenge coupled with the Global AIDS Fund. One or two of the African countries I saw were so poor, and I am thinking there are such enormous resources here, if they had a legal system, if they had

private property ownership. Uganda is one—and there are others—the most fertile country I have ever seen, and yet we are sending food aid. They could grow enough to feed not only Ugandans but many other countries, but in many cases they do not have the rule of law and they do not have private property, and so I compliment you on both.

Now, on the financial side of it, last year you talked me into a billion dollars for a new program. This year you are asking that program to grow to $2–1/2 billion. You have not obligated as of yet the billion dollars. Do you really need that $2–1/2 billion in 2005? Can we not slip some of that into 2006 and 2007. The increase we have on all nondefense programs is $2 billion, and you are asking a billion and a half of it for the Millennium Challenge Fund. You are not really quite ready to spend $3–1/2 billion or even obligate $3–1/2 billion, are you?

Secretary POWELL. I recommend you really not slip it into the out years, Senator. We need that money in our accounts now in order to start planning how we are going to ramp up this program as fast as we can. There are countries that are desperately in need.

Let me just touch on another effect that the program is having already. I am already hearing from a number of countries—you were concerned that they are not going to meet all the standards required for eligibility. They are asking: "Can we send a delegation to see you right away?" "What do we have to do?" "What do we have to do on the rule of law?" "What more do we have to do on corruption?" "What is our grade?" "What is the threshold for passing?" They want to be a part of this program. I think the way in which it is structured right now, with one now and two plus next year shows determination, shows the commitment of the President, of the American people and the Congress. So I would you not slip the two, and we will be ramping this up as far as we can.

Chairman NICKLES. I appreciate it. With the concept I am with you 100 percent and I compliment you.

One other compliment I want to make and that is in the Office of International Religious Freedom. Senator Lieberman and I sponsored that bill years ago. We found then that there was a lot of countries where people were persecuted and in some cases killed because of their religious beliefs. We find it with friends and allies even, in countries like Pakistan, Saudi Arabia or countries like China and others. The purpose of that bill was to highlight some of the problems and give us a lot of tools to help fix those problems, and I would just say I just have been looking at the report that was released just last December by the Commission, and it was an outstanding report. I would urge more attention I guess from all of us, Members of Congress and others. I find when we raise some of these issues with some of our countries, that our allies, our friends in the war on terrorism and so on, that they want to be cooperative. So I compliment the Ambassador-at-Large, Mr. Hanford, but also the work that that Commission is doing.

I am amazed at how significant religious persecution is today in lots of places in the world. In Pakistan somebody walked into a church and just machine gunned people, and that happened recently, and so I think this Commission helped highlight some of the problems and also has good suggestions for some of the solutions.

Secretary POWELL. Thank you, Senator. I fully support Ambassador Hanford and his work. It is a good report. Yesterday, I issued the Human Rights Report, and then we also have the Trafficking in Persons Report. All of these go to the human condition and what we believe God intended for all of mankind to enjoy, and we will continue to press these reports that frankly are the products of Congress. You wanted us to do this, and we take them all very, very seriously, and we go after these issues aggressively.

Chairman NICKLES. Thank you very much. I think maybe in many cases we in Congress have not done enough to followup on them, but we can do that with our individual contacts with some of the embassies and on some of our trips, and hope that the State Department people would as well.

Senator Conrad.

Senator CONRAD. Thank you again, Mr. Chairman.

Mr. Secretary, one of our colleagues suggested that somehow I had misled on the Greenspan testimony yesterday. I did not. I was quoting directly from the Washington Post Dispatch on what occurred there, and I just put it up. That is what I quoted from. "Fed Chief urges Cut in Social Security." That is the headline. "Future benefits must be curtailed, Greenspan warns." And I would be happy to go through the story, set the record straight here on what was said and what I alluded to. "Federal Reserve Chairman Alan Greenspan warned Congress yesterday the Federal Government has promised more retirement benefits than it can pay for and must consider scaling back those commitments soon to avoid damaging the economy in the future."

"I am just basically saying we are over committed at this stage," Greenspan told members of the House Budget Committee. Greenspan, who supported President Bush's 2001 tax cuts again endorsed Bush proposal to make the tax cuts permanent. However, he said in response to questions that raising taxes would inevitably be part of any successful effort to reduce the growing Federal budget deficit. he stressed her prefers cutting spending as much as possible before increasing taxes. He said, "You don't have the resources to do it all." To curtail future spending Greenspan urges Congress, as he has in the past, to consider cutting promised Social Security benefits to future retirees. "Otherwise," he said, "the growing burdens would create long term budget deficits that would drive up interest rates, depress economic growth, make it even harder for the Government to pay its bills."

That is what he said. That is about as clear as it can be. It is very interesting if one looks at what the President is proposing. He is proposing in his budget to borrow $2.4 trillion from Social Security that is funded by payroll taxes, and have tax cuts of $2.4 trillion over that same period that are largely going to income tax payers. That is the greatest shift of benefits from the many to the few in the history of this country. When one talks about class warfare, that is class warfare writ large.

Let me just ask you this.

Chairman NICKLES. Senator Conrad, you and I will need to debate that another day. The Secretary is being very generous with his time.

Senator CONRAD. I just want to ask you this on the supplemental. Will you be asking for a supplemental as you have the least 3 years?

Secretary POWELL. In 2005?

Senator CONRAD. Yes.

Secretary POWELL. I would expect that there would be a supplemental in 2005, sir.

Senator CONRAD. Can you give us any sense of how big it might be? Last year's reconstruction supplemental was $21 billion. Can you give us any sense——

Secretary POWELL. No, I cannot, sir. Really, I do not have any way of putting a number to it. If we could put a number to it clearly, then it would more likely be in the 2005 budget. It is up to the President ultimately to decide whether there will be a supplemental, what the amount is. But I think our planning assumption is that there will be a need for a 2005 supplemental.

Senator Bunning is not here, but since you mention it—I could not quite read the article, but I did hear you say the word "consider" reductions. I think the point the Senator was making earlier was that Mr. Greenspan had said "consider," whereas the headline suggests that he was advocating cuts.

Senator CONRAD. I do not think there is any question he is advocating cuts. He is saying to us to consider. It is his recommendation. I think that is very clear, and that is not only clear based on what he said yesterday, it is clear on what he said 2 weeks ago. It got almost no press attention. So I think it is very clear, he is saying to us we are over committed, none of this adds up, and it does not add up, and that is the problem we have.

When you send up a budget and you tell us here you are going to ask for a supplemental but you do not provide a number, the thing we know is the right answer is not zero. But what you have in this budget, or more accurately, the President has, is zero. We know that is not what it is going to be.

Chairman NICKLES. Mr. Secretary, I want to thank you. I might mention that last year when we did the very large, $20 billion supplemental, actually I think it is $21 billion, we were told that that would basically be it, and not to expect a 2005 supplemental. That is still my expectation. I could be corrected, but I would like to be corrected if that is the case. We were told that other countries were going to be participating more. That was a large, large, large amount of money, and I look at the amount of money that is compared to what we have done in the past, and we were basically assured last year, when Ambassador Bremer and the administration requested that $21 billion and a lot of us were swallowing hard, that we would not be seeing another supplemental for infrastructure for Iraq.

Secretary POWELL. I think we made it clear that there would not be another 2004 supplemental, and I do not know what Ambassador Bremer believes the needs in 2005 will be. But I cannot tell you today that neither the Defense Department, State Department, or other agencies of Government will not have need for a 2005 supplemental. It will be up to the President to decide whether or not a supplemental is forthcoming. It cannot be decided now what an amount might be in such a supplemental.

Chairman NICKLES. Mr. Secretary, thank you. My staff informs me that the commitment was that we would not see another supplemental in 2004.

Secretary POWELL. Right, Senator.

[The prepared statement of Secretary Powell follows:]

Secretary of State Colin L. Powell
The President's Budget Request For FY 2005
Written Remarks
Senate Budget Committee
26 February 2004

Mr. Chairman, members of the committee, thank you for the opportunity to testify on the State Department's portion of the President's Budget Request for Fiscal Year 2005.

The President's FY2005 International Affairs Budget for the Department of State, USAID, and other foreign affairs agencies totals $31.5 billion, broken down as follows:

- Foreign Operations - $21.3 billion
- State Operations - $8.4 billion
- P.L. 480 Food Aid - $1.2 billion
- International Broadcasting - $569 million
- U.S. Institute of Peace - $22 million

Mr. Chairman, the President's top foreign policy priority is winning the war on terrorism. Forty-eight percent of the President's budget for foreign affairs directly supports that priority by assisting our allies and strengthening the United States' diplomatic posture. For example: $1.2 billion supports Afghanistan reconstruction, security and democracy building, and more than $5.7 billion is provided for assistance to countries around the world that have joined us in the war on terrorism, and $3.5 billion indirectly supports the war on terrorism by strengthening our ability to respond to emergencies and conflict situations. Moreover, $190 million is aimed at expanding democracy in the Greater Middle East, in part to help alleviate the conditions that spawn terrorists.

In addition, $5.3 billion is targeted for the President's bold initiatives to fight HIV/AIDS and create the Millennium Challenge Corporation, both of which will support stability and improve the quality of life for the world's poor – and, again, help to relieve conditions that cause resentment and despair.

Mr. Chairman, let me elaborate a bit on how some of these dollars will be spent.

WINNING THE WAR ON TERRORISM

Winning on the battlefield with our superb military forces is just one step in defeating terrorism. To eradicate terrorism, the United States must help create stable governments in nations that once supported terrorism, go after terrorist support mechanisms as well as the terrorists themselves, and help alleviate conditions in the world that enable terrorists to bring in new recruits. To this end, in FY2005 the State Department and USAID will continue to focus on the reconstruction of Iraq and Afghanistan, support our coalition partners to further our counterterrorism, law enforcement and intelligence cooperation, and expand democracy and help generate prosperity, especially in the Middle East.

Building a Free and Prosperous Iraq

The United States faces one of its greatest challenges in developing a secure, free and prosperous Iraq. The USG is contributing almost $21 billion in reconstruction funds and humanitarian assistance to this effort. The World Bank and the International Monetary Fund are expected to provide another $4 to 8 billion in loans and grants over the next three years. These resources, coupled with the growing assistance of international donors, will ease the transition from dictatorship to democracy and lay the foundation for a market economy and a political system that respects human rights and represents the voices of all Iraqis.

The Coalition Provisional Authority (CPA) and the Iraqi Governing Council (IGC) have made great strides in the areas of security, economic stability and growth, and democratization. Iraqi security forces now comprise more than half of the total security forces in the country. In addition, the CPA has established a New Iraqi Army, issued a new currency and refurbished and equipped schools and hospitals. And, as you know, the CPA is taking steps to return sovereignty to the Iraqi people this summer.

Much work remains to be done. Working with our coalition partners, we will continue to train Iraqi police, border guards, the Civil Defense Corps and the Army in order to ensure the country's security as we effect a timely transition to democratic self-governance and a stable future.

At the same time, we are helping provide critical infrastructure, including clean water, electricity and reliable telecommunications systems which are essential for meeting basic human needs as well as for economic and democratic development. Thousands of brave Americans, in uniform and in mufti, are in Iraq now working tirelessly to help Iraqis succeed in this historic effort. Alongside their military colleagues, USAID, State Department and the Departments of the Treasury and Commerce are working to implement infrastructure, democracy building, education, health and economic development programs. These efforts are producing real progress in Iraq.

The UN Secretary General's Special Advisor, Lakhdar Brahimi, returned from Iraq last week and gave his report to the Security Council. The Secretary General released the report on Monday of this week. We have had the report since it went to the Security Council and have been studying it. By any measure, the task facing us is going to be difficult and complicated. We still intend passing sovereignty to the Iraqis at the end of June. What sort of transitional Iraqi government will then be developed, to prepare for elections at the end of this year or early in the next, is the question now. Creating a democratic government in Iraq will be an enormous challenge. But Ambassador Bremer, working with the Iraq Governing Council and with the United Nations and our coalition partners, is committed to success. And when State Department assumes the lead role in July, we will carry on that commitment. We are already thoroughly involved. And we will succeed.

Winning the Peace in Afghanistan

Mr. Chairman, Afghanistan is another high priority for this Administration. The U.S. is committed to helping build a stable and democratic Afghanistan that is free from terror and no longer harbors threats to our security. After we and our coalition partners defeated the Taliban government, we faced the daunting task of helping the Afghan people rebuild their country. We have demonstrated our commitment to this effort by providing over $3.7 billion in economic and security assistance to Afghanistan since 2001.

Through our assistance and the assistance of the international community, the government of Afghanistan is successfully navigating the transition that began in October 2001. Afghanistan adopted a constitution last month and is preparing for democratic national elections in June. With technical assistance from the U.S., Afghanistan successfully introduced a new stable currency in October 2002 and is working to improve revenue collection in the provinces. The lives of women and girls are improving as women pursue economic and political opportunities and girls return to school. Since 2001, the United States has rehabilitated 205 schools and 140 health clinics and trained thirteen battalions of the Afghan National Army (ANA). Also, President Bush's commitment to de-mine and repave the entire stretch of the Kabul-Kandahar highway was fulfilled. The road had not been functional for over 20 years. What was once a 30-hour journey can now be accomplished in 5 or 6 hours.

While the Afghanistan of today is very different from the Afghanistan of September 2001, there is still much left to accomplish. In the near-term, the United States will assist the government of Afghanistan in its preparations for elections in June to ensure that they are free and fair. To demonstrate tangible benefits to the Afghan people, we will continue to implement assistance on an accelerated basis. The FY2005 Budget contains $1.2 billion in assistance for Afghanistan that will be focused on education, health, infrastructure, and assistance to the ANA, including drawdown authority and Department of Defense "train and equip". For example, U.S. assistance efforts will concentrate on rehabilitation and construction of an additional 275 schools and 150 health clinics by June 2004, and complete training and equipping of fifteen army battalions. The U.S. will also extend the Kabul-Kandahar road to Herat so that people and commerce will be linked East and West across Afghanistan with a ground transportation link between three of the largest cities.

Support for Our Coalition Partners

As part of the war on terrorism, President Bush established a clear policy to work with other nations to meet the challenges of defeating terror networks with global reach. This commitment extends to the front-line states that have joined us in the war on terrorism and to those nations that are key to successful transitions to democracy in Iraq and Afghanistan.

Our assistance enables countries cooperating closely with the United States to prevent future attacks, improve counter-terrorism capabilities and tighten border controls. As I indicated earlier, the FY2005 Budget for International Affairs provides more than $5.7 billion for assistance to countries around the world that have joined us in the war on terrorism, including Turkey, Jordan, Afghanistan, Pakistan, Indonesia and the Philippines.

U.S. assistance has also resulted in unparalleled law enforcement and intelligence cooperation that has destroyed terrorist cells, disrupted terrorist operations and prevented attacks. There are many counterterrorism successes in cooperating countries and international organizations. For example:

- Pakistan has apprehended more than 500 al Qaeda terrorists and members of the Taliban through the leadership of President Musharraf, stronger border security measures and law enforcement cooperation throughout the country.

- Jordan continues its strong counterterrorism efforts, including arresting two individuals with links to al Qaeda who admitted responsibility for the October 2002 murder of USAID Foreign Service officer Lawrence Foley in Amman.

- The North Atlantic Treaty Organization has endorsed an ambitious transformation agenda designed to enhance its capabilities by increasing deployment speed and agility to address new threats of terrorism.

- Colombia has developed a democratic security strategy as a blueprint for waging a unified, aggressive counterterror-counternarcotics campaign against designated foreign terrorist organizations and other illegal, armed groups.

The U.S. and its Southeast Asian allies and friends have made significant advances against the regional terrorist organization Jemaah Islamiyah which was responsible for the Bali attack in 2002 that killed more than 200 people. In early August 2003, an Indonesian court convicted and sentenced to death a key figure in that bombing.

Since September 11, 2001, 173 countries have issued orders to freeze the assets of terrorists. As a result, terror networks have lost access to nearly $200 million in more than 1,400 terrorist-related accounts around the world. The World Bank, International Monetary Fund and other multilateral development banks have also played an important role in this fight by strengthening international defenses against terrorist finance.

While progress has been made attacking terrorist organizations both globally and regionally, much work remains to be done. The FY2005 President's Budget strengthens our financial commitment to our coalition partners to wage the global war on terror. Highlights of the President's request include $700 million for Pakistan to help advance security and economic opportunity for Pakistan's citizens, including a multi-year educational support program; $461 million for Jordan to increase economic opportunities for Jordanian communities and strengthen Jordan's ability to secure its borders; and $577 million for Colombia to support President Uribe's unified campaign against drugs and terrorism.

In September 2003, at the United Nations, President Bush said: "All governments that support terror are complicit in a war against civilization. No government should ignore the threat of terror, because to look the other way gives terrorists the chance to regroup and recruit and prepare. And all nations that fight terror, as if the lives of their own people depend on it, will earn the favorable judgment of history." We are helping countries to that judgment.

Mr. Chairman, one of the aspects of the War on Terrorism that gives us a particular sense of urgency is proliferation of weapons of mass destruction. These terrible weapons are becoming easier to acquire, build, hide, and transport.

On February 11, President Bush spoke at the National Defense University (NDU) and outlined the Administration's approach to this growing danger. The President described how we have worked for years to uncover one particular nefarious network – that of A.Q. Khan.

Men and women of our own and other intelligence services have done superb and often very dangerous work to disclose these operations to the light of day. Now, we and our friends and allies are working around the clock to get all the details of this network and to shut it down, permanently

We know that this network fed nuclear technology to Libya, Iran, and North Korea.

At NDU, President Bush proposed seven measures to strengthen the world's efforts to prevent the spread of WMD:

- Expand the Proliferation Security Initiative (PSI) to address more than shipments and transfers; even to take direct action against proliferation networks.
- Call on all nations to strengthen the laws and international controls that govern proliferation, including passing the UNSCR requiring all states to criminalize proliferation, enact strict export controls, and secure sensitive materials.
- Expand our efforts to keep Cold War weapons and other dangerous materials out of the hands of terrorists -- efforts such as those accomplished under Nunn-Lugar.
- Close the loophole in the Nuclear Nonproliferation Treaty that allows states such as Iran to produce nuclear material that can be used to build bombs under the cover of civilian nuclear programs.
- Univeralize the IAEA Additional Protocol.
- Create a special committee on the IAEA Board of Governors to focus on safeguards and verification.
- And, finally, disallow countries under investigation for violating nuclear nonproliferation treaties from serving on the IAEA Board of Governors.

As the President said at NDU, the nexus of terrorists and WMD is a new and unique threat. It comes not with ships and fighters and tanks and divisions, but clandestinely, in the dark of the night. But the consequences are devastating. No President can afford to ignore such a threat. And President Bush will not ignore it.

Expansion of Democracy in the Middle East

We believe that expanding democracy in the Middle East is critical to eradicating international terrorism. But in many nations of the Middle East, democracy is at best an unwelcome guest and at worst a total stranger. The U.S. continues to increase its diplomatic and assistance activities in the Middle East to promote democratic voices -- focusing particularly on women -- in the political process, support increased accountability in government, assist local efforts to strengthen respect for the rule of law, assist independent media, and invest in the next generation of leaders.

As the President emphasized in his speech last November at the National Endowment for Democracy (NED), reform in the Middle East is of vital importance to the future of peace and stability in that region as well as to the national security of the United States. As long as freedom and democracy do not flourish in the Middle East, resentment and despair will continue to grow -- and the region will serve as an exporter of violence and terror to free nations. For the United States, promoting democracy and freedom in the Middle East is a difficult, yet essential calling.

There are promising developments upon which to build. The government of Jordan, for example, is committed to accelerating reform. Results include free and fair elections, three women holding Cabinet Minister positions for the first time in Jordan's history, and major investments in education. Positive developments also can be found in Morocco, which held parliamentary elections last year that were acclaimed as free, fair and transparent.

In April 2003, the Administration launched the Middle East Partnership Initiative (MEPI), an intensive inter-agency effort to support political and education reform and economic development in the region. The President continues his commitment by providing $150 million in FY2005 for these efforts.

To enhance this USG effort with a key NGO, the President has doubled the NED budget to $80 million specifically to create a Greater Middle East Leadership and Democracy Initiative. NED is a leader in efforts to strengthen democracy and tolerance around the world through its work with civil society. We want that work to flourish.

As President Bush said in his November speech at NED: "The United States has adopted a new policy, a forward strategy of freedom in the Middle East. This strategy requires the same persistence and energy and idealism we have shown before. And it will yield the same results. As in Europe, as in Asia, as in every region of the world, the advance of freedom leads to peace."

Public Diplomacy in the Middle East

And the advance of freedom is aided decisively by the words of freedom.

Democracy flourishes with freedom of information and exposure to diverse ideas. The President's FY2005 Budget promotes expansion of democracy in the Middle East by providing public access to information through exchange programs and the Middle East Television Network.

New public diplomacy efforts including the Partnerships for Learning (P4L) and Youth Exchange and Study (YES) initiatives have been created to reach a younger and more diverse audience through academic and professional exchange programs. In FY2005, the P4L and the YES programs, funded at $61 million, will focus more on youth of the Muslim world, specifically targeting non-traditional, non-elite, often female and non-English speaking youth.

U.S. broadcasting initiatives in the Middle East encourage the development of a free press in the American tradition and provide Middle Eastern viewers and listeners access to a variety of ideas. The U.S. revamped its Arabic radio broadcasts in 2002 with the introduction of Radio Sawa, which broadcasts to the region twenty-four hours a day. As a result, audience size

for our Arabic broadcasting increased from under 2 percent in 2001 to over 30 percent in 2003. Based on this successful model, the U.S. introduced Radio Farda to broadcast to Iran around the clock. Building on this success, the FY2005 President's Budget Request provides over $70 million for Arabic and Persian radio and television broadcasts to the Middle East. This month, the United States launched the Middle East Television Network, an Arabic language satellite network that will have the capability of reaching millions of viewers and will provide a means for Middle Easterners to better understand democracy and free market policies, as well as the U.S. and its people. This network kicked off on February 14 with nine hours per day of broadcasting. By mid-March, the broadcasting will be 24/7. The network – *Al-Hurra*, or "the Free One" -- reaches 22 countries, including Iraq. President Bush has already appeared on the network and I did an interview earlier this week.

OUR NEW APPROACH TO GLOBAL PROSPERITY

President Bush's approach to global economic growth emphasizes proven American values: governing justly, investing in people, and encouraging economic freedom. President Bush has pledged to increase economic engagement with and support for countries that commit to these goals through an ambitious trade agenda and new approaches to development assistance focusing on country performance and measurable results.

The Millennium Challenge Account (MCA)

In February of 2003, we sent the Congress a budget request for the MCA and legislation to authorize the creation of the Millennium Challenge Corporation (MCC), the agency designed to support innovative development strategies and to ensure accountability for results.

The MCC will fund only proposals for grants that have clear, measurable objectives, a sound financial plan and indicators for assessing progress.

The Congress appropriated $1 billion for MCA for FY2004. The FY2005 Budget request of $2.5 billion makes a significant second year increase to the MCA and paves the way to reaching the President's commitment of $5 billion in FY2006.

Trade Promotion Authority (TPA)

President Bush recognizes that the fastest, surest way to move from poverty to prosperity is through expanded and freer trade. America and the world benefit from free trade. For this reason, one of his first actions upon taking office in 2001 was to seek TPA, allowing him to negotiate market-opening agreements with other countries. The President aims to continue vigorously to pursue his free trade agenda in order to lift developing countries out of poverty, while creating high-paying job opportunities for America's workers, businesses, farmers and ranchers and benefiting all Americans through lower prices and wider choices. As the President said in April, 2001 at the Organization of American States: "Open trade fuels the engines of economic growth that creates new jobs and new income. It applies the power of markets to the needs of the poor. It spurs the process of economic and legal reform. It helps dismantle protectionist bureaucracies that stifle incentive and invite corruption. And open trade reinforces the habits of liberty that sustain democracy over the long term."

Since receiving TPA in 2002, the President has made good on his promise, completing free trade agreements with Chile and Singapore, which were quickly approved by Congress and went into effect on January 1. We have recently completed negotiations with five Central American countries on the Central America Free Trade Agreement (CAFTA) and are working to bring the Dominican Republic into that agreement. Earlier this month, we announced the conclusion of an agreement with Australia. Negotiations are ongoing with Morocco, the Southern African Customs Union (SACU), Bahrain, and on the Free Trade Agreement of the Americas (FTAA). We are concluding comprehensive agreements that include market access for goods and services, strong intellectual property and investment provisions, and include commitments for strong environmental and labor protections by our partners. These arrangements benefit Americans and our trading partners.

Building on this significant progress, the President intends to launch free trade negotiations with Thailand, Panama, and the Andean countries of Colombia, Ecuador, Bolivia and Peru. The President has also stated his vision for a Middle East Free Trade Area by 2013, to ignite economic growth and expand opportunity in this critical region. Finally, the President is committed to wrapping up successfully the World Trade Organization's Doha agenda. The United States has taken the lead in re-energizing these negotiations following the Cancun Ministerial.

CARING FOR THE WORLD'S MOST VULNERABLE PEOPLE

Emergency Plan for AIDS Relief

When President Bush took office in January 2001, the HIV/AIDS pandemic was at an all time high, with the estimated number of adults and children living with HIV/AIDS globally at 37 million, with 68 percent of those individuals living in sub-Saharan Africa. From fiscal years 1993 to 2001 the total U.S. Government global AIDS budget was about $1.9 billion. As part of the Emergency Plan for AIDS Relief, the President proposed $2 billion in fiscal year 2004 as the first installment of a five-year, $15 billion initiative, *surpassing nine years of funding in a single year*. The President's Emergency Plan for AIDS Relief represents the single largest international public health initiative ever attempted to defeat a disease. The President's Plan targets an unprecedented level of assistance to the 14 most afflicted countries in Africa and the Caribbean to wage and win the war against HIV/AIDS. In addition, programs will continue in 75 other countries.

By 2008, we believe the President's Plan will prevent seven million new infections, treat two million HIV-infected people, and care for 10 million HIV-infected individuals and those orphaned by AIDS in Botswana, Cote d'Ivoire, Ethiopia, Guyana, Haiti, Kenya, Mozambique, Namibia, Nigeria, Rwanda, South Africa, Tanzania, Uganda and Zambia.

Announced during President Bush's State of the Union address on January 28, 2003, the Emergency Plan provides $15 billion over five years for those countries hardest hit by the pandemic, including $1 billion for the Global Fund to Fight AIDS, Tuberculosis and Malaria. The FY2005 Budget provides $2.8 billion from State, USAID, and the Department of Health and Human Services (HHS) to combat global AIDS, more than tripling funding for international HIV/AIDS since the President took office.

Over the past year, we have worked with the Congress to pass legislation laying the groundwork for this effort and to appoint a senior official at the State Department to coordinate all U.S. Government international HIV/AIDS activities. Ambassador Randall Tobias has been confirmed by Congress and has now taken steps to assure immediate relief to the selected countries.

On Monday of this week, Ambassador Tobias, Secretary Thompson, USAID Administrator Andrew Natsios, and I rolled out the strategy for this plan and announced the first dispensation of dollars -- $350 million in contracts to some of the NGOs and PVOs who will be carrying out the fight at the grass-roots level. It was a thrilling moment, I can assure you.

As a crucial next step, the FY2005 Budget Request expands on the Emergency Plan. By working together as a highly collaborative team, and placing primary ownership of these efforts in the hands of the countries that we are helping -- just as you will recall the Marshall Plan did so successfully in post-WWII Europe -- the Department of State, USAID and HHS can use significantly increased resources quickly and effectively to achieve the President's ambitious goals in the fight against global AIDS.

Mr. Chairman, President Bush summed it up this way in April of last year, "There are only two possible responses to suffering on this scale. We can turn our eyes away in resignation and despair, or we can take decisive, historic action to turn the tide against this disease and give the hope of life to millions who need our help now. The United States of America chooses the path of action and the path of hope." These dollars put us squarely on that path.

Emergency Humanitarian Assistance – Helping Others in Need

The President's Budget Request reflects a continued commitment to humanitarian assistance. The request maintains U.S. leadership in providing food and non-food assistance to refugees, internally displaced persons, and other vulnerable people in all corners of the world. In addition, the budget reflects the findings of the Program Assessment Rating Tool (PART) evaluations completed for the United Nations High Commissioner for Refugees and for USAID's Public Law 480 Title II international food assistance, which confirmed a clear purpose for these programs.

In 2003, the Administration provided funding to several international and non-governmental organizations to assist nearly 200,000 Angolan refugees and internally displaced persons return home after decades of civil war.

In an Ethiopia enveloped by drought, the Administration led international efforts to prevent widespread famine among 13 million vulnerable people, providing over one million metric tons of emergency food aid (valued at nearly half a billion dollars) to the World Food Program and NGOs, funding immunizations for weakened children, and supplying emergency seeds to farmers.

In Sudan, the Administration worked with the United Nations and the Government of Sudan so that vital assistance could be delivered to the Sudanese people. This year the U.S. will provide about $210 million in vital assistance to the people in the south, including approximately 125,000 metric tons (valued at nearly $115 million) in food aid, as well as non-food assistance, such as sanitation and water. We anticipate that a comprehensive peace agreement in Sudan will

allow us to expand significantly our development assistance to help the Sudanese people in effecting a long-awaited recovery following decades of civil war. The FY2005 Budget includes $436 million in humanitarian and development, economic, and security assistance funding, much of which will be contingent upon a peace settlement between the government and the south.

The FY2005 Budget ensures that the Administration can continue to respond quickly and appropriately to victims of conflict and natural disasters and to help those in greatest need of food, shelter, health care and other essential assistance, including those in areas starting to recover from conflict and war, such as Liberia. In particular, the budget requests funding for a flexible account to give the President the ability to respond to unforeseen emergency needs, the Emergency Fund for Complex Foreign Crises, funded at $100 million.

KEEPING AMERICANS SAFE AT HOME AND ABROAD

Mr. Chairman, we also have a sacred responsibility to look to the security of our citizens here and overseas, when that security is a part of our responsibility.

The State Department has the responsibility to protect more than 60,000 U.S. Government employees who work in embassies and consulates abroad. Since the 1998 bombings of two U.S. embassies in East Africa, the State Department has improved physical security overseas; however, as many of you are well aware, many posts are still not secure enough to withstand terrorist attacks and other dangers. To correct this problem, in 1999, the State Department launched a security upgrade and construction program to begin to address requirements in our more than 260 embassies and consulates.

Capital Security Cost Sharing Program

Working with the Congress, President Bush has accelerated the pace of improving and building new secure facilities. Moreover, we have reorganized the Overseas Buildings Office to manage the effort with speed, efficiency, and effectiveness. Within the budget, we are launching a plan to replace the remaining 150 embassies and consulates that do not meet current security standards over the next 14 years, for a total cost of $17.5 billion. To fund construction of these new embassy compounds, we will begin the Capital Security Cost Sharing (CSCS) Program in FY2005. We will implement this program in phases over the next five years.

Each agency with staff overseas will contribute annually towards construction of the new facilities based on the number of positions and the type of space they occupy. We arrived at the cost shares in the FY2005 President's Budget Request in consultations with each agency and the State Department's Overseas Buildings Office.

CSCS is also a major component of the President's Management Agenda Initiative on Rightsizing. Along with securing facilities, we have focused on assuring that overseas staffing is deployed where they are most needed to serve U.S. interests. As agencies assess the real cost of maintaining staff overseas, they will adjust their overseas staffing levels. In this way, new embassies will be built to suit appropriate staffing levels. The program is already producing rightsizing results. Agencies are taking steps to eliminate unfilled positions from their books to

reduce any unnecessary CSCS charges, which in turn is leading to smaller embassy construction requirements.

Border Security

Prior to September 11, 2001, the State Department's consular officers focused primarily on screening applicants based on whether they intended to work or reside legally in the United States. In deciding who should receive a visa, consular officers relied on State Department information systems as the primary basis for identifying potential terrorists. The State Department gave overseas consular officers the discretion to determine the level of scrutiny that should be applied to visa applications and encouraged the streamlining of procedures.

Today, Consular Affairs at the State Department, working with both Customs and Border Protection and the Bureau of Citizenship and Immigration Services at the Department of Homeland Security, are cooperating to achieve our goals more effectively by sharing information and integrating information systems.

The Department of State has invested substantial time, money, and effort in revamping its visa and passport process as well as its provision of American Citizen Services. The Department has more than doubled its database holdings on individuals who should not be issued visas, increased training for all consular officers, established special programs to vet applications more comprehensively, increased the number of skilled, American staff working in consular sections overseas, and improved data-sharing among agencies. The State Department, along with the Department of Homeland Security, is currently developing biometrics, such as fingerprints, digital photographs or iris scans, for both visas and passports in order to fulfill requirements of the Patriot and Border Security Acts and the International Civil Aviation Organization.

As a part of the State Department's efforts to screen visa applicants more effectively, and in particular to ensure that a suspected terrorist does not receive a visa to enter the United States, we will be an active partner in the Terrorist Screening Center (TSC). The TSC, established in December 2003, will maintain a single, consolidated watchlist of terrorist suspects to be shared with Federal, state, local and private entities in accordance with applicable law. The Department of State will also participate in the Terrorist Threat Integration Center (TTIC), a joint-effort aimed at reducing the potential of intelligence gaps domestically and abroad.

To achieve our goal of secure borders and open doors, in FY2005 the State Department plans to expand the use of biometrics to improve security in the visa and passport processes; more effectively fill gaps worldwide by hiring people with specific skills including language expertise; improve and maintain all consular systems; and more broadly expand data sharing with all agencies with border control or immigration related responsibilities. The budget in FY2005 includes $175 million for biometric projects including photographs and fingerprints to comply with Border Security and Patriot Acts.

The Border Security program underwent a PART analysis in the development of the FY2004 and FY2005 budgets and this budget request reflects the results of those analyses. The Department is moving ahead on program management improvements that clearly link to the Department of Homeland Security goals related to visa policy.

THE CRITICAL IMPORTANCE OF DIPLOMATIC READINESS

We created the Diplomatic Readiness Initiative (DRI) in 2002 to address staffing and training gaps that had become very adverse to the conduct of America's diplomacy. The goal of DRI was to hire 1,158 new foreign and civil service employees over a three-year period. These new hires, the first over-attrition hires in years, would allow us to provide training opportunities for our people and greatly improve the Department's ability to respond to crises and emerging priorities overseas and at critical domestic locations. To bring these new people on board – and to select the best men and women possible -- we significantly improved Department hiring processes, to include recruiting personnel from more diverse experience and cultural backgrounds and people who could fill critical skill gaps. In the process, we broke records in recruiting and thus had the best and the brightest from which to select. The Department of State will be reaping the benefits from this process for many years to come. We also created new mandatory leadership and management training, enhanced public diplomacy and consular training, and made significant increases in the amount of language training available for new Foreign Service Officers. DRI hiring has supported the Department's efforts in responding to crises since September 11th and provided the additional resources necessary to staff overseas locations that truly represent the front line in the war on terrorism.

Some of these positions, however, are being diverted to support new requirements not envisioned by DRI, such as permanently staffing new embassies in Afghanistan, Iraq, Sudan, and possibly in Tripoli. Because of this, the FY2005 Budget Request provides additional resources to continue our DRI commitment.

DRI has allowed the Department to focus on recruiting, training and retaining a high quality work force, sized to requirements that can respond more flexibly to the dynamic and demanding world in which we live. We need to continue it.

USAID has begun a similar effort to address gaps in staffing in technical skills, calling it the Development Readiness Initiative. USAID plans to hire approximately 40 Foreign Service Officers in FY2004 under this initiative. This Budget Request includes authority for USAID to hire up to 50 additional Foreign Service Officers in FY2005, in order to fill critical skill gaps identified through a comprehensive workforce analysis.

Mr. Chairman, I have focussed your attention for long enough. There is more in the President's Budget Request for FY2005; but what I have outlined above represents the top priorities for the State Department. I will be pleased to answer any questions you have about these priorities or about any other portion of the budget request in which you are interested. If I cannot answer the question myself, I have a Department full of great people who can; and I will get you an answer for the record.

Thank you.

Chairman NICKLES. I appreciate the clarification both from you and my very knowledgeable staff.

With that, Mr. Secretary, thank you very much for your appearance before the committee.

The committee is adjourned.

[Whereupon, at 12:15 p.m., the committee was adjourned.]

Statement of Senator Pete V. Domenici
Committee on the Budget
International Affairs Budget
Secretary of State Colin Powell

- Welcome, Mr. Secretary. Obviously, the portfolio of issues you and your department face continues to grow in size and importance to the future of this country.

- The war on terrorism, counter-proliferation of weapons of mass destruction and fighting the international AIDS epidemic are just a few of the major issues you are working on.

- Let me state **my appreciation** to you for your tireless efforts on these matters. Thank you also for the contributions you have made to this country over the course of your distinguished career.

- There are a number of issues that are of concern to me this year as it relates to international affairs.

- From the budgetary perspective, I am interested to know how we can enhance **security at our borders**.

- My home state of New Mexico shares a common border with Mexico. I remain concerned about the flow of narcotics and terrorists across that border and would welcome a discussion of the Department's plans to address this problem.

- The **proliferation** of weapons of mass destruction also continues to be an issue of utmost importance.

- Clearly, Libya's admission of a secret nuclear program is a major success in our effort to contain these dangerous weapons. However, many **challenges remain**.

- Iran and North Korea remain involved in activities that signal nuclear ambitions. Reports of Pakistan exporting technical assistance to countries seeking a nuclear capability appear almost daily in our newspapers.

- Obviously, our **diplomatic approach** to these problems is critical. From a policy perspective, I am anxious to hear from Secretary Powell on the upcoming negotiations with North Korea and his views of recent developments in Iran.

- Naturally, we are all interested in diplomatic efforts to rebuild **Iraq**.

- Following the **heroic efforts of our troops** to liberate the long-suffering people of this nation, much work has been done to help build democratic society.

- The road has been difficult. Brave American soldiers, United Nations diplomats, and Iraqis themselves have suffered painful losses in the rebuilding process.

- But despite these tragic losses, Americans and Iraqis alike remain committed to our common interest of building a free and stable nation.

- Clearly, this is in the best interest of Iraqis who, until now, have known nothing but tyranny. And it is my firm belief that it remains in the **vital national security interests of the United States** as well.

- In an era where the asymmetric threat of terrorism puts the safety of American citizens at risk, the world cannot afford to allow regimes with a proven record of using WMD to ignore the mandate of the global community.

- I believe Americans are safer today for the actions we took in Iraq.

- I also believe we now have a great opportunity to help Iraq achieve a bright future, and I certainly welcome hearing from the Secretary about our current efforts in Iraq.

- Thank you, Mr. Chairman.

STATEMENT FOR SENATOR BUNNING
SENATE COMMITTEE ON THE BUDGET
FY05 Foreign Affairs Budget Request
26 February 2004

Thank you, Mr. Chairman.

Mr. Secretary, I appreciate you taking the time to be with us today to discuss the President's Fiscal Year '05 budget request for International Affairs. I realize that there are many demands on your time in these pressing days, but I know that you value the importance of these exchanges with Congress. As you well know, it is imperative that the members of this Committee have the best information possible as we consider the important decisions that we have in front of us.

I look forward to hearing more about the progress with initiatives such as the Millennium Challenge Account and the Middle East Television Network. I also hope that a discussion of the safety of our overseas Foreign Service and State Department personnel will be included in today's hearing.

Again, thank you, Mr. Secretary, for appearing here today to engage in this dialogue with the Committee. We all have a year of tough choices ahead of us. I have a number of questions to ask the Secretary and I look forward to our conversation today and to working together as we face the challenges before us.

Thank you.

Brief Statement
February 26,2004

Thank you, Mr. Chairman.

First, let me say welcome and thank you to Secretary Powell for testifying before the Budget Committee today. As a member of the International Operations and Anti-terrorism Subcommittee on the Foreign Relations Committee and a former U.S. Congressional Delegate to the United Nations, I have a particular interest in your testimony.

Also, before I go any further, I wanted to recognize your leadership as the America's top diplomat and applaud your efforts during this Administration. I have heard you speak about our diplomatic corps serving as the American front line throughout the world and I completely agree.

This is only my second year on the Budget Committee, but I have learned a tremendous amount about how the Federal budget process works. The Federal budget process is not like the process you go through as a small business owner. As a small business owner, you create capital plans and executive budgets and real timelines that truly affect whether or

not you can pay your bills on time. Every little dollar counts and the numbers aren't so easily manipulated. At the Federal level, a billion here and billion there seem like pocket change to some of my colleagues who want to spend, spend, spend. We have to reign in spending this year. The President has proposed a way to do that, but more needs to be done. Reducing the deficit will be a matter of making tough choices and putting our money where our top priorities are.

So far, a top priority has been working with our international friends and partners to protect America and the world from terrorists and other bad actors. I know the U.N. Security Council Terrorism Committee has been working well to stop international terrorist financing and I encourage you to continue working with the CTC whenever possible.

The President's request for the international affairs budget differs from many of the budgets we've looked at so far. It is one of the few budgets that grows faster than the proposed .5% increase for non-defense discretionary funding. While we still have a lot of work to do on this and other budget measures, I was pleased to see the United Nations

UN headquarters project included in this year's budget request. Anyone who has spent time in that building knows the daily problems. The fact is that this international building would not meet any of today's building codes. As we debate the merits and costs of the program, I hope everyone will remember we are talking about safety and security of Americans and diplomats from the entire world.

With that, I would like to get into my first question.

United States Department of State

Washington, D.C. 20520
www.state.gov

MAR - 8 2004

Dear Senator Gregg:

In accordance with your request to Secretary Powell at the Senate Budget Committee hearing on February 26, I am pleased to transmit the enclosed paper on the Department's program for enhancing the security of U.S. Government employee dependents who are students ("USG Students") and other U.S. citizen dependents who are students ("US Citizen Students") in overseas schools. In addition, the head of our Overseas Building operations, General Charles Williams, was briefing your staff the same day on the Department's Capital Cost Sharing Initiative where this issue was also discussed.

Please be assured it is not the policy of the Department to withhold funding for security enhancements from any overseas schools attended by USG or US Citizen Students. From the beginning, as outlined in the Department's July 9, 2003 report to Congress on Improving Security at Overseas Schools, Phase III of the Department's plan has called for the provision of assistance to non-grant schools. The initial focus for those schools parallels the initial assistance being provided to schools that currently receive educational grants from the Office of Overseas Schools ("Grant Schools"): shatter-resistant window film, radio communication with the U.S. mission in the city, and public address systems to facilitate immediate communication with everyone on the school premises.

The Department's schools program initially addressed Grant Schools for a number of reasons: They include about 60% of the USG Students, as well as many US Citizen Students; U.S. missions already have a working relationship with them; and the Department already has an established grant funding mechanism in place for them. By contrast, many of the non-grant schools have relatively few USG or US Citizen Students or would be unlikely to accept Department security assistance for a variety of reasons.

The Honorable
Judd Gregg,
United States Senate.

(For example, in Western Europe, many USG and US Citizen Students attend host country public schools.) Sorting out which non-grant schools want and need which kinds of assistance will inevitably be a slower, more complex task.

Starting with the Grant Schools was the most effective means of providing enhanced protection for the most USG and US Citizen Students most quickly. As the program continues in FY04, FY05, and subsequent years, the Department will give more attention to the non-grant schools, with the ultimate objective of providing enhanced security to all USG and US Citizen Students to the extent it can be cost-effective.

We appreciate your interest and continued support for this program. I can assure you that ensuring the security and safety of U.S. government employees and their dependents, as well as other U.S. citizens abroad, is the highest priority of the Department and the Secretary personally.

If we can be of further assistance to you on this matter, please do not hesitate to let us know.

Sincerely,

Paul V. Kelly
Assistant Secretary
Legislative Affairs

Enclosure:
As stated.

THE SOFT TARGETS PROGRAM FOR SCHOOLS

Summary

In response to direction from Congress, the Department has established a three-phase, multi-year program to provide physical security enhancements to overseas schools attended by dependents of U.S. government employees and other U.S. citizens. This program addresses the 188 schools that receive educational grants from the Department's Office of Overseas Schools ("Grant Schools") first because (1) most of the U.S. students are in these schools and (2) the Department already has a working relationship with these schools, and (3) the machinery for transferring funds to these schools is already in place. Phase I, providing almost $10 million in basic security enhancements to Grant Schools, is in the execution phase. Phase II, providing almost $15 million for more individualized improvements to those schools, is in the project evaluation and grant preparation stage. Phase III, providing basic security enhancements for the non-grant schools, will be initiated this summer and funded in FY05.

Funding

In FY03 Congress earmarked "up to" $15 million in the OBO appropriation to address security vulnerabilities against "soft-targets," in particular schools. The Department is spending these funds at the rate of $5 million in each of FY03, 04, and 05. The Iraq Supplemental provided $10 million of new funding for the soft targets program, for an FY03 total of $15 million. Of the $15 million for FY03, approximately $8.5 million was obligated in FY03, and $6.5 million was carried over to FY04. From the funds Congress earmarked in FY04 for soft targets, approximately $10 million will go to schools, $5 million to recreation facilities, and $12 million to residential improvements.

Phase I School Grants

Phase I reached out to the 188 Grant Schools. The Department addressed these schools first for several reasons:

- About 60% of the U.S. employee dependents, as well as many other U.S. citizen students (aside from Defense Department employee dependent students), attend these schools.
- The Department already has a grant program for these schools, so the machinery is in place for prompt funding of security upgrades.
- The Office of Overseas Schools has a working relationship with these schools, which facilitates grant administration.
- Regional Security Officers (RSOs) at post have been working with these schools on other security issues and could help them quickly assess their initial needs.

These schools were offered any or all of the three basic security enhancements that the Department considers first priority:

- Shatter Resistant Window Film (SRWF)
- Radio access to the Embassy/Consulate Radio Network, to allow prompt notification of threat conditions
- A Public Address System to allow immediate notification of all school staff and students if action is necessary

As of January 31, 2004, 180 of the 188 schools had requested at least one of these security enhancements, and grants totaling $9.4 million had been allocated to the schools to fund acquisition and installation through the Office of Overseas Schools. Schools are notified of the grant and are reimbursed upon demonstration that the funds have been spent and the RSO considers the work is satisfactory.

Phase II School Grants

Phase II also addresses security needs at the 188 Grant Schools. These additional enhancements may include a wide range of items, depending on the individual circumstances:

- Walls, Fences, Perimeter Barriers
- Exterior/Interior Lighting
- Gates
- Drop Arms and similar vehicle barriers
- Cameras/Closed Circuit TV

United States Department of State
Washington, D.C. 20520

MAR 11 2004

Dear Mr. Chairman:

During the Secretary's February 26th hearings on the FY05 Budget, you requested views on the Inter-Country Adoption Reform Act (ICARE) that you and Senator Landrieu recently introduced. I welcome this opportunity to provide some preliminary views on the draft legislation. It is important to note that the scope of ICARE extends well beyond the purview of the Department of State alone, and a formal response will require full and formal consultations with the Department of Homeland Security and coordination with Office of Management and Budget. While the Department has some concerns with the bill, let me confirm that the Department shares with you goals implicit in ICARE, such as:

- Removing unwarranted obstacles and delays to American families seeking to adopt children abroad;
- Streamlining and simplifying procedures for intercountry adoption ;
- Recognizing and respecting the legal and emotional parent-child relationship created by intercountry adoption;
- Ensuring that Intercountry adoption offers the advantage of a permanent family to a child for whom a suitable family cannot be found in the child's country of origin;
- Ensuring that intercountry adoption procedures protect the rights of and prevent abuses against children, birth families, and adoptive parents involved in adoptions (or prospective adoptions), and that such adoptions are in the child's best interest; and
- Clearly defining the respective roles for the Department of State and the Department of Homeland Security.

Most of these goals and values are already embodied in the Intercountry Adoption Act (IAA), which provides for implementation of our accession to the

The Honorable
Don Nickles, Chairman,
Committee on the Budget,
United States Senate.

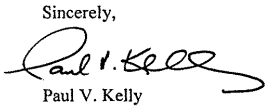
Hague Adoption Convention, and which we are in the process of doing. By embracing the IAA, we have embraced the concept that change is acceptable and necessary. Identifying what changes are needed in the intercountry adoption process is still under careful review at the Department of State. The work we have begun with DHS to develop new adoption procedures mandated in the IAA clearly will inform this review; we have already identified issues, such as how to address non-Hague adoptions, that may require further legislative clarification as we proceed with IAA implementation.

We believe that our primary task is to continue our efforts to implement the congressional mandate in the IAA. These efforts include drafting new regulations and preparing the Department of State to serve as the U.S. Central Authority under the Hague Adoption Convention. We have worked extensively with the many stakeholders involved in this endeavor and we are committed to meeting Congress's mandate. Under the direction of Assistant Secretary Harty, the Bureau of Consular Affairs' Office of Children's Issues will serve as the U.S. Central Authority, given its experience in coordinating the Department's policies on intercountry adoptions.

We have welcomed the interest and concern expressed by Members of Congress relating to our progress in implementing the IAA, and have worked closely and collaboratively with many offices and the Congressional Coalition on Adoptions Institute to provide regular briefings and updates. We will continue this important and very useful dialogue as we move forward on the IAA.

Let me take this opportunity to thank you for letting us share our views and to reaffirm the Department's commitment to working with you toward creating an intercountry adoption system that protects the rights and interests of adoptive American families.

Sincerely,



Paul V. Kelly
Assistant Secretary
Legislative Affairs

United States Department of State
Washington, D.C. 20520

MAR 16 2004

Dear Senator Bunning:

This letter is in response to your question to Secretary Powell on February 26th regarding the status of international negotiations on the Federal Flight Deck Officers (FFDO) Program.

At present, the FFDO is solely a domestic program administered by the Transportation Security Administration (TSA). In response to a request from TSA, State officials have met with TSA officials to discuss the possible expansion of the FFDO program to include international flights of U.S. carriers.

Pursuant to these conversations, State and TSA officials have approached foreign governments on the issue. Many foreign governments remain steadfastly opposed to allowing armed U.S. pilots into their countries. For example, State Department and TSA officials met last December with the European Civil Aviation Conference (ECAC) and solicited their views on armed pilots. ECAC polled their member states, which include over thirty countries within Europe, and the response was uniformly negative. ECAC explained that even if a U.S. pilot *inadvertently* brought a firearm into a country in Europe today, the responses could range from arrest of the pilot(s) to terminating bilateral air services agreements with the United States, which would have serious consequences. Firearms are explicitly prohibited in many countries, and U.S. pilots would be subject to those countries' firearms laws, which are often strict.

The Honorable
James Bunning,
United States Senate.

Question For The Record Submitted to
Secretary of State Colin L. Powell
By Senator Bunning (#1)
Senate Budget Committee
February 26, 2004

Question:

The law creating the armed pilots program allows them to operate on international flights. According to an op-ed in Monday's *Roll Call,* none are being allowed to do so because the state department has not negotiated agreements with other nations. Why not, and is your department working with the Department of Homeland Security to make that happen? Is DHS cooperating, or are they the problem?

Answer:

At present, the FFDO is solely a domestic program administered by the Transportation Security Administration (TSA). In response to a request from TSA, members of my staff have met with TSA officials to discuss the possible expansion of the FDDO program to include U.S. carriers flying internationally.

Pursuant to these conversations, State and TSA officials have approached foreign governments on the issue. Many foreign governments remain steadfastly opposed to allowing armed U.S. pilots into their countries. For example, State Department and TSA officials met last December with the European Civil Aviation Conference (ECAC) and

continue to press the Global Fund to be an effective, results-based organization to ensure effective use of the U.S. contribution to the Global Fund.

Director of the Fund, Richard Feachem, has publicly stated his support for the President's Emergency Plan and the need for both multilateral and bilateral assistance.

Question:

B. Mr. Secretary, I don't believe our bilateral initiatives conflict in any way with our commitment to the Global Fund. It makes sense to me that we put some of our eggs in the Global Fund basket, and encourage other countries to do so as well. But it also makes sense that we put most of our eggs in the basket that is most directly accountable to you, to the President and the Congress, and the taxpayer.

How do you anticipate that your department and the Global AIDS Coordinator will interact with the Global Fund to ensure that we are maximizing both our investment in the Global Fund and our investments in the President's initiative?

Answer:

The Office of the U.S. Global AIDS Coordinator will continue the close relationship with the Global Fund already established through the hard work of Health and Human Services Secretary Tommy G. Thompson, who chairs the Board of the Global Fund. Ambassador Tobias' staff and members of the interagency Global Fund team meet frequently and often with members of the Global Fund Secretariat to ensure our programs complement one another. Secretary Thompson has placed a staff member in Geneva to serve as our day-to-day liaison to the Secretariat. We also will

Questions for the Record Submitted to
Secretary of State Colin L. Powell
Senator Bunning #2
Senate Budget Committee
February 26, 2004

Question:

I want to applaud the president and you for the funds included in this budget to promote democracy in the Middle East. I have no doubt that as democracy is introduced in the Middle East, the fanaticism that breeds terrorists is less and less likely to exist. However, I am also concerned about encouraging democracy just 90 miles from our shores in Cuba. How does this budget help advance democracy in Cuba? Should we spend more to prevent Castro from jamming Radio Marti and TV Marti?

Answer:

Our policy is to encourage a rapid, peaceful transition to democracy in Cuba. Supporting Cuba's fledgling civil society with informational materials and humanitarian goods is the best way to encourage such a transition. In the face of open hostility by the Cuban government towards both the United States and pro-democracy activists, the U.S. has greatly increased high-level public statements on Cuba human rights issues, encouraged other members of the international community to address Cuba human rights issues, and continued our moral and material support for Cuban civil society.

Specifically, the U.S. Government through its economic assistance has so far successfully distributed 55,000 printed items and 244 magazine

subscriptions to independent librarians, in addition to distributing 1,500 radios capable of receiving international broadcasts. The U.S. has also distributed a smaller quantity of highly sought Cuban political and historical literature (otherwise unavailable in Cuba) and purchased locally available books for independent libraries.

The U.S. Interest Section in Havana has worked with Radio/TV Marti to improve programming, gauge its effectiveness, and test alternatives to existing broadcasting methods. Technical improvements have allowed the U.S. to beam TV Marti into public areas of the Interest Section, where it can be viewed by Cuban citizens, and to increase Internet access through a Multimedia Center located in a public area of the Interest Section. We also continue to search for more effective ways get our message to the Cuban people through Radio and TV Marti as we have instituted new and more popular programming.

The Cuban government feels threatened by the growth and strength of the opposition. In March 2003, it conducted one of the most egregious acts of political repression in decades in Cuba. Some 75 members of Cuba's civil society, whose only offense was to exercise their fundamental freedoms, were convicted in summary proceedings to lengthy prison terms averaging

20 years each. The world is united in condemning this brutal repression.

We will continue to support Cuban civil society, despite regime repression.

Questions for the Record Submitted to
Secretary of State Colin L. Powell
Senator Bunning (#3)
Senate Budget Committee
February 26, 2004

Question:

As the head of the President's new Commission for Assistance to a Free Cuba, could you briefly describe the progress the commission has made on the report that is due to the President on May 1, 2004?

Answer:

Five interagency working groups are in the process of writing the chapters of the report. The working groups are pressing forward with the ambitious agenda laid out for the commission. They continue to research and refine their findings in order to offer comprehensive recommendations for U.S. government action. We will provide the initial report to the President by May 1, as directed.

Questions for the Record Submitted to
Secretary of State Colin L. Powell by
Senator Jim Bunning (#4)
Senate Budget Committee
February 26, 2004

Question:

Mr. Secretary, one of the key provisions of U.S. law with respect to Cuba policy is the requirement that U.S. assistance be withheld to countries providing aid to the Castro regime. Which countries are we focusing on? What steps are we taking to help ensure that U.S. foreign assistance is not indirectly benefiting Cuba's tyrannical regime?

Answer:

The provision of law to which I believe you refer is Section 498 of the Foreign Assistance Act of 1961 which requires that the President determine the extent to which an independent state covered by the FREEDOM Support Act is acting to "terminate support for the communist regime in Cuba, including removal of troops, closing military and intelligence facilities, including the military and intelligence facilities at Lourdes and Cienfuegos, and ceasing trade subsidies and economic, nuclear and other assistance." If the President determines that a country is providing such assistance to Cuba, then U.S. assistance will be terminated unless the President chooses to exercise one of the exceptions provided in the statute.

In 1991, Moscow ended its $4 billion a year subside of the Cuban economy. In 1992 Russia halted construction of the Juragua nuclear power plant near

Cienfuegos, Cuba. Russia maintained a credit line for mothballing parts of the facility completed before suspension, but Fidel Castro announced in January 2001 that Cuba had decided against continuing with the project. In 1993, Russia withdrew its last remaining combat troops from Cuba. On October 17, 2001 President Putin announced Russian withdrawal from Moscow's intelligence facility at Lourdes, Cuba. The Russians completed the dismantling of the Lourdes site by late summer of 2002, and the Government of Cuba announced that it would convert the former listening post to a large computer science campus. With the closing of the facility, Russia ceased providing Cuba a $200 million annual payment for its use. Russian officials continue to assert that Russia is not providing assistance to Cuba, and that all trade is conducted on a commercial, non-preferential basis. Russian-Cuban economic interaction centers on oil-for-sugar barter arrangements and nickel plant investments, both part of a 2001-2005 trade plan agreement which established "recommended" trade targets. According to the agreement, Russia aims at delivering 1.5-2.0 million tons of oil per year to Cuba. Other Russian exports include spare parts, fertilizers, and steel. Cuba exports the lion's share of its sugar production to Russia each year, as well as nickel, medicines, vaccines and medical equipment, citrus fruits, cigarettes and rum. Russia and Cuba recently announced plans to

increase mutual investment. Tourism, energy, and mining were noted as promising avenues of economic cooperation.

Thus the U.S. has no evidence from which to conclude that the Governments of Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine or Uzbekistan are at this time providing military, intelligence, economic, nuclear, or other assistance to the Government of Cuba. We will continue to monitor this in accordance with the statute.

Question for the Record Submitted to
Secretary of State Colin L. Powell by
Senator Bunning (#5)
Senate Budget Committee
February 26, 2004

Question:

Do we tie economic assistance to a country's willingness to make economic and political reforms that will move it closer to a free-market economy? Could you address what assurances, if any, the U.S. has asked from recipients of our foreign aid that they will engage in political reforms that will move them toward greater democratization and respect for human rights?

Answer:

The United States Government does tie economic assistance to a country's willingness and effectiveness in introducing political and economic reform. As the National Security Strategy makes clear, the USG will provide resources to aid countries that have met the challenge of national reform, and we will insist upon measurable results to ensure that development assistance is actually making a difference in the lives of the world's poor. One of the best, but by no means only, examples of this is the Millennium Challenge Account (MCA), which will fund programs in countries whose governments have already demonstrated that they rule justly, invest in their people, and encourage economic freedom. Governments must fight corruption, respect basic human rights, embrace the rule of law, invest in health care and education, follow responsible economic

policies, and enable entrepreneurship. The Millennium Challenge Account will reward countries that have demonstrated real policy change and challenge those that have not implemented reforms. Simple assurances will not suffice.

In addition, USAID has committed to assisting those countries on the threshold of qualifying for the MCA, but that still fall short of the mark. In those countries, USAID will support development through programs under the MCA rubric of ruling justly, investing in people, and encouraging economic freedom, with particular attention to areas of weakness in qualifying for the MCA. In its ongoing broader assistance program, USAID implements democracy and governance activities in nearly 80 country and regional programs that help nations develop and consolidate effective, authoritative, and legitimate democratic governance.

Questions for the Record Submitted to
Secretary of State Colin L. Powell
Senator Bunning (#6)
Senate Budget Committee
February 26, 2004

Question:

What benefits does the U.S. get out of sending $1.9 billion in military aid to Egypt?

Answer:

The United States receives a range of strategic benefits from our military assistance to Egypt. This assistance has helped to facilitate peace between Israel and Egypt for the past twenty-five years, thereby eliminating one of the world's foremost military hot spots. Egypt is a strong partner in the Global War on Terrorism and is also a key regional partner for joint training exercises. These strategic benefits provide a valuable return on investment for the American taxpayer.

The FY 2005 request for Egypt consists of $1.3 billion in Foreign Military Financing (FMF) and $1.2 million in International Military Education and Training (IMET). FMF specifically supports the development of a modern Egyptian military to ensure regional stability, facilitates Egypt's participation in future coalition operations, provides force protection for the U.S. military in the region, and guarantees U.S. access to

the Suez Canal and over-flight routes to support the Global War on Terrorism.

The $1.3 million IMET funds play a critical role in the development of the Egyptian armed forces. These funds allow Egypt to send students to U.S. military education courses, which foster one-to-one military relationships that improve interoperability and coordination, and serve U.S. regional interests.

Questions for the Record Submitted to
Secretary of State Colin L. Powell by
Sen. Jim Bunning (#7)
Committee on the Budget
February 26, 2004

Question:

Could you please comment on the $15 billion the President has pledged for the new Global AIDS Initiative and the implementation of the Mexico City policy?

Answer:

The Mexico City Policy applies only to assistance for family planning activities by foreign non-governmental organizations, not to assistance for HIV/AIDS funding or other health activities that do not involve assistance for family planning. The President's extension last year of the Mexico City Policy to State Department programs expressly did not apply to HIV/AIDS assistance. Any group will be eligible to apply for HIV/AIDS funding under the President's Emergency Plan subject to relevant provisions of U.S. law.

Questions for the Record Submitted to
Secretary of State Colin L. Powell
Senator Bunning (#8)
Senate Budget Committee
February 26, 2004

Question:

This budget includes a 9% increase for the UN and related agencies. Of the $819 million that is included in these accounts, how do we account for the use of these funds by UN organizations? Is there anything we can do to ensure that UN organizations reflect U.S. policies when spending U.S. provided funds? Do we ask for any accounting of U.S. funds from UN organizations?

Answer:

The $819 million relates to U.S. assessed dues for the budgets of the UN and its affiliated agencies. As the major contributor to most UN agencies, the U.S. plays an active role in negotiating the level and composition of these budgets. Our approach calls for budget levels which reflect financial discipline and are consistent with U.S. priorities in the agencies' program of work. The U.S. also has been active in introducing the concept of results-based-budgeting in the UN system, which calls for improved priority-setting and evaluation of agency programs, including the elimination of obsolete activities. In addition, the fact that virtually all budgets are approved by consensus helps ensure that U.S. views on programs and budgets are reflected in the final outcome.

The UN agencies have several mechanisms in place to ensure proper accounting of U.S. and other members' funds. All funds received and administered by the agencies are subject to scheduled performance reviews by member states and to financial audits by the respective external auditors. In most cases, budget performance reviews are conducted annually, while financial audits are conducted biennially. The outcome of such audits is reviewed and approved by the member states. The United States is always an active participant in the review of these audits. Additional oversight of funds and budgets is provided by the UN's expert Advisory Committee on Administrative and Budgetary Questions (ACABQ), which includes a U.S. member, and by the Office of Internal Oversight Services (OIOS). The U.S. was instrumental in creating the OIOS in the UN in 1994. Since then, the U.S. has worked to expand the OIOS concept to other UN agencies in order to strengthen their audit and investigative capabilities.

Questions for the Record Submitted to
Secretary of State Colin L. Powell
Senator Bunning (#9)
Senate Budget Committee
February 26, 2004

Question:

Could you please address the U.S. Information Agency and how the activities and focus of that agency are changing and adapting to world events – in particular, with regard to the Muslim world and the proposed Middle East television network?

Answer:

In 1999, the U.S. Information Agency was consolidated into the State Department, pursuant to P.L. 105-277, the Foreign Affairs Reform and Restructuring Act of 1998. The Under Secretary of State for Public Diplomacy and Public Affairs now has oversight of the public diplomacy functions of cultural and educational exchange as well as international information programs and the public affairs function of providing information to the U.S. audience.

The Under Secretary serves as the Secretary's representative to the Broadcasting Board of Governors, an independent federal agency that maintains oversight of *Alhurra*, the new 24/7 Arabic language Middle East Television Network, which began broadcasting on February 14, 2004.

In the years since 9/11, the Department has shifted funding for educational and cultural exchanges to the Middle East and South Asia, increasing it from 17% to 25%, and we continue to prioritize to the overall Muslim world. Prior to 9/11, in FY01, the Department sponsored only two reporting tours for Muslim journalists. Since 9/11, there have been 49 tours for journalists from Arab and Muslim-majority countries. The Department has translated four times the amount of material into Arabic than it did before. In our print publication program, 60% of new titles since 9/11 have been aimed at Muslim and/or Arabic audiences. We will continue this trend.

We have begun a comprehensive new program called Partnerships for Learning, aimed at increasing undergraduate and high school exchanges, with a focus on the Muslim world. Today, 170 high school students from predominantly Islamic countries are living with American families and studying at local high schools. Another 450 high school students from the Middle East and South Asia will come here in 2004 for the next academic year. In addition, seventy undergraduate students--men and women--from North Africa and the Middle East will come to the U.S. in FY-2004 for intensive English language training prior to their enrollment in university degree programs.

Through our School Internet Connectivity Program, 26,000 high school students from the Middle East, South Asia, South East Europe, Central Asia and the Caucasus have collaborated since 2000 with U.S. students in online projects focused on building mutual understanding across the topics of current affairs, entrepreneurship, health, and civic responsibility. Under Secretary Tutwiler is also initiating a program of micro-scholarships for English education, and to allow foreign students who otherwise would lack access to attend American Schools in their own countries. Micro-scholarships will follow the model of the successful micro-credit programs through which the U.S. has helped numerous entrepreneurs and small businesses in developing countries.

Questions for the Record Submitted to
Secretary of State Colin L. Powell
Senator Bunning (#10)
February 26, 2004

Question:

The 2002 Russia uranium agreement with the United States aims to reduce uranium in Russia by allowing U.S. commercial nuclear generation facilities to buy the uranium. Part of the agreement allowed a Russian company, Globe Nuclear Services and Supply (GNSS), to contract with U.S. utility companies for the sale of the Russian uranium. On January 1, 2004, Tenex, a subsidiary of the Russian government, terminated its deliveries of uranium to GNSS. Tenex has indicated to the United States that it will begin directly supplying Russian uranium to the United States. This has caused uncertainty in the U.S. utility market about the future sales of Russian uranium, including whether current contracts with GNSS will remain valid. Can you describe the steps that the State Department is taking to expeditiously resolve the uncertainties surrounding this matter? What is the State Department doing to ensure that Tenex will honor the contracts between U.S. companies and GNSS?

Answer:

The State Department is working with all the parties to resolve this problem in a manner that meets the commitments that have been made to U.S. utility companies. We have raised this problem with senior officials of the Russian government (both the Ministry of Foreign Affairs and the Ministry of Atomic Energy) as well as with the commercial parties involved (Tenex, GNSS, and U.S. utility customers). The Russian side has expressed a willingness to meet the commitments to U.S. customers, but there is not yet a mechanism in place to do that. We will continue to remain engaged with this issue as a matter of priority until it is resolved.

Questions for the Record Submitted to
Secretary of State Colin L. Powell
Senator Domenici (#11)
Senate Budget Committee
February 26, 2004

Question:

Do you share my view that improved coordination of nonproliferation would advance our national interests?

Answer:

We share your view that coordination is critical to the nation's nonproliferation efforts. We believe that the current system of coordination, under the NSC, has worked quite effectively to advance our national interests. NSC chairs the Proliferation Strategy Policy Coordinating Committee, consisting of assistant secretary-level representatives from State, Defense, Energy, and other concerned agencies. This group is charged with interagency policy coordination and oversight of nonproliferation and threat reduction assistance programs. This process operates in a manner that is, for all intents and purposes, identical to the mechanism envisioned in the Nonproliferation Assistance Coordination Act of 2002 (Title XIII, Subtitle C of PL 108-228).

Questions for the Record Submitted to
Secretary of State Colin L. Powell
Senator Domenici (#12)
Senate Budget Committee
February 26, 2004

Question:

What assurances can you provide me that this impasse [Russian plutonium disposition program stymied due to lack of a U.S.-Russia liability-indemnification framework to guide it] will be broken soon so that we can return to progress in this program with its true global significance?

Answer:

The U.S. believes prompt ratification of the Cooperative Threat Reduction (CTR) umbrella agreement would create a more positive environment for resolving liability issues for other agreements by reducing the chances that CTR itself might be reopened. Since December we have pressed Russia on this at senior levels, including at the level of Secretary Powell, Secretary Rumsfeld and Secretary Abraham. We have made clear that ratification would not prejudice either side's position with respect to liability provisions for other agreements and would benefit such negotiations. Russian officials have indicated their intent to submit the CTR umbrella agreement for ratification, and we expect that the GOR will focus further on CTR ratification at an appropriate early time following the Russian presidential elections March 14.

We remain committed to finding a solution to the continuing and important liability and indemnification problems and have devoted considerable interagency energy and resources in analyzing them internally. Such issues are holding up not just the critical plutonium disposition program, but also other bilateral programs that advance key U.S. interests. Our aim is to get CTR on firmer ground and, for other programs, to move the liability issue toward resolution before the Sea Island Summit in June. We will continue to keep you and your staff apprised of developments and progress in these areas.

Question for the Record Submitted to
Secretary of State Colin L. Powell
Senator Domenici (#13)
Senate Budget Committee
February 26, 2004

Questions:

I note that the Department of State has requested $40 million to assist Mexico for International Narcotics and Law Enforcement Affairs activities.

a) Would you please describe some of the initiatives that would result from this assistance?

b) In particular, can Americans from southern border-states likes New Mexico expect that this assistance will help stem the flow of narcotics into the United States?

c) Will this also enhance our ability to protect against terrorist infiltration?

Answer:

The Mexican Government is one of the U.S. Government's principal partners in the international antidrug effort. Mexico is a critical link country in the chain of supply of illegal drugs that threaten the United States. It is a major producer of heroin, marijuana, and synthetic drugs and the principal transit corridor for smuggling drugs from the Andean region.

The $40 million for Mexico International Narcotics and Law Enforcement Affairs (INL) funding in the FY 2005 budget request will support bilateral counterdrug and border control programs aimed at disrupting the production and movement of drugs, attack associated transnational crimes (such as terrorism, non-

drug smuggling, money laundering, etc.), and strengthen the control of our mutual border.

a) There are seven broad project initiatives (administered by our Mexico City Embassy's Narcotics Affairs Section - NAS):

1) Border Security: The NAS Border Security Program, begun with the $25 million FY 2002 Emergency Supplemental Fund, is designed to advance three goals along the Mexican/U.S. border: infrastructure that keeps pace with travel and commerce; the secure flow of people; and the secure flow of goods. The initial program consists of helping Mexico implement five projects: ten non-intrusive inspection systems for six border cities, Cancun, and Mexico City; dedicated lanes for low-risk commuters to cross the border expeditiously at eight border cities; computer information systems to screen passengers between Mexico and the U.S.; a border safety training program for 650 Mexican immigration personnel; and development of border simulation software to plan upgrades of inspection services at border crossings. FY 2005 funds would be used to expand this project to additional crossings.

2) Training and Professionalization: This supports ongoing projects designed to augment and complement Mexican federal and state law enforcement and judicial training institutions (through operational

assessment, curriculum expansion, and accreditation) and to improve Mexico's ability to train its own officials. NAS also provides specialized and advanced training courses for both law enforcement and judicial system officials to enhance personnel capacity and capabilities in areas not currently covered by traditional Mexican training.

3) Law Enforcement Infrastructure: NAS provides targeted support to augment Mexico's own investment in its law enforcement agencies to develop the physical and technical infrastructure required to effectively investigate and prosecute transnational crime. FY 2005 funds would allow NAS to continued assistance that, in the last few years, has enabled President Fox to pursue a major reorganization of the federal police force into a new Federal Investigative Agency (AFI) with responsibilities comparable to the FBI and DEA. A second initiative centers on similar assistance to the Organized Crime Unit (UEDO), focusing in FY 2005 on establishing and equipping the national headquarters.

4) Anti-Corruption: Corruption has been one of the major challenges for all law enforcement in Mexico, and especially for counterdrug efforts. NAS would utilize FY 2005 funding to support the efforts of the Internal Affairs Unit of the Attorney General's office to deter, detect, and investigate unethical and corrupt practices. In addition, NAS would

promote the "Culture of Lawfulness" program, a secondary school program that encourages the development of a civil society through respect for the rule of law and rejection of corrupt practices. These projects complement President Fox's massive effort to root out and deter corruption government-wide.

5) Interdiction and Eradication: It is worth noting that most of the operational financing for Mexico's highly successful interdiction and eradication (opium poppy and marijuana) programs are borne by the Mexican government. NAS assistance focuses primarily on airwing support for the Attorney General's office (which conducts aerial eradication and supports interdiction missions). The vast bulk of our FY 2005 request in this area would be used to upgrade the aging UH-1H helicopter fleet and purchase new reconnaissance helicopters.

6) Anti-money Laundering: Although Mexico now has reasonably sound money laundering statutes, it still lacks the tremendous infrastructure required to monitor financial transactions, investigate suspicious activity, and prosecute criminal activity. FY 2005 projects would provide officials in investigative offices with advanced, high-capacity computer equipment and software required for this massive task, plus technical and expert assistance and training.

7) Demand Reduction/Community Outreach: Although the major thrust of U.S. assistance has been in disrupting the trafficking of illegal drugs, NAS has also pursued limited programs in confronting the growing problems of Mexican domestic drug abuse. The FY 2005 request includes funding to continue supporting Mexican NGO-implemented drug abuse prevention and education projects, particularly in the north where drug abuse levels are three times higher than the national average. A second area of support will be to augment Mexico's initiative in the state of Chihuahua to encourage indigenous communities in drug-producing or trafficking regions to forego the cultivation of opium poppy or marijuana. The initiative includes prevention education, community mobilization, and promoting viable alternative crops.

b) Our bilateral efforts to disrupt the flow of drugs to the US have resulted in significant, impressive, concrete results. In 2003, Mexico seized over 350 kilograms of opium/heroin, 20 metric tons of cocaine, 2,019 metric tons of marijuana, and 652 kilograms of methamphetamines. In 2002 (2003 official U.S. estimates are not yet available, but would be comparable to those of 2002), Mexico destroyed 19,157 hectares (47,300 acres) of opium poppy and 30,755 hectares (76,000 acres) of marijuana -- this prevented approximately 325 metric tons of heroin and 30,000 metric tons of marijuana from getting to U.S. markets. In

addition, Mexico successfully attacked the trafficking organizations that smuggle drugs from Mexico and the Andean region (some 70% of the cocaine entering the U.S.), bringing down leadership, disrupting smuggling and distribution networks, and eliminating illicit profits.

c) Yes, our bilateral programs directly improve homeland security. The Northern Border Security project described above was specifically designed to improve the control of our extensive, shared border (and to minimize the delay to legal border crossing without compromising U.S. security concerns). Although focused principally on counterdrug efforts, our bilateral programs are enhancing the professionalism, efficiency, and capacity of Mexican law enforcement, criminal investigation, and judicial offices in efforts against terrorists and other criminal activity that assists terrorists (money laundering, weapons smuggling, corruption, identity theft, illegal border crossing). Another major benefit flowing from these programs is the increase in cooperation and coordination among law enforcement and judicial officials (at federal, state, and local levels) in areas of mutual interest and concern -- especially criminal and terrorism activities along our mutual border.

Question for the Report Submitted to
Secretary of State Colin L. Powell
Senator Enzi (#14 A)
Senate Budget Committee
February 26, 2004

Question:

Complex Foreign Crisis Fund appears to be an alternative to requests for supplemental appropriations. There is much concern, however, about incorporating such an emergency account into our regular budget. It seems that we are admitting that we expect to have international crises every year.

A. Please describe exactly what type of foreign crises this fund would be used for and how the money would be allocated for different objectives.

Answer:

The funding would allow the President to address many of the post-conflict crisis activities that go under-funded, or are not funded at all. The reliance on supplemental funding – a slow and cumbersome process – to address on-the-ground real-time crisis is not realistic and often leads to too little, too late. As we have seen in Afghanistan, Liberia, Sudan and Haiti, we must have the capacity and resources to meet the expected and unexpected post-conflict crisis challenges ahead.

Depending on the actual crisis, funds could be allocated to address a number of needs. In the area of security, funds could be used to support early disarmament, demobilization, and reintegration efforts as well as short-term support for non-UN multinational peacekeepers and civilian police.

Justice and reconciliation funding could be used to deploy human rights monitors, address rule of law impediments, support reconciliation efforts at the local or national level. In the area of displaced persons, funding could be used for necessary reintegration efforts. Social and economic needs could be adequately addressed in the areas of micro-enterprise grants, temporary employment programs and support for much-needed social sector support for such sectors as education and health needs. Democracy and governance resources could address anti-corruption efforts, civil administration needs and civil society strengthening efforts.

Question for the Report Submitted to
Secretary of State Colin L. Powell
Senator Enzi (#14 B)
Senate Budget Committee
February 25, 2004

Question:

Complex Foreign Crisis Fund appears to be an alternative to requests for supplemental appropriations. There is much concern, however, about incorporating such an emergency account into our regular budget. It seems that we are admitting that we expect to have international crises every year.

B. If this fund is not provided by Congress again this year, what options would the State Department have should any foreign crisis occur?

Answer:

Already overextended funds would have to be reprogrammed from within existing on-going programs. Reprogramming results in robbing Peter to pay Paul and in most cases these reprogrammed resources are woefully inadequate to address the full range of requirements.

Question for the Report Submitted to
Secretary of State Colin L. Powell
Senator Enzi (#14 C)
Senate Budget Committee
February 25, 2004

Question:

Complex Foreign Crisis Fund appears to be an alternative to requests for supplemental appropriations. There is much concern, however, about incorporating such an emergency account into our regular budget. It seems that we are admitting that we expect to have international crises every year.

C. If no foreign crisis should occur in one year, what would be done with the funds? Would they roll over from year to year or be reprogrammed?

Answer:

Funding would be available until expended and thus would continue to the next year only to address complex foreign crises. These funds could not be reprogrammed for other purposes.

Questions for the Record Submitted to
Secretary of State Colin L. Powell by
Senator Mike Enzi (#15)
Senate Budget Committee
February 26, 2004

Question:

A. Secretary Powell, you recently chaired the first MCC Board meeting and began a process that is expected to result in the naming of the first country participants this May. In debate before the Senate Foreign Relations Committee and the House International Relations Committee, it has been clear that Congress expects full transparency in the process of selecting both indicators and countries as well as the amounts of funding they receive. How do you see that being provided?

Answer:

The MCC will be transparent to Congress and the public. The MCA Act requires it, but beyond that, transparency is one of the core principles of the MCC. We want countries to have a clear understanding with us of expectations and performance and for Congress and the public to have confidence in the integrity of our operation.

The Board held its first meeting on February 2, just ten days after the President signed the bill establishing the MCC. The Board designated a list of candidate countries, which was then reported to Congress and published in the Federal Register and on the MCC website. On March 3, the MCC reported its Selection Criteria and Methodology to Congress and on March 5 published the information in the Federal Register and on the

MCC website. Publication kicked off a 30-day public comment period on the selection criteria and methodology and on the qualifications of candidate countries for the MCA. The MCC held a meeting with representatives of MCA candidate countries on March 5 and a well-attended public meeting that was broadcast over the Internet on March 10.

Before the Board meets to select countries in May, the MCC will consult with Congress on the extent to which the candidate countries meet the selection criteria and methodology. The selection methodology requires that the Board in its report to Congress on eligible MCA countries justify eligibility determinations and selections for compact negotiation.

MCA countries will identify their own priorities and develop their own compact proposals in consultation with the MCC. The process must be inclusive, reflecting the input of civil society, the business community and other parts of society. The MCC will consult with the Congress before beginning compact negotiations. The funding level of MCA compacts will depend on the Board's assessment of the relative merits of the proposals submitted, including implementation plans and capacities. All approved compacts will be reported to the Congress and posted on the MCC website. The MCC will notify Congress when it obligates funds.

The MCC will also provide at least quarterly public disclosure of assistance provided and will provide Congress an annual report on its operations.

Question

B. The budget includes $2.5 billion for the MCC in FY2005, a 150% increase over the FY2004 amount. Given the delay in launching the program this year, will it be possible to spend this level of funding efficiently?

Answer

The MCC has gotten off to quick start, meeting all the legal deadlines to enable the earliest possible Board selection of MCC partners in May. Soon after the Board selects MCA countries, the MCC will begin to engage countries as they determine their priorities and develop programs to meet their targeted objectives. MCA assistance cannot start until after the Board approves a compact proposal from an MCA country.

The amount of time it will take countries to complete compacts with the MCC will vary. We have encouraged candidate countries that are interested and believe they may have a chance of qualifying to begin now to become familiar with the MCC law and to consider the growth and

development priorities they would propose if they were selected. The MCC will evaluate the proposals on their feasibility and ability to generate growth.

Because of the truncated first fiscal year, the MCC is planning its operations over its first 17 months of operation with FY04 and FY05 budgets and countries as a cohesive program. The MCC will seek proposals from the countries the Board determines are MCA eligible in FY 2004 and FY 2005. The compacts will establish multi-year programs that involve significant up-front commitments in order to permit the countries to pursue their growth related objectives.

We hope to conclude compacts with some countries before the end of FY04 but believe compact discussions for most FY04 eligible countries will conclude in FY05. Early in FY05 the Board will select additional MCA countries from the broader pool of countries eligible in that fiscal year. The $1 billion appropriated for FY04 will be insufficient to fund programs in the number of countries likely to qualify in the first year. The $2.5 billion requested in the President's budget for FY05 is needed to fund programs for both first and second year eligible countries.

The MCC also has the authority to allocate funds to support the efforts of threshold countries, so that they can take steps to improve their prospects for future eligibility. Thus, we are confident that the MCC will be able to fully utilize both its FY 2004 appropriation and the requested amount for FY 2005. Appropriation of the requested amount in FY04 also gives credibility to the President's commitment to ramp up funding for the MCA to $5 billion per year by FY 2006.

Questions for the Record Submitted to
Secretary of State Colin L. Powell
Senator Enzi (#16A)
Senate Budget Committee
February 26, 2004

Question:

Will contributing agencies share in the decision-making process, as with the International Cooperative Administrative Support Services (ICASS) program? How much funding do you expect to get overall from other agencies participating in the Capital Security Cost Sharing Program in one fiscal year?

Answer:

Under the Capital Security Cost Sharing (CSCS) Program, contributing agencies participate in the process for allocating cost shares. CSCS Program costs are to be allocated annually to each agency on the basis of its total number of authorized overseas positions. State conducted a comprehensive survey to identify the number and type of cost-sharing overseas positions at each post in Spring 2003; after this, agencies were given the opportunity to reduce their position count by abolishing unfilled positions, and certain types of positions were exempted, e.g., those in host government space. State will repeat the survey every 2 years, and in the future, adjustments will be made between surveys if an agency documents reductions in positions.

With regard to constructing new embassy compounds (NECs), State will build NECs in the order they are listed in the Long-Range Overseas Buildings Plan (LROBP), as they are already ranked in order of security need, as directed by Congress in the Secure Embassy Construction and Counterterrorism Act of 1999. Agencies participate in the development of the LROBP and during the planning and design phases of new embassy projects. Agencies with an overseas presence meet annually with the Department of State's Bureau of Overseas Buildings Operations and the Bureau of Diplomatic Security to discuss the process of identifying posts to move into the Priority List for Replacement Facilities. Agencies may provide input to State's Regional Bureaus on which posts should be added to the Priority List of diplomatic facilities to be replaced, and also may provide input during the ranking process for the top 80 posts. Posts that are scheduled to receive a NEC establish interagency committees to develop staffing projections. Those projections are vetted with the agency headquarters after they are submitted to the Department's Regional Bureaus. Further coordination/involvement occurs during preparation of the detailed Space Requirements Program (SRP). The SRP, which identifies specific needs in each facility, is circulated to agencies at post and their headquarters for input.

The CSCS Program will generate $17.5 billion over 14 years (FY 05 through FY 18; contributions by State and other agencies will be phased in over 5 years beginning in FY 05). After the 5-year phase-in period, annual funding will be $1.4 billion, all from the CSCS Program.

State and ICASS also receive allocations, like everyone else. ICASS-associated charges are then distributed to all other agencies based on their use of ICASS services. With regard to agency shares, State bears approximately one-third of the CSCS costs, ICASS bears one-third, and 27 other agencies collectively bear the other third.

Of the $785.3 million requested in the Embassy Security, Construction and Maintenance appropriation in FY 05, $162.6 million is for State's share of the CSCS Program. Along with an anticipated $83.7 million in cost sharing contributions from other agencies, the Department will have $869.0 million for the construction of NECs.

Questions for the Record Submitted to
Secretary of State Colin L. Powell
Senator Enzi (#16B)
Senate Budget Committee
February 26, 2004

Question:

From a practical perspective, what is the difference between OMB providing the Department of State directly with funds to pay for secure compounds overseas, or having OMB include funds in each agency budget to cover contributions to State for overseas compound security?

Answer:

The CSCS charges are per capita and world-wide; every position under Chief of Mission authority overseas is included. The per capita charge creates a new incentive for agencies to rightsize every one of their overseas positions, thus advancing the President's Management Agenda Directive on Rightsizing and addressing Congressional concerns about the extent of the U.S. Government's overseas presence.

The President's Management Agenda calls for:

- establishing mechanisms to link agency policies on overseas presence
- integrating rightsizing into workforce plans
- linking personnel assignment to construction planning.

Including a share in each agency's budget allows Congress, agencies, and the public to see the capital cost of stationing personnel overseas. CSCS causes all agencies to help fund overseas facilities and to consider the full cost of stationing personnel overseas and rightsize their staffing.

Questions for the Record Submitted to
Secretary of State Colin L. Powell
Senator Mike Enzi (#17)
Senate Budget Committee
February 26, 2004

Question:

Global HIV-AIDS

Background: The President's FY2005 budget proposes $2.8 billion from all agencies - of which $2.2 billion is from the State Department and USAID - to address the global AIDS crisis. This represents an increase of about 16%. The Administration proposes that most of the resources be managed by the Global AIDS Coordinator and requests once again only $200 million for the Global Fund.

A. Secretary Powell, I have heard criticisms of the President's approach to fighting HIV/AIDS overseas – that we are shortchanging the multilateral Global Fund in favor of bilateral programs. My understanding is that our pledges and payments to the Global Fund are roughly equivalent with our share of the world's gross domestic product (GDP). That doesn't count the rest of our more than $2 billion commitment through the Presidents Emergency Plan.

   Is this an accurate assessment of our contributions to the Global Fund?

Answer:

The U.S. remains the single largest contributor to the Fund, with close to 40 percent of all current pledges through 2008. Other nations also tend to give much less to the battle against HIV/AIDS on a bilateral basis than does the U.S. With our significant expertise and worldwide presence, the U.S. has a comparative advantage in making effective use of bilateral channels for assistance that smaller nations simply cannot match. The Executive

Questions for the Record Submitted to
Secretary of State Colin L. Powell by
Senator Sarbanes (#18)
Senate Budget Committee
February 26, 2004

Question:

a) Specifically, where in the fiscal year 2005 submission are the monies for embassy operations in Iraq found?

Answer:

The FY 2005 budget request includes funding for State Department operations in Iraq in areas where we have a good estimate of requirements.

The request provides $46 million for some operating costs, including $17 million for support costs and $29 million for staffing for the U.S. Embassy in Baghdad. Support costs are noted in the budget presentation under built-in changes, and embassy positions are part of the request for people to meet new staffing requirements.

In addition, funding of $97.3 million from the FY 2003 and FY 2004 supplementals will meet partial initial operating/security costs ($35.8 million) and interim facility requirements ($61.5 million).

Question:

b) When will the Embassy be up and running?

Answer:

By July 1, CPA will transition to an Embassy. Embassy office buildings will include an Interim Chancery, housing limited unclassified operations including American Citizens' Services; and an Interim Embassy Annex for the remaining staff (currently the CPA headquarters).

Question:

c) Where will it be located in Baghdad?

Answer:

The interim chancery and annex will be located in Baghdad's Green Zone.

Question:

d) Will you make use of existing buildings or will you undertake new construction?

Answer:

Interim facilities will be used until a New Embassy Compound is constructed.

Question:

e) What is the projection of staff size?

Answer:

Projected American State staffing is 135 to 160 positions.

Question:

f) What is the breakdown of staff by agency, starting with State?

Answer:

We are working with other agencies to identify their personnel requirements and expect that U.S. Embassy Baghdad will become one of, if not the largest embassy in the world. Departments and Agencies which have already requested a presence in Baghdad include:

Department of Agriculture – Foreign Agricultural Service
Department of Defense – DIA and Office of Security Cooperation
Department of Health and Human Services
Department of Homeland Security
Department of Justice – ATF, OPDAT, DEA, FBI, and US Marshals
Environmental Protection Agency
U.S. Agency for International Development
Department of the Treasury
Department of State

Question:

g) Where will the personnel be housed?

Answer:

Personnel will be housed on the Embassy Annex compound in modular housing units installed by CPA for its personnel.

Question:

h) Will families be allowed at post?

Answer:

Not for the foreseeable future.

Question:

i) Will the Embassy use its own electricity and water supplies?

Answer:

The interim chancery will generate its own power until adequate city power is available. The Annex is powered by a generator plan that supports that part of the green zone. Chancery water will be provided from the city through city mains. Annex water will be provided by recently installed wells. In addition, bottled water is used for drinking.

Question:

j) If yes, how will those sources compare to sources used by the local population?

Answer:

The electrical situation is improving as the infrastructure is repaired. We expect to be operating on city power next year and utilize generators only for backup. The basic water supply is the same as used by the local population.