PRESIDENT'S FISCAL YEAR 2007 BUDGET WITH U.S. DEPARTMENT OF THE TREASURY SECRETARY JOHN SNOW

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

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PRESIDENT'S FISCAL YEAR 2007 BUDGET WITH U.S. DEPARTMENT OF THE TREASURY SECRETARY JOHN SNOW

WEDNESDAY, FEBRUARY 15, 2006

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

The Committee met, pursuant to notice, at 10:35 a.m., in room 1100, Longworth House Office Building, Hon. Bill Thomas (Chairman of the Committee) presiding.

[The advisory and revised advisories announcing the hearing follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
January 31, 2006
FC–16

CONTACT: (202) 225–1721

Thomas Announces Hearing on President's Fiscal Year 2007 Budget with U.S. Department of the Treasury Secretary John Snow

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing on President Bush's budget proposals for fiscal year 2007 within the jurisdiction of the Committee on Ways and Means. **The hearing will take place on Tuesday, February 7, 2006, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 1:00 p.m.**

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

BACKGROUND:

On February 6, 2006, President George W. Bush is expected to deliver his fiscal year 2007 budget to Congress. The President's budget includes numerous tax proposals and other issues that fall under the jurisdiction of the Department of the Treasury and the Committee.

In announcing the hearing, Chairman Thomas stated, "The President's budget includes tax and other issues related to the Department of the Treasury functions and the Committee. I look forward to reviewing the President's budget and discussing the relevant proposals with Secretary Snow."

FOCUS OF THE HEARING:

Secretary Snow will discuss the details of the President's budget proposals that are within the Committee's jurisdiction.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*109th Congress*" from the menu entitled, "*Hearing Archives*" (*http://waysandmeans.house.gov/Hearings.asp?congress=17*). Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You ***MUST REPLY*** to the email and ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Tuesday, February 21, 2006. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

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

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

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

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

*** * * CHANGE IN DATE AND TIME * * ***

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
February 03, 2006
FC–16 Revised

CONTACT: (202) 225–1721

Change in Date and Time for Hearing on President's Fiscal Year 2007 Budget with U.S. Department of the Treasury Secretary John Snow

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, today announced that the Committee hearing on President Bush's budget proposals for fiscal year 2007 with U.S. Department of the Treasury Secretary John Snow, previously scheduled for 1:00 p.m. on Tuesday, February 7, 2006, in the main Committee hearing room, 1100 Longworth House Office Building, **will now be held at a future date and time to be determined.**

All new details for the hearing will be announced in a subsequent advisory, including details for providing a submission for the record. All previously-received submissions will be carried over and should not be resubmitted. (For more information, see Full Committee Advisory No. FC–16, dated January 31, 2006).

*** * * CHANGE IN DATE AND TIME * * ***

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
February 06, 2006
No. FC–16 Revised #2

CONTACT: (202) 225–1721

Change in Date and Time for Hearing on President's Fiscal Year 2007 Budget with U.S. Department of the Treasury Secretary John Snow

Congressman Bill Thomas (R–CA), Chairman of the Committee on Ways and Means, today announced that the Committee hearing on President Bush's budget proposals for fiscal year 2007 with U.S. Department of the Treasury Secretary John Snow, previously scheduled for 1:00 p.m. on Tuesday, February 7, 2006, in the main Committee hearing room, 1100 Longworth House Office Building, **will now be held on Wednesday, February 15, 2006, beginning at 10:30 a.m.**

The deadline to provide a submission for the record will now be close of business, Wednesday, March 1, 2006. All other details for the hearing remain the same. (See Full Committee Advisory No. FC–16, dated February 1, 2006).

Chairman THOMAS. Good morning. This is the third in a series of hearings examining President Bush's proposed budget for fiscal year 2007. The Chair would like to welcome Secretary John Snow of the United States Treasury Department.

As the Secretary knows, we were scheduled to hold this hearing last Tuesday, but the hearing was quite properly postponed due to the funeral of Coretta Scott King. Mr. Secretary, we thank you for accommodating our schedule and look forward to your testimony.

As the President noted in his address to the Nation last month, the economy is growing at a very healthy rate. The economy created 2 million jobs last year. Average economic growth for the year was 3.1 percent. Unemployment is down to its lowest level since pre-9/11, 4–7 percent. Inflation remains contained.

Due to the strong growth in the economy, tax receipts in the past 2 years have been increasing faster than expected. The Chair believes timely tax relief enacted in recent years—and I believe many prominent economists agree—has been an important contributing factor to this growth.

While this hearing is geared to look to the future and the next budget, I want to note that the House and the Senate are now in conference on a tax reconciliation package which would maintain tax policies that have helped keep the United States economy strong. Congress is also working on a bill to strengthen the security of Americans' pension plans, but the Senate has not yet seen fit to do the necessary procedures to reach conferenceable level.

The President's fiscal year 2007 budget proposal continues to focus on deficit reduction. Last week, the President signed the Def-

icit Reduction Act. I look forward to hearing about some of the President's proposals from you, Mr. Secretary, on how we can continue this trend of fiscal responsibility.

Before I turn to the gentleman from New York, the Chair would like to advise members that immediately following this hearing, we will be marking up the views and estimates letter to the Budget Committee on aspects of the Federal budget that fall within the Committee's jurisdiction.

The Chair recognizes the gentleman from New York for any comments he may wish to make.

[The opening statement of Chairman Thomas follows:]

Opening Statement of The Honorable Bill Thomas, Chairman, and a Representative in Congress from the State of California

Good morning. This is the third in a series of hearings examining President Bush's proposed budget for Fiscal Year 2007. The Chair would like to welcome Secretary John Snow of the U.S. Treasury Department. As the Secretary knows, we were scheduled to hold this hearing last Tuesday, but postponed it due to the funeral of Coretta Scott King. Mr. Secretary, we thank you for accommodating our schedule and look forward to your testimony.

As the President noted in his address to the nation last month, the U.S. economy is growing at a healthy rate. This economy created two million jobs last year; average economic growth for the year was 3.1 percent; and unemployment is down to its lowest level since July 2001 at 4.7 percent and inflation remains contained.

Due to the strong growth in the economy, tax receipts in the past two years have been increasing faster than expected. Timely tax relief enacted in recent years is, in my view and the view of many prominent economists, an important contributing factor to this growth.

While this hearing is geared to look to the future and the next budget, I want to note that the House and Senate are [*preparing for a conference/currently in conference*] on a tax reconciliation package which would maintain the tax policies that have helped keep the U.S. economy strong. Congress is also working on a bill to strengthen the security of Americans' pension plans.

The President's Fiscal Year 2007 budget proposal continues to focus on deficit reduction by keeping the economy strong and cutting unnecessary spending. Last week, the President signed the *Deficit Reduction Act*. That legislation, which reduced the deficit by almost $40 billion over the next five years, is part of our ongoing efforts to put our fiscal policies in order. I look forward to hearing about some of the President's proposals on how we can continue this trend of fiscal responsibility.

Before I turn over the time to the Gentleman from New York, the Chair would like to advise Members that immediately following this hearing, we will be marking up the views and estimates letter to the Budget Committee on aspects of the Federal budget that fall within the Committee's jurisdiction.

I now recognize the gentleman from New York, Mr. Rangel, for any opening statement he may have.

Mr. RANGEL. Thank you, Mr. Chairman.

Mr. Secretary, let me first publicly thank you for the many courtesies that you have extended to me by giving me some type of heads up as to things that the administration is considering doing. I am not used to it here in the House, and so I appreciated even more the fact that the President indicated that he was really looking forward to a less partisan approach to some of the programs that he was proposing. So I hope if time permits—and I know your schedule is limited—that you might go directly to the tax conference that we expect to have where the Senate appears to have said that they want tax cuts to include the alternative minimum tax as well as the corporate dividend and capital gain tax cuts. The

President said that he wants that to be made permanent, and if possible, I would like to know what direction you might give the conferees.

I am pretty confident that I will be selected as a conferee. I am not certain I will know where the conference will be held.

Also, there is a concern about the report that you received as relates to tax reform. I hope you might include what, if anything, you intend to do with that.

The President seemed to have revisited Social Security, and he is referring that to some type of a Committee or commission or something that I assume would look like it is bipartisan. To the extent that you can, we would like some help with that.

Of course, everyone is concerned about the deficit, and I am certain that you believe that is no major problem to the United States. But I do not know whether you can do anything with this partisanship that we have. But it is abundantly clear that you should not expect Democrats just to support anything that is given to us. To the extent possible—and I know you are restricted, being in the executive branch—it would be helpful if you can make some suggestions as to those areas that we may have agreement how we can be supportive on at least some of the things that the President would want.

Thank you once again for adjusting your schedule to meet with us.

Chairman THOMAS. I thank the gentleman.

Any member that may have a written statement can place it in the record, without objection.

Mr. Secretary, we have received your written statement, and without objection, it will be placed in the record, and you can address us any way you see fit.

STATEMENT OF THE HONORABLE JOHN SNOW, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary SNOW. Thank you very much, Mr. Chairman. I will be brief.

It is always an honor and a privilege to appear before the Committee on Ways and Means, the Committee that has such effect on the lives of our country and means so much to the well-being of our country. I commend you for the work you do on this Committee.

This is, Mr. Chairman, my fourth appearance before you. I thank Mr. Rangel for his comments. I would comment that appearing here today is far different than when I appeared 3 years ago. Today, as you noted, Mr. Chairman, the economy is on a good path. Then it wasn't. Then growth was sluggish, capital spending was anemic, jobs were not being created at a sufficient rate. Today we have the other side of that. Today we have an economy that is growing an expanding. We have business confidence high. We have consumer confidence high. We have capital spending strong, and we have lots of good jobs being created, and we are seeing real wages rise. We are also seeing government revenues rise to the highest level in American history.

I would urge you to continue to sustain the policies, support the policies that have made this possible, and at the center of those policies are the lower tax rates on capital and dividends that were

enacted, Mr. Chairman, very much with your leadership back in May of 2003.

The lower tax rates that were put in effect then have really put the American economy on the right path. They are at the center of this strong recovery we are enjoying, and it is awfully important to sustain that lower tax environment.

The President's budget reflects his commitment to do just that, to keep the American economy growing and expanding. It also reflects the commitment to bringing the deficit down. We are all concerned about the deficit, but there are only two ways to deal with the deficit: one is to continue to have a strong, growing, expanding economy, creating more jobs and profitable businesses because that raises the tax receipts to the government; and, of course, the other side of the equation is to continue to be tightly attuned to controlling spending, spending constraint. Both of those ideas are embraced in the President's budget, along with the priorities of homeland security and prosecuting the war on terror effectively.

With that, Mr. Chairman, I again thank you for the opportunity to appear before you and look forward to your questions.

[The prepared statement of Secretary Snow follows:]

Statement of The Honorable John Snow, Secretary, U.S. Department of the Treasury

Good morning. Thank you Chairman Thomas and Ranking Member Rangel for having me here this morning.

I'm pleased to be here today to talk with you about the President's Fiscal Year 2007 budget. This budget represents the President's dedication to fiscal discipline, an efficient federal government and the continuation of a thriving U.S. economy.

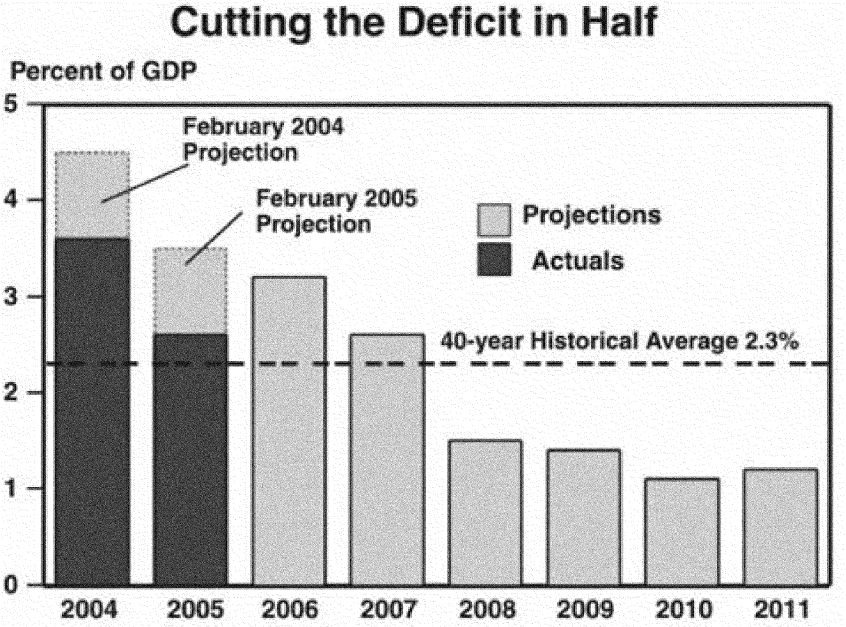
Across the board, agencies were asked by the President to look closely at their budgets and make tough decisions, because fiscal restraint is not only necessary for deficit reduction, it is a necessary component of government that is responsible to the people who employ it.

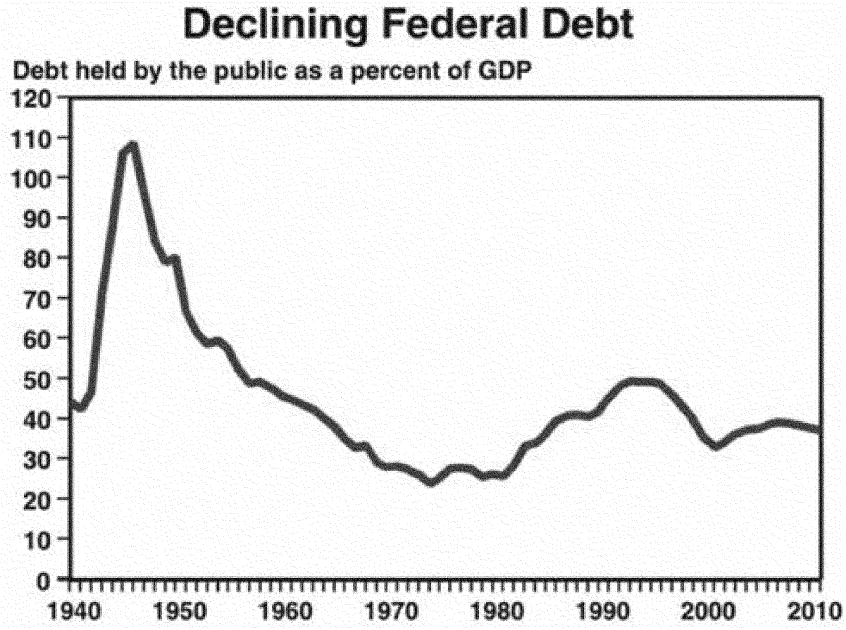
Those tough decisions were made at all levels of government management, and as a result the President's budget holds the growth of discretionary spending below the rate of inflation and cuts spending in non-security discretionary programs below 2006 levels.

The Administration has identified 141 programs that should be terminated or significantly reduced in size because they aren't performing or could perform better with consolidation; they aren't giving taxpayers their money's worth. The savings for the American taxpayer would be 14 billion dollars.

Cutting the programs that aren't working and improving the efficiency of the ones that are is all part of accountability to the taxpayer. To assist lawmakers in this shared effort, the Administration launched ExpectMore.gov, a website that provides candid information about programs that are successful and programs that fall short, and in both situations, what they are doing to improve their performance next year. I encourage the members of this Committee and those interested in our programs to visit ExpectMore.gov, see how we are doing, and hold us accountable for improving.

This budget, with its policies of economic growth and spending restraint, keeps us on track to meet the President's steadfast goal of cutting the deficit in half by 2009.



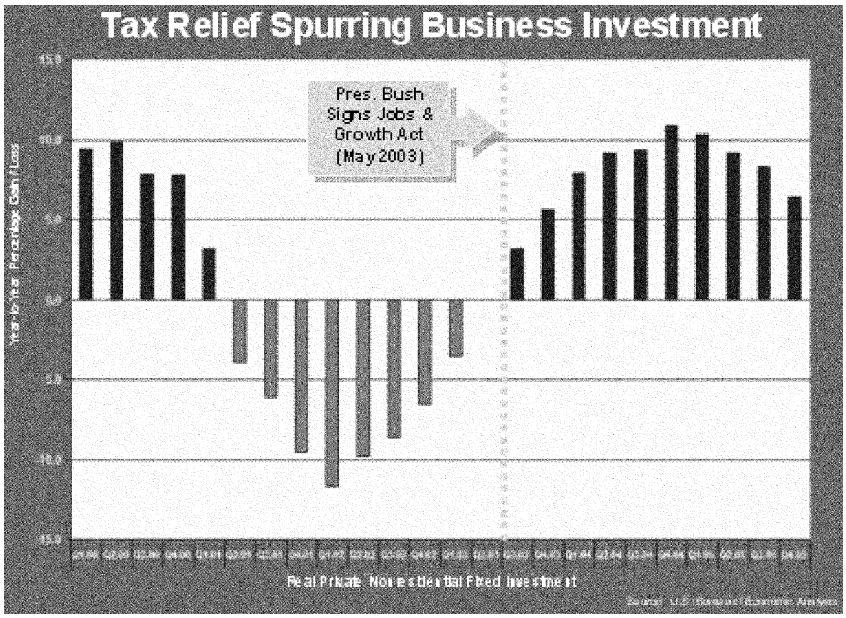


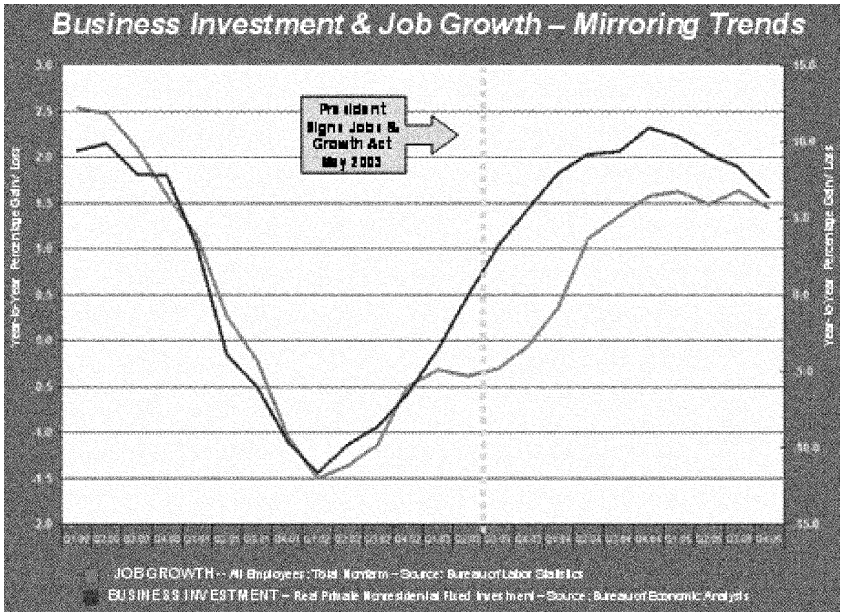
The budget also seeks to avoid a tax increase by making the President's tax cuts permanent; I want to take a moment to explain why that is entirely consistent with our deficit-cutting goals.

In short, lower tax rates are good for the economy and a growing economy is good for Treasury receipts. Indeed, our rate of economic growth led to record levels of

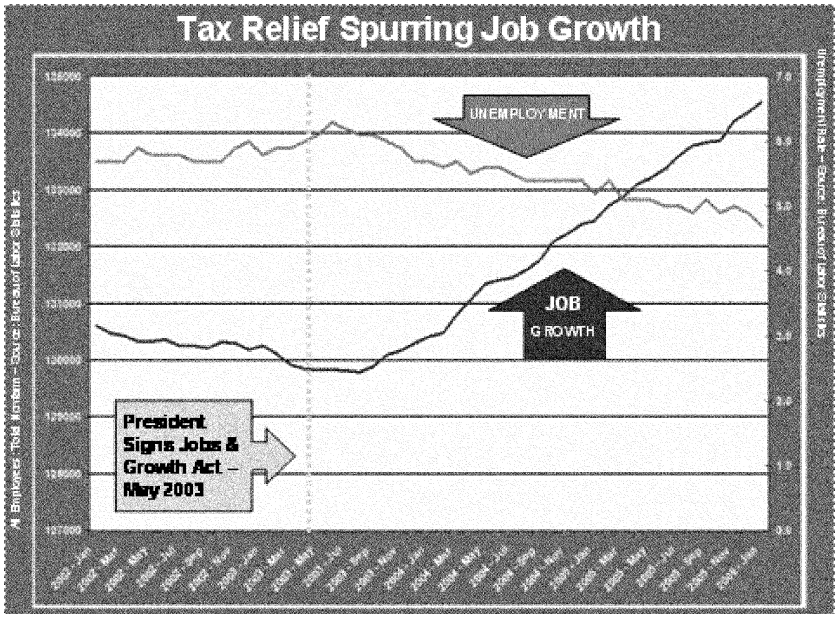
Treasury receipts in 2005. And, going forward, we project that receipts will rise every year. In 2011 we will again reach, as a percentage of GDP, the levels we've seen over the average of the last 40 years.

And there can be no question today that well-timed tax relief, combined with responsible leadership from the Federal Reserve Board, created an environment in which small businesses, entrepreneurs and workers could bring our economy back from its weakened state of just a few years ago. Tax relief encouraged investment, which has ultimately led to job growth. The American economy is now unmistakably in a trend of expansion, and those trend lines can clearly be traced to the enactment of the tax relief.

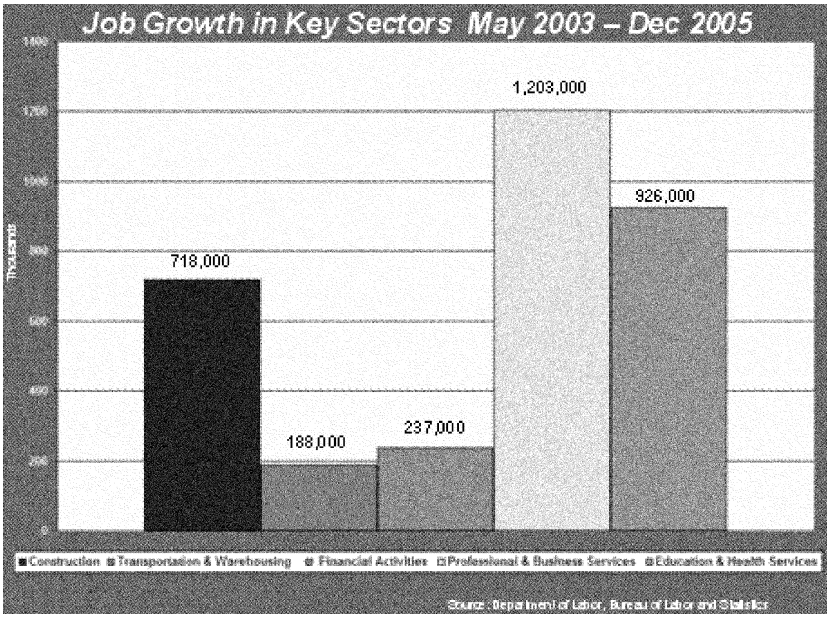




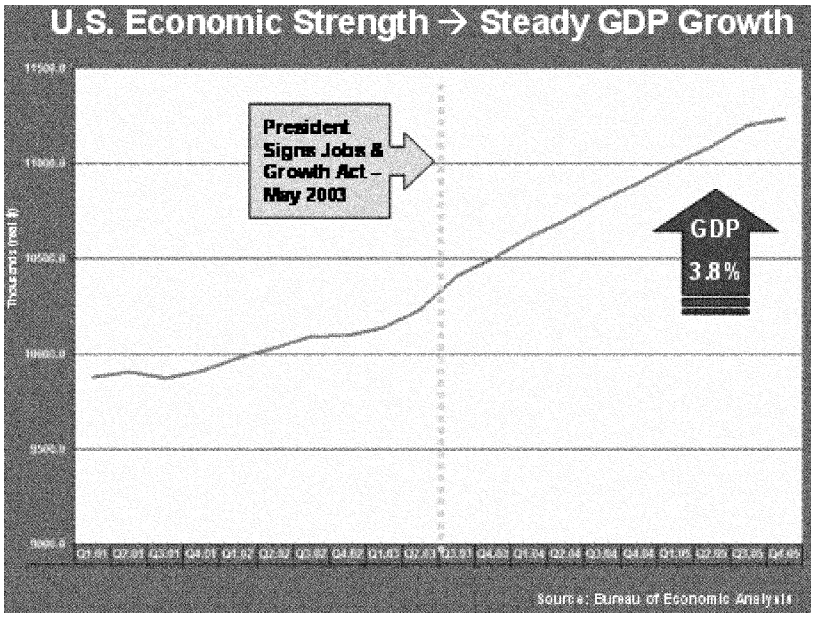
Since May of 2003, the economy has created 4.7 million jobs, two million of them in the last year alone.



That's a lot of job growth, and there are a lot of very good jobs in that number. Industries with above-median hourly earnings and particularly large jobs gains since August 2003 include: specialty trade contractors (463,000 workers paying an average hourly wage of $19.55), ambulatory health care services (394,000 workers $17.86), and building construction (167,000 paying $19.05).



We found out the week before last that unemployment has fallen from 4.9 percent to 4.7 percent, running lower than the average for the 1970s, 1980s and 1990s. GDP growth was three and a half percent last year.



U.S. equity markets have risen, and household wealth is at an all-time high.

Additionally, real per capita disposable (after-tax) income has risen by 7.3 percent from 2000 to 2005 and that's very good news for workers.

The U.S. is, as the President often notes, the economic envy of the world.

When we look at the underlying fundamentals of the economy, its strength proves deep and solid, and we can see that businesses and workers have every reason to be optimistic about the future.

For example, we see that productivity growth remains strong. Output per hour in the non-farm business sector has risen at an average annual rate of 3.2 percent since the end of 2000, faster than any five-year period in the 1970s, 1980s or 1990s.

Household net worth—that's assets minus debts—is a record high, and not just because of housing. Deposits—the money in checking accounts, savings accounts, and money market funds—are at a record high and are larger as a share of disposable income than at any time since 1993. Defaults on residential mortgage loans at commercial banks are at historic lows.

In the past two years, the economy has generated about 170,000 jobs per month, and that includes the two-month slowdown in job growth in the aftermath of Hurricanes Katrina and Rita. In the past 32 years, new claims for unemployment insurance have almost never been as low as they have been recently, the *only* exception being the peak of the high-tech bubble from November 1999 to June 2000.

Core inflation remains low, and that's good news for everyone.

Independent private-sector forecasts point to continuing good news, and inflation-adjusted hourly wages grew 1.6 percent between September and December and this trend should continue.

We are, it appears, witnessing the tipping point on wages—when incomes rise for workers and business combined, but workers once again increase their incomes faster than businesses. Once businesses have been doing well for a while, they ultimately compete those increases in income away by competing harder for labor. The result is higher wages and higher standards of living for workers.

Both on leading indicators and a deeper background analysis, the American economy proves to be on solid footing. The question that those of us in government must look at now is this: *why* is our economy performing so well and what can we do to continue these positive trends?

It is a sweeping and important question, so today we'll ask a more focused question: what can our *budget* do, or not do, to keep the economy on track?

The answer to that is twofold: first, control spending. Second, don't increase taxes—let taxpayers keep as much of their money as possible to invest and spend.

And of course I use the term "taxpayer" quite broadly. I ask you to think of the individual and family budgets that benefit from lower taxes, but also of the small-business budgets. Lower marginal rates, for example, help small firms because they tend to file their taxes as individuals, not as corporations. We are proposing to allow small businesses to be able to deduct up to $200,000 of business-expanding investment as a permanent feature of the tax code, for example. This tax benefit encourages expansion and job creation in the sector that produces three-quarters of the nation's net new jobs.

Lower rates and a degree of certainty in the system are absolutely critical to keeping our economy, and our excellent rate of job creation, on track. And I cannot say this strongly enough: we can't beat the budget deficit without a strong economy. Tax increases carry an enormous risk of economic damage and I can tell you today that the President will not accept that risk. He will not accept a tax increase on the American people.

Fiscal discipline, combined with economic growth, is the correct path to deficit reduction, period, and we cannot let difficult decisions run us off of that path that we know is right.

Our government does, of course, face economic demands that are exceptional, from fighting the war on terror to helping the victims of devastating hurricanes put their lives back together. These are costly events that lead to unwelcome, brief deficits. They should be regarded as temporary as they are entirely surmountable with continued economic strength and spending restraint in the areas where it is possible and appropriate.

The second way for the budget to help keep the economy on track is to focus the taxpayers' precious resources on things that we know will make a difference.

In order for America to continue to be a dynamic engine of growth, President Bush is outlining action in three key areas: healthcare, energy, and America's competitiveness.

Affordable and Accessible Health Care. The President's reform agenda will help to make health care more affordable and accessible. Health Savings Accounts—putting patients in charge of their health care—will contribute to this goal. We need to make health insurance portable, make the system more efficient, and lower costs. We also need to level the playing field for individuals and the employees of small business by allowing small businesses to form Association Health Plans.

The expansion of high deductible health plans and HSAs is something I'd particularly like to emphasize. Combined with a high deductible health plan, HSAs allow people to save for future health care expenses while providing immediate protection against catastrophic health expenses. Furthermore, by giving people more control over their health care spending, they offer a more affordable alternative to traditional health insurance.

Today, millions of Americans—many of whom were previously uninsured—are enjoying access to more affordable health insurance because of the increased availability of HSA-qualified HD health plans. These plans are more available and becoming more popular, because saving for health care needs in an HSA now has the same tax advantages as a traditional health insurance plan.

It only makes sense to expand the scope of HSA qualified health insurance by making their premiums deductible from income taxes and payroll taxes when purchased by individuals. This is an important innovation that will significantly reduce the cost of health insurance purchased by individuals, particularly important for working people who don't have a federal income tax liability. As many of my friends on the Democratic side of the aisle have pointed out to me—payroll taxes are one of the most significant tax burdens for the poor. This innovation will enable more individuals to purchase affordable health insurance. Expanding HSAs so that policy holders and their employers can make annual contributions to cover all out-of-pocket costs under their HSA policy will further encourage adoption of qualified HDHP plans.

All told, the President's HSA proposals are projected to increase the number of HSAs from the current projected for 14 million to 21 million.

Advanced Energy Initiative. The President has said that the best way to break America's dependence on foreign sources of energy is through new technology. So the President announced the Advanced Energy Initiative, which provides for a 22 percent increase in clean-energy research at the Department of Energy. This initiative also builds on the energy legislation finally passed by the Congress last year that encourages and rewards energy conservation activity.

American Competitiveness Initiative. This ambitious strategy by the President will significantly increase federal investment in critical research, ensure that the U.S. continues to lead the world in opportunity and innovation, and provide American children with a strong foundation in math and science.

This budget also gives us an opportunity to look at the other ways—in addition to keeping tax rates low—that the Federal Government can make adjustments that add to a growth-friendly environment for the businesses, entrepreneurs and workers that produce that economic growth. Tax code reform remains a priority for this President and the President's Advisory Panel on Federal Tax Reform provided us this year with a strong foundation for a national discussion on ways to ensure that our tax system better meets the needs of our dynamic, 21st century economy. I appreciate the fine work of Senators Mack and Breaux, for their outstanding leadership of the Panel.

You'll notice that the budget provides for a one-year patch to protect the middle class from the AMT. It is a temporary fix because the AMT needs to be resolved through broader tax reform.

This issue is also reflected in the budget through the proposed creation of a new Dynamic Analysis Division within Treasury's Office of Tax Policy. Understanding the full range of behavioral responses to tax changes, including how tax changes affect the size of the economy and, subsequently, tax revenues, is critical to designing meaningful, effective tax reform, and we believe this small expenditure will have an enormous pay-off for the American taxpayer.

With a focus on these and other good policies, we'll keep America competitive in the world and keep our economy strong as it has been for some time now.

In closing, I want to point out that a lot of good can come from a smart federal budget, and a considerable amount of harm can come from a bad one. Let's use the FY 2007 budget to make good policy—restrained as the circumstances dictate on spending but aggressive on the expansion of opportunity.

I look forward to working with all of you on enacting this budget. Thank you for having me here today; I'm pleased to take your questions now.

Chairman THOMAS. Thank you, Mr. Secretary, and the Chair is acutely aware of the truncated nature of this particular hearing. We usually have the privilege of an open-ended hearing with you. Later this afternoon we will have the U.S. Trade Representative,

our former colleague, Mr. Portman. Because of that, the Chair will indicate, with the acceptance of the other members on the majority side, that the Chair will go in reverse order and that the Chair would then recognize the gentleman from California, Mr. Nunes.

Mr. NUNES. Thank you, Mr. Chairman. It is a pleasure to get to go first for a change. Normally——

Chairman THOMAS. The gentleman is on the clock.

[Laughter.]

Mr. NUNES. Normally, Mr. Secretary, by the time it gets to me, this Committee room is empty, and you and I would be the only ones left here with the Chairman.

One of the attacks that I have heard over and over again is that the tax cuts have increased the budget deficit. I think it is important for the American people to hear this time and time again because I do not think they hear it enough: that, in fact, the numbers and the projections that you have given is that the tax cuts have actually decreased the size of the deficit. I wondered if you could talk about this again because I think it is important for the American people to hear this, that, in fact, the tax cuts have increased revenue to the Federal Government.

Secretary SNOW. Congressman Nunes, when the tax cuts, the tax relief of 2003, were being proposed, we saw the tax revenues of the United States in a steep decline. Today, we see them in a steep ascendancy, and the tax revenues of the United States are today higher than they have ever been at any time in our history, and the reason is the economy is growing and expanding. The economy is performing well.

Mr. NUNES. But despite the tax cuts, tax revenue is higher than it has ever been in our history.

Secretary SNOW. I think what we have demonstrated here is that lower tax rates are consistent with more tax revenue.

Mr. NUNES. How important is the extension of the capital gains tax cut to this continued growth in revenue?

Secretary SNOW. It is absolutely essential. It is absolutely essential because what the lower rates on invested capital did was to promote investment. When you get higher investment, you get businesses hiring and creating jobs, and you get stronger labor market conditions.

Mr. NUNES. I think you also have people who are making business decisions now based on—and I think they are worried about what the capital gains tax is going to be. So I think it is important that this Committee act on enacting these as quickly as possible.

Secretary SNOW. Failure to do so can only have a negative effect.

Mr. NUNES. Right. I want to talk a little bit about Medicare Part D because there is a lot of misnomers out there in the world and in my local press back home that Medicare Part D has been a disaster. But I have another opinion on that. I think if you look at it now, it is 20 percent less in terms of the spending that is actually taking place. We went from a projected $38 billion in spending on Medicare Part D to about $30 billion, and that is the projection for 2006. In fact, despite everything that you hear about Medicare Part D, my office in California has not received any calls with complaints on Medicare Part D. We have had some questions, but we

have not taken any calls from people who had a serious problem with Medicare Part D.

Could you talk about the current projections and future projections for Medicare Part D?

Secretary SNOW. Yes, Congressman Nunes, I can. There were clearly some start-up issues in some places, but most people, most seniors, found that things went fairly smoothly, and they are now enjoying benefits they did not have before. Millions of Americans have access to prescription drugs through Medicare that did not have it before, and a testimony to the power of markets and competition, the cost is lower than the original—by 20 percent, as you said, than the original estimates.

Secretary Leavitt and his colleagues are working to clear up the remaining problems, but in talking to him recently, he was confident that the projections of reaching some 28 to 30 million new people covered by the program would be achieved.

Mr. NUNES. The final question that I will talk about is last year the President made a strong attempt to fix Social Security for the long term, and I was very disappointed at the State of the Union address when the President discussed Social Security and it seemed to be fixed and that the Congress had failed to act and you saw the minority party stand up in unison and cheer that, in fact, we had not fixed Social Security.

My first Committee hearing here in the Ways and Means room, we sat through several people who had spoken about ideas and plans to fix Social Security long term, and the minority criticized nearly every person that was up there discussing possible fixed for Social Security.

I have been disappointed in that, and I hope that the American people realize and I know you realize that Social Security is going broke. Could you just discuss the future of Social Security——

Chairman THOMAS. The Chair will indicate that any questions that run over the time, the Chair would hope that the Secretary would respond in writing. It will be more difficult for members because our electronic timing is not working. But I can assure those junior members who only know digital time there are ways to tell time.

[Laughter.]

Chairman THOMAS. That is not tied to some electric structure.

Mr. NUNES. Mr. Chairman, I am used to the colors, and I didn't see the——

Chairman THOMAS. I understand that it just went red if that will help you. The Chair has the time here, and the gentleman from New York and I are practicing what we first learned in terms of the big hand and the little hand.

[Laughter.]

Mr. NUNES. Thank you, Mr. Secretary. Thank you, Mr. Chairman. I yield back.

Chairman THOMAS. The gentleman's time has expired.

The ranking member informs me that to facilitate movement on their side of the aisle, he has requested and my assumption is it has been cleared with his members, they will each have 2½ minutes and we will take two members at a time so that we would accommodate two members within each 5-minute window.

Does the gentleman want a show of hands?

Mr. RANGEL. I don't think so. Then we would have the opportunity to come back again, but it will give us——

Chairman THOMAS. Maybe. The gentleman from New York is recognized under his rules.

Mr. RANGEL. Thank you, and we will have somebody check the clock, you know, to see whether or not it——

Chairman THOMAS. We can always vote on it.

Mr. RANGEL. Okay. Mr. Secretary, could you share how many people would get a tax increase this year and how much that would be if we did not improve the alternative minimum tax? Have you got any idea of the impact of not doing anything on the alternative minimum tax?

Secretary SNOW. Oh, yes, Mr. Rangel. I think the number is very sizable. We very much support—the administration very much supports addressing that issue this year. It is 18 million or so. It is a very large number.

Mr. RANGEL. If we don't do the capital gains cut or the corporate dividend cut, how many people would receive a tax increase?

Secretary SNOW. The number there—let me see.

Mr. RANGEL. I would gather it would be none since it does not expire until 2008.

Secretary SNOW. Well, in that sense, yes, but——

Mr. RANGEL. Well, that is the sense that I am talking about, is that I would hope that Treasury would—you see, the Chairman believes that I am trying to help just the rich people in the United States by supporting very strongly the alternative minimum tax and trying to give a priority over the others. What is your opinion about the priority, or the President's opinion?

Secretary SNOW. Well, I think clearly sustaining the—extending the dividend and cap gains cuts are critical.

Mr. RANGEL. No question about that, but in terms of priority and the limited scope that we have to work with, what would the priority be of you and——

Secretary SNOW. Well, I would do both. I think that both——

Mr. RANGEL. You support the Senate's position that both should be done?

Secretary SNOW. I think both. I think it is important to do both, yes.

Mr. RANGEL. You would advise the conferees to do both?

Secretary SNOW. Well, I would certainly think Congress needs to get both done this year, yes.

Mr. RANGEL. Then you would advise the conferees—would you suggest to them how they could pay for it since the President wants these things permanent?

Secretary SNOW. Well, these come in within the President's budget numbers.

Mr. RANGEL. Okay. I don't think they do.

Mr. Stark, I yield 2½ minutes.

Mr. STARK. Thank you, Chair, and welcome, Mr. Secretary.

Mr. Secretary, I wanted to follow up on an issue on health care. On page 8 of your testimony you herald the coming of health savings accounts, and you suggest that it will make health care more affordable, and you say we need to lower health care costs. You say

that HSAs are an important innovation that will significantly reduce the cost of health insurance purchased by individuals.

Now, we checked this out with Mr. Bolten and Secretary Leavitt, and they both concur that in your budget, you spend $156 billion over 10 years on health savings accounts. That is the lost revenue and some minor distribution on outlays.

So, we have that in writing. You are going to spend $156 billion over 10 years for the health savings accounts. But nowhere can we find any health care savings.

You claim that it is more affordable and that the costs will go down, but if that were the case, it would show up in the budget in increased revenues because of savings to employers. So, can you tell me what cost savings there are and where you have any figures that indicate that in your budget?

Secretary SNOW. Mr. Stark, the savings will come to millions of people——

Mr. STARK. Stop. Mr. Secretary, expenses are in the budget, and they are clearly defined. Something, faith-based savings in the long-distant future you and I may not be around to see. What, if any, savings are in your budget as a result of the $156 billion expenditures?

Secretary SNOW. Congressman, as I was saying, the savings show up in the improvements in the overall health care system in the coverage of millions of people who otherwise wouldn't have access to low-cost health care coverage. That is a real——

Mr. STARK. That is just shifting costs, Mr. Secretary. That is not—where does it—if there are savings of any more than $100, it has to show up in your budget. Where is it?

Secretary SNOW. Well, the savings will be for that small business that cannot afford to make health care available today who, because of the tax advantage of health savings accounts——

Mr. STARK. Then he would pay more in taxes, wouldn't he, that small business, and it would show up in your budget. Come on. Where are the savings?

Secretary SNOW. The savings, as I say, are in the budgets of millions of families all across——

Mr. STARK. But they are not in your budget, are they?

Chairman THOMAS. The gentleman's time——

Secretary SNOW. The important thing is to improve health care.

Chairman THOMAS. —has expired.

The Chair is wondering if that is a call for dynamic scoring, but that will be left to other questioners to clarify that.

Does the gentleman from Indiana wish to inquire?

Mr. CHOCOLA. Yes, I do. Thank you, Mr. Chairman. Thank you, Mr. Secretary, for being here.

Last week, OMB Director Josh Bolten was here testifying before the Committee, and he talked about the fact that the growth in entitlement spending is one of the greatest challenges our country faces in the future. I think that in order to solve a problem, we have to find a way to define the problem, and like you, I used to work for a publicly traded company, and we had extensive reporting and disclosure requirements of our unfunded long-term liabilities for transparency and planning purposes.

Do you think it would be helpful for us to face up to these challenges by clearly stating what the unfunded liabilities of the Federal Government are? Some estimate it is in excess of $43 trillion. Do you think that the there's annual financial report of the Federal Government would be a good place to include such a statement?

Secretary SNOW. Yes, I do. I think we need more transparency on these unfunded obligations going forward. They are reflected to some degree in the trustees' Report of Social Security and the trustees' Report of the Medicare and Medicaid systems.

Mr. CHOCOLA. Going back to your previous life in the public company setting, we used to go through budget processes, and division managers would come in, and we would have discussions about actual cuts in spending. There would always be complaints and we were always going to lose all our customers, we were going to lose all our employees, the business was going to fail. But what we found, when we found ways to do more with less, we actually improved our customer service, we improved our products, we improved the financial shape of the business and the security of the employees.

When we go through these budget discussions at the Government level, when we have smaller increases, we hear those same cries of despair.

Do you think government is so different that we cannot actually spend money better, have better government at a lower cost, especially when it comes to entitlement spending?

Secretary SNOW. Oh, absolutely not, Congressman. I think we have the capacity to manage better in government. I know we are trying to do that. I think these programs can be managed better, and that is the premise of the President's budget. It is to streamline and manage better and give better results to the taxpayers for their expenditures.

Mr. CHOCOLA. Again, going back to OMB Director Josh Bolten's testimony—I think you had an op-ed in the Wall Street Journal today—he had one last week where he again talked about entitlement spending. In fact, his quote was, "No plausible amount of tax increases could possibly close the enormous gap that will be created by the unsustainable growth in entitlement programs."

Do you agree with that?

Secretary SNOW. Oh, absolutely. Absolutely. The consequences on the economy of trying to borrow our way through that or raise taxes to cover those expenditures would be devastating.

Mr. CHOCOLA. If we do nothing to effectively address the growth in entitlement spending in the near future, what would you estimate the long-term consequences of that would be?

Secretary SNOW. Well, Congressman, I don't think we would ever let that happen. As I think it was Winston Churchill once said, "America always gets it right after it has tried everything else."

I think we will find a way through this. That is one reason for the bipartisan commission on Medicare and Medicaid and Social Security and aging and retirement that the President proposed in his State of the Union. We just have to find an answer to this. We cannot allow those consequences to occur.

Mr. CHOCOLA. So, you think it is our responsibility to stay focused on this, and we would not be doing our responsibility to the American people and future generations if we don't act seriously with reform measures in the near future?

Secretary SNOW. Congressman, I agree with you. All of us in public life, in Congress and in the administration, have that obligation.

Mr. CHOCOLA. Thank you, Mr. Secretary.

Mr. Chairman, I yield back.

Chairman THOMAS. The gentlewoman from Pennsylvania.

Ms. HART. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for being with us again. I want to commend your office for putting out information immediately when the health savings account law went into place. We spent a significant amount of time distributing information to employers and some small businesspeople who were looking to try to accommodate both themselves and some of their employees by providing HSAs. We saw some statistics that show that I think 37 percent of the purchasers of HSA had previously been uninsured. The Employee Benefits Research Institute noted that a third of the people with HSAs have household incomes of less than $50,000. These numbers are actually flying in the face of what the naysayers said about HSAs.

Could you talk to me a little bit more about what we see as the prospect with some of the changes the President has proposed for future success of the HSA and how that will help to impact health care costs?

Secretary SNOW. Yes, Congresswoman Hart. The argument against the HSAs is that they are for the wealthy and the young, the healthy. The argument against the HSAs is that they are not fair, they somehow represent a threat to the established employer-based health care system, and that they won't be taken advantage of by lower-income people and by people in lower-income categories.

The evidence just plain does not support that. All the evidence we have seen, in fact, points in the other direction. The numbers I have got indicate that some 42 percent of all the HSA plan purchases are with people with earnings of less than $50,000. That is not the rich and the wealthy of America. Forty-five percent are at least 40 years old. Something like 25 percent are——

Ms. HART. Not that 40 is old, Mr. Secretary, but——

Secretary SNOW. No, but they are not 21.

Ms. HART. Right, and that is what we were told by the naysayers when we first passed the law.

Secretary SNOW. And 20 percent are at least 50. So, what we are getting here—and one-third, I think—one-third, a number approaching one-third or around one-third—did not have insurance before. So, clearly, these HSAs are meeting a real marketplace need.

Ms. HART. That having been said, we are encouraged obviously by that because we are helping to cover some people who were uninsured and what we thought about sort of freeing up the insurance market and providing different opportunities for product is a good thing, obviously, for the American people. But the concern about—and we discussed it initially when we were looking at the

law, when we were writing the law, that HSAs could also exert downward pressure on health care costs. Have we seen any of that at this point? Or is that something that we think we will see a little bit more of in the future?

Secretary SNOW. The experience is still fairly fresh, but the evidence I have seen suggests that the premiums are rising more slowly for HSA policies than they are for general health care insurance policies, which does suggest that the HSAs will help to hold down health care costs in the future, yes.

Ms. HART. With the changes that the President announced, how do you think that will improve the product and people's participation in purchasing them?

Secretary SNOW. I think it is going to be very positive for the HSAs because what it does is raise the contribution limits. It is targeted—the changes are targeted on lower-income and middle-income people by making the payment of the premiums an above-the-line tax deduction, by taking payroll taxes, and providing a credit for payroll taxes on the HSAs. Payroll taxes are generally thought to be quite regressive, so if you get a credit for payroll taxes, you are making the system more progressive.

I think it is going to lead to millions of Americans who today cannot afford health care, people who are working for small businesses where the small business employer cannot afford to make the policy available. Millions of self-employed people who cannot quite afford it will now find that it is affordable, and the refundability feature will make it available to many lower-income people.

Ms. HART. Actually, that point you made about small businesspeople and entrepreneurs is the one I think that is key for the communities I represent. I spent all January hearing about that issue, so thank you for that, and we will work with you to make sure this happens.

Secretary SNOW. Thank you.

Chairman THOMAS. Does the gentleman from Michigan wish to inquire?

Mr. LEVIN. Thank you.

Welcome Mr. Secretary. On page 4, you talk about the increase in jobs, 4.7 million since May of 2003. Do you know how many manufacturing jobs have been lost in this country since May of 2003?

Secretary SNOW. Yes, Congressman. We have lost manufacturing jobs over that period, and for a long period, regrettably, before that.

Mr. LEVIN. But do you know how many?

Secretary SNOW. Yes, I think it is well over a million.

Mr. LEVIN. Since May of 2003? It is large.

Secretary SNOW. It is large.

Mr. LEVIN. I think the total loss since 2000 is about 3 million. Of that, since May 2003, it has been about 335,000. We have lost that many manufacturing jobs. You described this rosy scenario, Mr. Secretary. I wish you would also talk about the less rosy scenario for families.

In that regard, I want to ask you, earlier in your testimony you laud the program cuts, 141 program cuts. Let me just read to you

a list of those that are cut or eliminated and ask if you support that.

Cuts in funding for the National Cancer Institute, do you support those cuts?

Secretary SNOW. I support the President's budget.

Mr. LEVIN. Those cuts are in the budget, so you support those cuts.

All right. I was at a meeting yesterday, 750 people working on anti-drug programs. There was reference to the elimination of grants for the Safe and Drug-Free Schools program, $347 million. So, you support that because you support the administration's position.

Vocational education cut $1.3 billion. You want to comment on that? You support that, too?

Secretary SNOW. That is part of the President's budget.

Mr. LEVIN. Okay. Clean Water, which is of such concern in our State and many others, a reduction in the revolving fund program by $199 million. This is for water projects. You support that also.

Secretary SNOW. I support the President's budget, which has that, but much more in it as well, Congressman.

Mr. LEVIN. The manufacturing education partnership, that is cut $55 million. You support that also. All right. I think that is part of the problem, Mr. Secretary. Thank you. Mr. Cardin is going to take the over 2½.

Mr. CARDIN. Mr. Secretary, the Chairman indicated that Ambassador Portman will be with us this afternoon, and every time I asked him about China and currency, he says I have to ask you. So, let me ask you the question.

The trade imbalance has been reported for 2005 at $726 billion, about $200 billion with China. We know that China ties its currency to the U.S. dollar, which does not allow it to seek its true economic level.

We know that China made a commitment on July 21st, 7 months ago, to allow its currency to be increased by 2.1 percent, a modest, very modest amount, certainly not anywhere near the discount that we believe is somewhere between 15 and 20 percent—15 percent and 40 percent, excuse me, and that the appreciation has been but 0.6 percent since they made their announcement. So, U.S. producers and manufacturers and farmers are fighting an uphill battle based upon the value of the Chinese currency.

We put on top of that the dependency upon the China currency ourselves. They buy U.S. dollars. They now have a foreign currency amount in about—the dollars I have now is that they are over $800 billion in holding foreign currency.

So, the question becomes: What are we doing about it? What steps are we taking in order to become less dependent upon Chinese buying U.S. dollars? What are we doing to get the exchange at a fair rate?

Secretary SNOW. Congressman, we are disappointed there has not been more progress in this arena. As you know, I have had a number of trips to Beijing, many consultations with counterparts in the government of the Republic of China. They did make the step of delinking, but since then there has been inadequate movement. We remain committed to getting movement. We need to see

movement. We are disappointed in the failure to get movement. We are going to continue to press them. Now——

Mr. CARDIN. I just hope we have a time schedule. You do not have to announce it to me today, but I do hope we have a time schedule as to when our patience runs out.

Secretary SNOW. We are not satisfied.

Chairman THOMAS. Does the gentleman from Colorado wish to inquire?

Mr. BEAUPREZ. Thank you, Mr. Chairman.

Secretary Snow, great to have you here again. I actually want to follow a little bit the line that was established by the gentleman from California, Mr. Stark. I am looking at a press report, National Review Online, that highlights this issue of capital gains, revenue receives from capital gains and actually going back to projections made in 2003 prior to the tax cuts that estimated in 2004 and 2005 we anticipated under the old revenue mechanism, standard, that we would have received at the Federal Treasury about $125 billion over those 2 years, 2004 and 2005. We, of course, cut the tax rate, and it was estimated that there would be, in the gentleman from California's words, lost revenue of about $27 billion.

What we actually found out, apparently, is that instead of the original estimate of $125 billion, the revised estimate downward of $98 billion, we actually have received in your Federal Treasury, our Federal Treasury, a combined $151 billion or a net gain of about $53 billion from that lost revenue number.

Do you care to opine on that?

Secretary SNOW. Well, I have learned to be modest in making revenue projections, but what the experience of the last 3 years suggests is something the Chairman alluded to, and that is that when you get the American economy performing better, you get the macroeconomic variables of jobs and GDP and employment rising, it has a powerful effect on the Federal revenue stream, the government receipts stream. We have seen this play out, and we frankly underestimated the power of the strengthening of the economy on the government receipts stream.

Mr. BEAUPREZ. Well, for purposes of this Committee and Congress's, I guess, obligations, it raises that whole issue of dynamic scoring that we talk about, and I also noticed in some of the materials that have come to us on behalf of this budget, that under your direction, under the Treasury's direction, you are proposing a dynamic analysis division within Treasury. I am intrigued by that idea and would love to hear from you about that.

Secretary SNOW. Congressman, what that involves is creating the capacity inside the Treasury Department to understand how changes, big changes in the Code, like changes on marginal tax rates or changes in corporate tax rates or changes in cap gains and dividends rates, affect the whole economy. Once we can get a better connection between big tax changes and the whole economy, then we can go to what I think we all want to be and having a better understanding of how to score those changes for revenue purposes.

I think we will find, if we do this analytically, that we are going to have bigger playbacks, feedbacks into the revenue stream of the Federal government than we have probably foreseen in the past.

Mr. BEAUPREZ. Well, in the private sector, I certainly put together a few budgets myself in my past lives, and we always used something that resembled the dynamic scoring theory in trying to project ahead if we make investment today, what the revenue results of that investment might be tomorrow and in the out-years. So, that makes perfect sense to me.

In the time I have got remaining I want to inquire about maybe another issue, and it relates really to your op-ed in the Wall Street Journal, which I have read, that I think is in today's paper. You say in there that, according to the Securities Industry Association, people that are actually investing in equities are typically middle-class persons saving for retirement with a household income of about $65,000 annually. You got on later to say that about 91 million Americans actually own equities.

Here is my question: I am looking at another table that says that about 96 percent of the income tax actually paid in this country is paid by 50 percent of the people that file tax returns, or a little over 64 million tax returns—some of those joint returns, I am sure—with an adjusted gross income over $28,000.

I am going to guess then that most of the people that are paying the freight in this country also own equities.

Secretary SNOW. Yes, you are right. You are correct.

Chairman THOMAS. The gentleman's time has expired.

Mr. BEAUPREZ. Thank you, Mr. Secretary.

Chairman THOMAS. The gentleman from Georgia.

Mr. LINDER. Thank you, Mr. Chairman.

Mr. Secretary, nice to see you again. Thanks for coming. I want to move a little bit further on the dynamic scoring. On the weekend after Thanksgiving this past year, Wal-Mart, which knows something about retailing, cut their prices 10 percent across the board. If they had been in Government, they would have had everybody jumping up and down saying you are going to lose 10 percent of your revenues and more than percentage of your profits. But it didn't happen that way. Why can't you just call in some of those folks who have been doing this throughout their lives? I can just imagine a Vice President for government Affairs telling the chief executive officer of Wal-Mart you are going to lose 10 percent of your revenues, and the Wal-Mart guy looking at him saying, "Son, we have been doing this a long time. You can go back to Washington."

Why can't you bring in some of those folks and see what they do?

Secretary SNOW. Well, Mr. Linder, the point you are making is a good one. There clearly is a feedback cycle between investments and revenues in the private sector, and in the public sector there is a feedback cycle between lower tax rates, a larger economy, and the government revenue stream.

What we don't yet have is the ability to quantify that sufficiently, and what we want to do is put ourselves in the position to be able to do just that. I agree with you. I agree with you.

Mr. LINDER. You mentioned in your statement that Tax Code reform remains a priority for this President. We did not hear him mention in the last State of the Union address. You mentioned to me privately up here that there was going to be an aggressive pursuit. Can we have a rough idea of when that might happen?

Secretary SNOW. We are not putting ourselves under any artificial timeline. What we are doing, though, at the Treasury is carefully considering all options, including, I must say, your well-thought-through proposal, along with others, and the tax panel's recommendations to us.

You only get to do tax reform about once every 20 years. You know, in my lifetime it was JFK in the early 1960s, and then it was Ronald Reagan in the mid-1980s, and now it is George Bush in the first decades of the 2000s, a new century.

We have got to make sure we do it right, and I have told the President and told the White House we are going to work on this very hard and we are going to send him our very best thinking, but without any artificial timeline on it.

Mr. LINDER. China has been raised here recently during this hearing, and because most nations that float their currencies wash out the relative tax components within the price system at the borders in the currency exchanges, if we wanted a pure consumption tax with no tax on income at all, China would either have to float its currency or suffer a 22-percent legal WTO-compliant tariff vis-a-vis the United States. Are we looking at that?

Secretary SNOW. Yes, we are looking at the whole idea of border adjustability, the relationship between flexibility of rates and taxes. All of that is part of this broad review that we are doing, very much.

Mr. LINDER. Thank you, Mr. Secretary.

Mr. Chairman, I yield back.

Mr. SHAW. [Presiding.] Mr. McDermott?

Mr. McDERMOTT. Thank you, Mr. Chairman.

Mr. Snow, every couple years you come up here with another fraudulent proposal from the President. This HSA proposal is about as fraudulent one as I have ever seen.

Now, you say you have evidence—at page 8, you say, "The President's proposal is projected to increase the number of HSAs from the current projected 14 million to 21 million." Where did the study come from? Who did it? Did Treasury do it?

Secretary SNOW. Congressman, that work is a combination of places inside the Executive Branch.

Mr. McDERMOTT. Did you look at the study and okay it?

Secretary SNOW. People——

Mr. McDERMOTT. You are not calling it a Treasury study.

Secretary SNOW. Right.

Mr. McDERMOTT. You are just saying it is sort of——

Secretary SNOW. You know, the——

Mr. McDERMOTT. How do I get a hold of it?

Secretary SNOW. Well, there are people—you know, the competence on this subject isn't entirely within the Treasury. There is some competence at the Department of Health and Human——

Mr. McDERMOTT. But you are making the proposal, and——

Secretary SNOW. Yes.

Mr. McDERMOTT. —it is going to have an impact on the budget of this country and on the individual budgets of Americans.

We watched what happened with 401(k)s, and what every employer did was drop his guaranteed benefit program and give an HSA to people—or, excuse me, a 401(k). The same is going to hap-

pen here. If you have read the Wall Street Journal article a couple of weeks ago, they say: I think what employers are really after is that they are moving the risk from their balance sheet to the employees.

Do you disagree with that statement?

Secretary SNOW. Oh, absolutely.

Mr. MCDERMOTT. You think—what is there that is going to require employers to stay giving the benefit package they are giving today?

Secretary SNOW. The desire to attract and retain their workforce?

Mr. MCDERMOTT. But you have no studies that make any estimate of how many people are being moved one way or another in this process?

Secretary SNOW. Well, we have—as I said, we do have an estimate. Treasury has done an estimate of the——

Mr. MCDERMOTT. A written estimate where I can look at the parameters?

Secretary SNOW. Well, I think to make an estimate we would have to write it down somewhere and run the math on it.

Mr. MCDERMOTT. Why don't you make it available to us. Mr. Chairman, I ask that it be made available to the Committee, and also that we put into the record, I ask unanimous consent, the Wall Street Journal article.

[The article follows:]

February 3, 2006

Health Accounts Have Benefits For Employers

By THEO FRANCIS and ELLEN E. SCHULTZ
Staff Reporters of THE WALL STREET JOURNAL; Page B1

Amid the debate over whether health-savings accounts will fix America's health-care problems, another important effect has received less notice: The accounts are generating savings on payroll taxes for companies that adopt them, and they could hasten a shift of health-care costs from companies to employees.

Trade groups cheered President Bush's call in his State of the Union address Tuesday to expand key elements of health-savings accounts, or HSAs. The President's proposals could make it more attractive for millions of people to sign up for HSAs, either on their own or at the growing number of companies that are adopting them.

The growing acceptance of HSAs accelerates a transition in health-care benefits, from employers providing a safety net to employees taking on more risk. The shift parallels a similar trend away from traditional pensions in retirement benefits. Indeed, HSAs may be poised to become the 401(k)s of health care: a low-cost substitute for a once-standard workplace-provided benefit, which can offer employees greater flexibility but also can increase their financial burdens and risk.

"I think what [employers] are really after is that they're moving the risk from their balance sheet to the employees," said Richard T. Evans, a health-care analyst with Sanford C. Bernstein & Co. in New York. "The risk is being transferred without the consumer really realizing it," he said.

Just as the 401(k)—invented as a supplemental benefit—ended up supplanting pensions, HSAs could do the same to traditional employee health insurance. Already, companies with HSAs are enjoying savings on payroll taxes that mirror gains they made in the shift to 401(k)s.

"Employers are saying they want some certainty" in health-care costs, says Daniel Halperin, a Harvard University law professor. Although HSAs don't place the full burden of paying for health care on employees, "it's a movement in that direction," he said.

But employers see this trend as simply reflecting the changing nature of the employment relationship, says James Klein, president of the American Benefits Council, a trade group for employers and the benefits industry. "It's a positive trend in our view—it's not a panacea, but it's something that ought to be encouraged."

Health-savings accounts enable workers to set aside pretax pay—sometimes combined with contributions from their employer, if the company chooses to contribute—to pay for certain health-care costs. The account can be applied to health-care costs up to a minimum deductible of $1,050 for an individual and $2,100 for a family in 2006. After that, costs are covered by a catastrophic insurance policy that users must purchase.

Established in 2003, HSAs are flexible in ways many experts have long sought. Money in the accounts can be rolled over from year to year, taken with the employee to a new job and spent on non-health-care-related items after age 65. They also are available to people who don't have insurance through their employers or who are unemployed. Mr. Bush is proposing that such people be allowed to contribute with pretax money.

Business groups generally hailed Mr. Bush's proposals, including the National Association of Manufacturers, the insurance industry and the financial-services industry, which is poised to reap billions of dollars in fees from managing money squirreled away in HSAs. Among the major companies offering employees an HSA option are Wal-Mart Stores Inc., DaimlerChrysler AG's Chrysler Group and General Motors Corp.

Chrysler Group says it contributes an annual $500 to single employees' accounts and $1,000 for families. "Most companies do it because it makes sense economically for the company and the employee," says spokesman Dave Elshoff. A Wal-Mart spokesman declined to comment on specifics of Mr. Bush's proposals but says the company has "advocated that there be more latitude in HSAs."

About three million people have taken out the high-deductible insurance that qualifies them to open an HSA, about triple the number of a year ago, according to America's Health Insurance Plans, the insurance trade group. Of those, about one million consumers have actually opened an HSA, the group says. The White House has said it intends its proposals to expand the number of Americans using HSAs to 21 million by the end of the decade.

Proponents say HSAs will help rein in health costs because employees will be more careful about how they spend their money. Critics say HSAs are unfair because they saddle the sick with the costs of treating themselves, rather than spreading those costs across large groups.

Employers decide whether to contribute money to the accounts. Even if they do contribute, the employer's total cost for each employee in an HSA is generally lower than for a worker in a traditional health plan. For example, employers typically pay $3,284 for a single employee in a traditional insurance plan; covering the same employee in a high-deductible plan would cost $2,850, according to the Kaiser Family Foundation.

Even if they don't contribute a cent, employers still get tax benefits. And the more of their own pay employees set aside each year, the bigger their employers' tax breaks. That's because employers ordinarily have to pay a variety of payroll taxes on cash income their employees earn; these taxes fund Social Security, Medicare and state and federal unemployment programs. But under at least some HSA arrangements, employers can skip most of those taxes on employee contributions to the account, bringing the employer savings of as much as 7% to 10%, according to some estimates.

For example, for an employer with a thousand workers collectively setting aside $1.5 million, the employer would save as much as $150,000 a year. Those savings are in addition to the income-tax deduction the employer gets for contributions it makes to the accounts. At a minimum, "the [payroll-tax] savings basically pay the administrative costs," said Rebecca Miller, a tax specialist with Minneapolis accounting firm McGladrey & Pullen.

Those tax savings could give employers "an incentive to encourage contributions" from employees, said Princeton University economist Uwe Reinhardt.

While payroll-tax savings do benefit employers, they are unlikely to be a decisive factor for employers considering HSAs, said Mr. Klein, the employer lobbyist. "In the scheme of what health-care costs are, I doubt that would be a compelling reason to move to that kind of plan design."

Employees also enjoy payroll-tax savings, which helps make the accounts attractive to them. What's more, the Bush administration proposal also calls for allowing people to put even more money into the accounts, enough to cover not only deductibles, as provided by current law, but also the cost of premiums, copayments and amounts not covered by their health plan. Currently, maximum annual con-

tributions to an account are limited to the lesser of the plan's deductible or a fixed amount: $2,700 for individuals and $5,450 for a family in 2006.

Mr. SHAW. Mr. Lewis?

Mr. LEWIS OF GEORGIA. Thank you very much, Mr. Chairman. Thank you, Mr. Secretary, for being here.

Mr. Secretary, I would like to just ask you a general question. We continue to make the tax cut permanent. We are engaged in a conflict in Iraq. The tax cut helped those at the very top. You did not say anything in your statement and the administration has not said anything about shared sacrifices. The only people giving up something are our young men and our young women that are losing their lives or losing their limbs in this war. What are the American people, what is the administration asking the American people to give up, to make some sacrifices? We are all in this thing together. I would just like to hear you elaborate.

Secretary SNOW. Well, Congressman Lewis, that is a good question, and the answer, of course, is this budget slows the growth rate of a number of programs. We think it does it in a responsible way. We think it does it in a way that long term will better serve the interests of the country. But I have a number of fellow Cabinet members who feel quite constrained. You know, they feel they have been held back on spending that they otherwise might want to have done.

Mr. LEWIS OF GEORGIA. Mr. Secretary, since you raised the question of the Cabinet, in Cabinet meetings—maybe you are not free to say, but do you ever have a discussion, do you ever talk and say some of us should be prepared to ask the Nation, to ask the President, to ask the American people to give up something, to sacrifice?

Secretary SNOW. What this budget, Mr. Lewis, is trying to do is sustain the growth of prosperity across America, encourage the job creation process, and raising wage levels and income levels across America. That is at the heart of what this budget is seeking to do, and that is why we are asking Congress to make the tax cuts permanent and——

Mr. LEWIS OF GEORGIA. Well, how can you in God's name ask to make the tax cuts permanent when we are engaged in a war, we have men and women, our young people dying in Iraq, dying in Afghanistan, and then you are going to make the tax cuts permanent? Is that fair?

Secretary SNOW. Well, yes, it is fair. It is important that we continue to focus on the well-being of people who are the citizens of this country. There are 4.7 million Americans that have jobs today who did not have them 3 years ago. I think that is an impressive record and something we want to continue. We want to see real wage rates continue to raise. We want to see prosperity continue to grow in America. This budget is designed to make that happen.

Mr. SHAW. The time of the gentleman has expired.

Mr. Ryan? Were you here? Okay. Mr. Cantor?

Mr. CANTOR. Thank you, Mr. Chairman.

Mr. Secretary, it is good to see you again.

Secretary SNOW. Thank you.

Mr. CANTOR. Thank you so much for being here before us, and just following up on the questioning just before me, you know, I take a different view. I look at the fact that we do see objective evidence that the tax rate on dividends and capital gains being lowered produced phenomenal results. I hear the gentleman from Georgia's complaint that perhaps we are not paying enough attention to our men and women in uniform, and I do know that in the budget being presented by the President, we are increasing the amount of funds going to defense and our efforts in the war on terror, including Iraq, Afghanistan, and other places.

I would ask, in the form of a statement first, that we need to have a strong and vibrant economy at home, we need to continue to grow, and we need to produce prosperity so that we can afford to keep this country safe. I believe that there is irrefutable evidence that the tax cuts have produced more jobs, the tax cuts have produced more Federal revenue than, as was stated before, the CBO estimate ever even imagined.

But on the point of health care and health savings accounts, we need to be concerned about our competitiveness. We need to make sure that American business can compete abroad and at the same time provide the health benefits that American workers have become accustomed to and, frankly, need. I believe from the studies that I have seen that health savings accounts produce a situation where individuals can have more choice at play in terms of their health care decisions.

I was wondering, Mr. Secretary, if you can talk a little bit about the President's health savings accounts proposals and how they would encourage continued use by employers, because we know that recent studies have indicated 31 percent of those involved with HSAs now were uninsured previously. So, how are we improving the use of health savings accounts through the proposals.

Secretary SNOW. Let me take a minute and go through this because it is very important, and I appreciate the chance to respond to that good question.

As you know, there are many, many small businesses in America today who find it very difficult or impossible to afford health care. I have talked to many of these employers as I have traveled the country, and they like to be in a position to make health care available, but they just cannot afford it.

At the same time, there are many self-employed people who find it difficult to afford health care, and one reason is the fact that there is a fundamental inequity today between those who seek to buy their health care in the private marketplace and those who get it through their employer. If you get it through your employer, it is enormously tax-advantaged. It is excluded from income taxes. It is excluded from payroll taxes. If you are buying it in the open market, it isn't. You pay for it with after-tax dollars, making it much more expensive.

What the HSAs at their very heart do is end that inequity. They make contributions tax deductible. They make the premiums tax deductible. They give you a credit back for the payroll taxes. So, in effect, putting the private market, open market purchases on the same basis as the employer-provided health care, that is going to

lead to a lot more health care there the private marketplace, and that is a good thing. It is going to mean lots of people who aren't covered today get coverage, and that is a good thing. That is showing up in these statistics. The new proposals the President has made are going to strengthen the ability of HSAs to meet the need of the uncovered.

Mr. CANTOR. Thank you.

Mr. SHAW. Does the gentleman yield back the balance of his time?

Mr. CANTOR. I yield back, Mr. Chairman.

Mr. SHAW. Mr. Neal?

Mr. NEAL. Thank you, Mr. Chairman.

Mr. Secretary, defense spending has gone during the last 5 years, I believe, from about $257 billion to $439 billion. We have created a Department of Homeland Security, about $40 billion. Medicare Part D was estimated initially to cost about $400 billion and now it is about $740 billion. We are fighting two wars—one in Afghanistan for a little bit more than $1 billion a month, and about $1.5 billion a week in Iraq. We have Hurricane Katrina standing in front of us.

Annually, the Congress in the past has done 13 spending bills, and I think it is down to 12 now, and the President based on your earlier comments, you said it was the priority of the administration to restrain spending. Now, has the President vetoed any spending packages during the last 5 years?

Secretary SNOW. No.

Mr. NEAL. Have you recommended any vetoes to the President during these times, during your time as Secretary of the Treasury?

Secretary SNOW. Yes, several.

Mr. NEAL. Would you wish to share with us which ones you have recommended for veto?

Secretary SNOW. Well, the necessity for taking that action wasn't called for because the suggested changes we recommended were made.

Mr. NEAL. Well, you know, Lawrence Lindsey recommend to the administration some time ago what the real cost of the wars in Afghanistan and Iraq were going to be. The Secretary of OMB, when he first came before the Congress, current Governor of Indiana, he said it was going to cost about $60 billion. We hear this argument that it is time to restrain spending, but the President has not vetoed any spending bills, right?

Secretary SNOW. Congressman, I have acknowledged that, but I have also said that the Congress and the President, the White House, have worked together to bring bills in line with the President's expectations.

Mr. SHAW. Mr. Jefferson?

Mr. NEAL. That is 2½ minutes, sir?

Mr. SHAW. That is 2½ minutes. If Mr. Jefferson wants to give you some of his minutes, he can.

Mr. Jefferson?

Mr. JEFFERSON. Thank you, Mr. Chairman. I wish I could.

I want to ask, Mr. Snow, about the issues we have back home in the aftermath of Katrina. I appreciate the early help you gave us with waivers and so on, with the EITC and other issues, but the

big issue back home is housing, how to get people back on a permanent basis.

We are about now at the end of the deferral period for most mortgage holders and homesteads back home where we are going to face massive foreclosures just right about now. It is going to affect the banking industry, and it is going to affect the creditworthiness of a whole region. We have got to do something dramatic and creative, and we are going to recommend soon—I want to see if I can get your support for this sort of an idea—where we permit the homeowners to defer making mortgage payments over a period of time, up to 18 months, until sometime in 2007, or unless they occupy the house sooner, where we have the Treasury, in effect, pay the note along the way. At the end of this 18-month period, we would permit restructuring or refinancing or a solid second mortgage that permits the persons to pay the Treasury back from their own financing, back to the Government, and that way relieve both the banks and homeowners of the burden of foreclosure.

Would you support such a concept?

Secretary SNOW. Congressman, you and I have worked together on things in the past, and I think you know we try and keep an open mind. I certainly am prepared to talk to you and see if something along those lines would work. But I am not familiar enough with the proposal to be able to give an informed comment on it at this point. But I will certainly follow up with you. Of course, we have had many conversations with you and your colleague, Mr. Baker, on finding the right answers here, and we are in continuing conversations on that subject.

Mr. JEFFERSON. This would be well short of the Baker bill as a solution, but it would be an immediate response to a crisis.

The other thing is in this so-called high ground in the city that did not flood, we have about 5,000 to 8,000 blighted houses that can be fixed, are not in floodplains but in areas that did not sustain flooding. There I would like to—what we have done for the low-income housing tax credit for the rental property, we would like to do it for the single-family homeowners in that area. With that sort of concept, I would like to ask you the same consideration of this concept so we can attack this thing on two fronts. I hope we can get some real movement on these ideas.

Secretary SNOW. Congressman, as you know, we have tried to work with you, put in place recommendations that Congress acted on for tax relief, the expensing for small business and the GO Zones and so on. So, clearly, we want to work with you to make sure that the community comes back.

Mr. JEFFERSON. Well, thank you. We appreciate that.

Mr. SHAW. The time of the gentleman has expired.

Mr. Ryan?

Mr. RYAN. Thank you.

I have two lines of questioning I want to go to, one tax, then monetary, so I will try and fit it all in. Tax policy, a number of my colleagues have been talking about capital gains and realizations, dividend income and the estimates. Let me just quickly go through some numbers. Our estimators here in the House Joint Tax Committee, assured Congress in 2003 that the capital gains tax cut, going from 20 percent to 15 percent, would reduce revenues by $3

billion from 2003 to 2005, with bigger losses after that. According to the CBO, actual revenues were $62 billion higher than Joint Tax predicted over a three-year period.

Now, this isn't a one-time mistake. In 1997, when President Clinton lowered capital gains tax rates from 28 to 20 percent, Joint Tax mis-estimated revenue losses, which were increases by $84 billion.

The track record at Treasury is basically the same. The OTA scoring methodology that you have has not only been wrong once, it has been wrong every time, and so we have a scoring methodology we know through fact and proof is wrong. Yet we have this tidal wave of taxes coming to the American taxpayer at the end of the decade. I don't like to really say make the tax cuts permanent as much as I like to say let us prevent large tax increases from being inflicted on our constituents in the American economy. If we go into tax reform or dealing with this tidal wave of taxes at the end of the decade, with this flawed scoring methodology, it is going to be very difficult to fix this problem.

I understand you are doing some modeling over there. You are running new simulations. What specifically is Treasury doing to make the scoring methodology more accurate?

Secretary SNOW. Congressman, what we are doing is establishing an Office of Dynamic Analysis that will develop the capabilities over time—and we hope soon—to get at the issue that you have put your finger on. I think all of us who have a hand, as I suggested earlier, in doing revenue estimates, need to be pretty humble, because we have clearly missed—we have underestimated here the power of lower tax rates on the Government's revenue stream. I am struck by the fact that despite—Mr. Neal asked me about all this spending, and certainly we have commitment and we need to spend for those commitments, but the January surplus was 21 billion. The December surplus was 11 billion. The reason, in the face of this spending, that we are getting this good results on the budget is the revenue side, the revenue piece.

Mr. RYAN. The great thing about modeling is we can use hindsight to test our models to see whether they are accurate or not. Do you plan on taking the results of this office and putting them into practice? Then I have a quick question on monetary policy, so if you could give ma quick answer.

Secretary SNOW. The answer is yes, sure, that is the purpose of it.

Mr. RYAN. Dr. Bernanke is, I think, testifying right now, the new Fed Chair. It is his first time here in Congress. In academia, and I believe when he was at the CEA, he publicly endorsed the concept of inflation targeting, which I think is a very wise prospect. What is your take on inflation targeting? Should we engage in explicit inflation targeting, and if so, question number one, do we have to amend the Humphrey–Hawkins Law in order to engage in inflation targeting; and number two, should we endorse and adopt an inflation targeting rule?

Secretary SNOW. Congressman, I have made a practice of not commenting on Fed policy.

Mr. RYAN. I thought so.

Secretary SNOW. There is sort of a division of labor. They do not talk about exchange rates, and I do not talk about interest rates and inflation targeting.

I think it is important to respect that division of labor.

Mr. RYAN. Okay.

Secretary SNOW. Thank you.

Mr. RYAN. Thank you. I yield back.

Mr. SHAW. Mr. Tanner?

Mr. TANNER. Thank you, Mr. Chairman.

Thank you, Mr. Secretary. Currently there is about 47 percent of the debt held by the public is in foreign hands, and last year about 90 percent of our Treasury securities were purchased by foreigners. In your opinion, is there any level of foreign ownership of our debt that would have national security implications?

Secretary SNOW. Mr. Tanner, I think the investment in the U.S. securities that we see from many foreign sources is today a reflection of the strength of the U.S. economy and our capital markets. So, I think it is really a vote of confidence in America, and when people invest in America, they get a stake in America and get a stake in seeing our institutions continue to do well. So, overall, I think we would have to view the investment in U.S. securities, equities, treasuries, fixed income instruments of the private sector and public sector as a positive thing.

Mr. TANNER. I understand that, but is there any level of foreign ownership that would cause concern from the national security standpoint? For example, if they had a geopolitical interest or some long-term strategic interest for which they were willing to take a short-term economic hit, there is, I would assume, some level if we owe—do you see any level at which this would be of concern?

Secretary SNOW. Congressman, we would of course monitor that and take action long before we saw it becoming a concern, but I do not think it is advisable to put any precise quantification on that. But I take your point.

Mr. TANNER. Would we have any warning signs, in your opinion, when we were getting close to that point?

Secretary SNOW. I think we understand those markets pretty well, and have capacity to deal with that, I do.

Mr. TANNER. Let me ask you this. You said, last year in Iowa, that the consequences of continued deficit spending likely would be higher interest rates with the resulting drain on the economy. If financial markets lose confidence, then funds are made available only at higher interest rates. Do you still agree with that?

Secretary SNOW. Absolutely.

Mr. TANNER. Now, as you know——

Mr. SHAW. The time of the gentleman has expired.

Mr. Becerra?

Mr. BECERRA. Thank you, Mr. Chairman.

Mr. Secretary, thanks for being here.

Secretary SNOW. Thank you.

Mr. BECERRA. I wanted to talk a little bit about something you had said earlier about how the economic recovery has been good, that this economy is sending benefits to all Americans. That can sometimes present a deceiving picture when you talk in terms of averages. You talked about average growths in terms of wages and

so forth. But a quick example, to make my point very clear, if we were to take the income of an average American, middle class American, and take the income of Bill Gates, and if we were to take the average of those two incomes, all of a sudden we have two billionaires in our midst. The reality is that that middle class American is no closer to being a millionaire than to being a billionaires. So, we have to be very careful when we talk about averages.

That is why when you break down this economic recovery that we have seen over these last couple of years, you begin to realize that the benefits of that recovery have principally gone to folks who are very, very wealthy, while the richest 10 percent in this country over the last 5 years has seen its income rise by about 4 percent. The average, the typical American family has actually seen its real weekly wages go down by about 1 percent. So, we have to be very clear to dissect this so we can really see how average Americans are benefiting, not lumping average Americans in with very wealthy Americans, and making it look like on average everyone is doing well.

The other point I wanted to make—and I hope there is a question in here—is that when we talk about this economic picture being so rosy, I have to ask myself, why is it that in this budget, which you said you support from the President, did we have to cut funding for widows who are trying to bury their deceased spouses. There is a $255 Social Security benefit that widows receive, death benefit that widows receive when their spouse—who, by the way earned that deceased benefit—expires. This budget, your budget, would propose cutting the $255 funeral cost benefit under Social Security that a widow receives. That saves you $2 billion when you have an over $400 billion deficit.

You also are using the entire $190 billion surplus in the Social Security Trust Fund to mask the size of the deficit. So, if you were not to include the Social Security Trust Fund surplus, the actual size of the deficit, and if you were to include the cost of the war——

Mr. SHAW. Time of the gentleman has expired.

Mr. BECERRA. —the deficit would be about $600 billion.

Mr. BECERRA. Thank you, Mr. Chairman.

Mr. SHAW. If there was a question there, the Secretary will have to answer it in writing.

Mr. Foley?

Mr. FOLEY. Yes. Mr. Secretary, I do have to say the tax policies of this administration have worked. Retail sales numbers are robust. We cross 11,000 on the Dow. Unemployment is the lowest in a generation. Tax policy is spurring investment. We have the greatest homeownership of our lifetime. So, those are proof positive these are working.

The question though that I do have, I understand that as Secretary of Treasury, you chair the Committee on Foreign Investment in the United States. Looking over the budget, I could not find any line item that specifically funds the Committee. Recent reports have indicated the Committee has approved the transfer of ownership from Peninsula and Oriental Steam Navigation Co., a privately-owned British company, of the ports in this country, New York, Newark, Philadelphia, Baltimore, Miami, New Orleans, in

other words, every major seaport on the Eastern seaboard, to a company owned by the government of the United Arab Emirates.

Just crossing the wire this morning, United Arab Emirates are engaged in active negotiations with Iran to increase trade opportunities at a time when we are trying to deal with the threat Iran poses to the entire world. You recently acknowledged in an earlier statement that we have had a tough time convincing the Chinese government to adjust their currency. How will we get a government entity who now controls the major shipping points of interest in this country to do what we would like them to do if we cannot impact the Chinese on a simple currency adjustment? What was rationale, first, for the security risk posed by the potential sale, and are we going to be able to dictate to them the critical security issues?

When I travel to Guatemala, to various and sundry places, one of my first questions to their officers are, what are you doing to secure the cargo coming to the United States of America? Now I have a concern that a foreign national will own the ports in which those goods are arriving. Could you expound?

Secretary SNOW. Yes. Thanks, Mr. Foley, for that good question on the CFIUS. The Committee on Foreign Investment in the United States is chaired by the Treasury Department. We never comment on particular transactions, but what I can say is the Committee is made up of all of the relevant agencies of the U.S. Government, from Homeland Security to Defense, to Intelligence, to Justice, to make sure that any foreign purchase of a U.S. based company does not pose a threat to the national security of the United States. That is the job of CFIUS, to make sure that any acquisition of U.S. companies does not pose a threat. Often what happens is that the acquiring entity agrees to a series of conditions that are designed to make sure that the security interests of the United States are protected.

Let me say that is a process that I have watched. I think it works very well, and I think it is designed to well protect the security interests of the United States.

Mr. FOLEY. One of the concerns, the GAO had a report to the Exon–Florio, which is the presidential directive to protect the Nation on foreign investment. The GAO reports that there are weaknesses, obviously, in the Committee's implementation. It says specifically, "Congress should consider amending Exon–Florio to more clearly emphasize the factors that should be considered in determining potential harm to national security." I guess that is the one thing that is troubling me. Washington Times today says we should be improving port security in an age of terrorism, not outsourcing decisions to the highest bidder. The ports are thought to be the country's weakest homeland security link with good reason. Only a fraction of the Nation's maritime cargoes are inspected. The root question is this: why should the United States have to gamble its port security on whether a subsidiary of the government of the United Arab Emirates happens to remain an antiterrorism ally?

I guess that is the sum and substance. They are today. What happens tomorrow? How do we have safeguards implemented in law?

Secretary SNOW. Congressman, the CFIUS process—and again I have to be very careful not to go very far here because of legal restrictions I am under—but——

Mr. SHAW. But, Mr. Secretary, if I may, according to the rules set out by the Chairman, you will have to respond to that in writing.

Secretary SNOW. Good.

Mr. SHAW. Mr. Doggett?

Mr. DOGGETT. Thank you, Mr. Chairman.

Mr. Secretary, just putting the Republican budget cuts in proper perspective, all of the cuts that Republicans just approved, student loans to Medicaid, to child support enforcement and other vital programs, will this year fail to pay for even one single month in Iraq. All of these cuts amount to about half of the almost $9 billion that incredible Bush administration mismanagement in Iraq has just lost. That is $9 billion, not even counting all the Halliburton no-bid contracts of taxpayer money that the administration cannot find, can't keep track of.

If we approved every single penny that you have recommended in this budget that you are peddling today, it would pay for little more than four more months in Iraq, and of course, all of this doesn't count the terrible cost in the lives and limbs of young Americans.

The question I have for you relates to your claims that you are going to make us more competitive with this budget, because this new budget once again essentially freezes Pell grants at levels that students received about 30 years ago. You propose to eliminate most of the Perkins Loan program, which half a million students rely on for fixed rate low interest loans, and replace those with the new high interest Boehnert Loan program, which has these rates and fees that students don't currently have to pay. This will add about $5,000 on average to the debt that students have to pay when they are already struggling with debt. It would seem that the competitiveness you envision is more students having to scramble and compete against each other for more scarce Federal resources.

Is the administration's solution here based on the idea that our students will be more competitive if they have more debt that they have to pay off and will work harder, or is this just consistent with your philosophy that since we are going to have endless national debt, it does not hurt for our students to have endless personal debt?

Secretary SNOW. Congressman, if you will look at the record of this administration on education, what you see is something on the order of a 40 percent increase of spending since the administration took office, 40 percent——

Mr. DOGGETT. Well, you don't disagree on the Pell grants, that they are frozen at a level 30 years ago?

Mr. SHAW. Mr. Pomeroy.

Mr. POMEROY. Mr. Secretary, we have a lot of ground to cover. Let's begin. Referring to your op ed piece in the Wall Street Journal today, you indicate fully half of all households benefiting from the lower tax on dividends alone, there can be no doubt that lower tax on investment benefited the majority of American people quite directly.

Later in that same article you say: Keep in mind, the typical investor today, according to Securities Industry Association, is a middle class person saving for retirement with a household income of $65,000.

Now, is that where you come up with your conclusion that half of all households benefit from this lower tax on dividends?

Secretary SNOW. That and the fact that because of the lower taxes on dividends and capital gains, there are so many more people working in America——

Mr. POMEROY. But the beginning of your sentence you said, yes, that—so yo acknowledge that. Now, how does the tax structure, if you say that these people are holding this money through the stock investments made through their retirement funds, as I understand the taxation of retirement funds, Mr. Secretary, you do not have capital gains taxes and dividends taxes attaching to those funds. Is that correct?

Secretary SNOW. There will be taxes when the moneys are withdrawn.

Mr. POMEROY. Correct. But that tax, Mr. Secretary, is figured at ordinary income tax rates, not capital gains tax rates or dividend tax rates. So, it is my understanding, Mr. Secretary, that contrary to what you are suggesting today, these capital gains and dividend tax issues don't relate to the money coming out of retirement funds when someone is retiring and is drawing down their IRA.

Secretary SNOW. Everybody who participates in the equity markets of the United States, and that is over half of the households——

Mr. POMEROY. That is a very—if you are going to say, well, we all benefit the——

Secretary SNOW. Well, there were something like 36 million people have taxable dividends. 36 million is a pretty good sizable portion of the American——

Mr. POMEROY. I have figures from North Dakota, Mr. Secretary, that says that basically 73 percent of the taxpayers across all income tax levels receive no benefit from 15 percent capital gains, no benefit at all. I believe you are misstating the taxation——

Mr. SHAW. The time of the gentleman has expired.

Mr. Lewis?

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

Welcome, Mr. Secretary. I want to go in just a little bit of a different direction here, kind of a niche issue. I know that one of the administration's ongoing priorities is restructuring of the Black Lung Disability Trust Fund debt. I understand that both you and Secretary Chao have identified this as a key priority and a basic good government issue. With the trust fund nearly $9 billion in debt, without restructuring, it can never be solvent. As you may be aware, I have introduced a bill to take this problem on and hopefully solve it. I don't know if you are aware of the legislation. It is H.R. 3915. If you are and if you have had a chance to look at it, do you think this will address the problem and hopefully solve it?

Secretary SNOW. Congressman, I am aware of it, but I have not had an opportunity to really review it. If you would like me to, I

will look at it and give you written comments on it or call you and talk to you about it.

Mr. LEWIS OF KENTUCKY. I would appreciate that. If there is anything else that you think we need to do to bring solvency to this fund, then I would appreciate your comments.

Secretary SNOW. I would be pleased to do that, and I have made a note of it.

Mr. LEWIS OF KENTUCKY. Great, thank you.

I yield back.

Mr. SHAW. Gentleman yields back.

Mrs. Tubbs Jones?

Mrs. TUBBS JONES. Mr. Chairman, thank you.

Good afternoon, Mr. Secretary. How are you, sir?

Secretary SNOW. Good, thank you.

Mrs. TUBBS JONES. One of my colleagues on the Republican side said this was the greatest housing boom we had ever seen, and the dollar is—this is the greatest bankruptcy boom we have ever seen too. In fact, Financial Services passed some legislation because the financial markets didn't want to many people to be able to declare bankruptcy; isn't that a fact, sir?

Secretary SNOW. Well, I think——

Mrs. TUBBS JONES. Don't take too long to answer. I only have 2½ minutes.

Secretary SNOW. Yes. There were reforms in the bankruptcy laws enacted.

Mrs. TUBBS JONES. As a result of the high number of people filing bankruptcy, coming as a result of this great housing boom and predatory lending.

Secretary SNOW. No. I think there was some serial bankruptcies declared in a way that wasn't consistent with the intentions of the bankruptcy laws.

Mrs. TUBBS JONES. Some serial bankruptcies declared inconsistent, but that would have been—I won't argue with you about that, but the fact is, there are a high number of bankruptcies, even though you are suggesting that at this time, this is the greatest housing boom or economic standard that we have had.

Let me move on to another subject, Mr. Secretary. The Social Security privatization included in the President's budget. The dollars that are going to be expended to privatize over 10 years is something around $1.1 trillion; is that correct, sir?

Secretary SNOW. It is in the budget. I think it is something on that—I think it is a little less, like three-quarters of a trillion, I think, is the number that I remember, but we can check that.

Mrs. TUBBS JONES. But it is a big number, regardless of whether it is three-quarters of $1.1 trillion.

Secretary SNOW. Right.

Mrs. TUBBS JONES. That is money that we have to expend up front in order to fund privatization; is that correct, sir?

Secretary SNOW. Yes, over that period.

Mrs. TUBBS JONES. In fact, all of the stories, all the polls, all of those say that the American public does not favor privatization as a result of the cost, right?

Secretary SNOW. I think it depends on what poll you look at and who you talk to.

Mrs. TUBBS JONES. I mean the polls were strong enough that the President backed up on his decision to try and privatize in 2006; is that a fair statement?

Secretary SNOW. Well, it didn't happen.

Mrs. TUBBS JONES. It didn't happen, and it did not happen as a result of the American public raising their arms saying, "Mr. President, we do not want to privatize Social Security."

Secretary SNOW. Well, I think it failed to garner bipartisan support is a fair statement.

Mrs. TUBBS JONES. Because it didn't garner bipartisan support, that means there are enough Republicans, along with Democrats, who oppose it and you couldn't move forward.

Thank you, Mr. Chairman.

Mr. SHAW. Mr. Thompson?

Mr. THOMPSON. Thank you, Mr. Chairman. Mr. Chairman, the budget calls for a tax increase on a very significant portion of agriculture that I represent. It is the second try to do this in the way of user fees. I have a letter that I would like to submit for the record, signed by 20 bipartisan members opposed to that.

Mr. SHAW. Without objection.

[The letter follows:]

July 26, 2005

The Honorable Bill Thomas
Chairman, House Ways & Means Committee
U.S. House of Representatives
Washington, DC 20515

The Honorable Charles Rangel
Ranking Member, House Ways & Means Committee
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Thomas and Ranking Member Rangel:

We urge you to strongly oppose any efforts by the Administration to impose greater tax burdens on the wine industry through new user fees. This industry is already one of the most heavily taxed and regulated in the country and any additional tax burden would be harmful to the future growth of the industry.

As you may recall, the Administration's FY06 Budget proposal included a provision authorizing the Treasury Department's Alcohol and Tobacco Tax and Trade Bureau (TTB) to collect user fees in order to offset the cost of its operating budget. These proposed permit and application fees amount to nothing more than an additional tax on top of the billions of dollars in excise taxes that the alcoholic beverage industry already pays.

It has come to our attention that there may be an effort to include such a provision in the upcoming tax reconciliation package. We urge you to strongly oppose any such effort. This provision would unfairly burden the wine industry, in particular the thousands of small, family owned wineries across the country, many of which have just opened in the last few years. Any additional tax burden would jeopardize the significant growth that the industry is currently experiencing.

It is unwise and unfair to further tax an industry simply for complying with Federal regulations and we hope that you will join us in opposing any such provision.

Thank you for your time and consideration and we look forward to working with you on this issue.

Sincerely,

Mike Thompson
George Radanovich
Steve Israel
Maurice Hinchey
Lynn Woolsey
Lois Capps
Doris O. Matsui
Timothy Bishop
Jim Costa
John T. Doolittle
Louise Slaughter
Ken Calvert
Randy Kuhl
Mary Bono
Sherwood Boehlert
David Wu
Darlene Hooley
Doc Hastings
Richard Pombo
Greg Walden

Mr. THOMPSON. Thank you, Mr. Secretary, for being here. I am concerned about a real lack of oversight, not only behalf of your shop, but ours as well.

According to the GAO, 16 of 23 Federal agencies aren't in compliance with proper accounting standards. This week we learned from your own IRS that there is a huge tax gap, somewhere between 290 and $345 billion that we are not collecting. The Department of Homeland Security and Government Accountability Office has released a recent report on Katrina. We are all seeing that. We know that there has been terrible mismanagement in everything from the payments to the hurricane victims, to thousands of trailers sitting unused. Now there are reports of all the private sector problems associated with the reconstruction in Iraq. Who is watching the store, Mr. Secretary? Shouldn't we be having more oversight investigations and shouldn't we be working together to do this?

Secretary SNOW. Congressman, there is always need for more attention to details in managing things. I agree with you.

Mr. THOMPSON. I would like to see some effort, joint effort for greater oversight so we can get a handle on this, because this would go a long way in balancing our budget problems.

Quickly, on the alternative minimum tax, the President stated that this should be addressed in the fundamental tax reform, but there is no proposal in the budget. Does that mean that the President doesn't want to fix the problems associated with alternative minimum tax?

Secretary SNOW. No, no. Quite the contrary.

Mr. THOMPSON. Then how do we do it?

Secretary SNOW. You do it in the context of broad-based tax reform and we will——

Mr. THOMPSON. But it is not in budget.

Secretary SNOW. well, no, because we have not yet finalized our efforts to come up with recommendations to the President.

Mr. THOMPSON. But there is not a place for it in the budget.

Secretary SNOW. Well, because we have not yet come up with the proposals.

Mr. THOMPSON. But in the same budget you are extending tax cuts that do not expire for years, but the alternative minimum tax has already expired and it is poised to hurt millions of Americans.

Secretary SNOW. We support the patch on the alternative minimum tax.

Mr. SHAW. The time of the gentleman has expired.

Mr. Hulshof?

Mr. HULSHOF. Thank you, Mr. Chairman.

I cannot believe my good friend from the State of California would advocate tax breaks for wealthy people. I say that tongue in cheek.

Mr. Secretary, welcome. I cannot let pass, however, some of the rhetoric that has already become part of this hearing's record. I have heard the terminology "shared sacrifice." Correct me, Mr. Secretary, if I misspeak. It is my understanding that 5 percent of the top wage earners in this country pay over half of the country's bills.

Secretary SNOW. That is correct.

Mr. HULSHOF. More specifically, a successful professor in Columbia, Missouri, who may have published a book, is paying for welfare benefits for needy families in Columbus, Georgia. A wealth businesswoman in Washington, Missouri is paying for free housing for those in Washington State. Americans reached into their pockets in the aftermath of Katrina and were generous in providing for those victims of that tragedy. Yet now we are seeing that some, some of the victims of that catastrophe have been spending that money not to pay for the necessities of life. Probably most importantly, regarding shared sacrifices, there are families in Monroe City and Herman, Missouri and other small towns, whose loved ones have paid the ultimate sacrifice for what we are doing in Iraq, and those families believe those sacrifices have been worth it.

So, that is my comment. You need not comment on my comment, Mr. Secretary.

But I do want to pivot and talk about, associate myself with some of the remarks of Mr. Ryan, Mr. Foley, about how these pro-growth tax policies have in fact spurred growth and investment in our economy. I think any fair-minded individual would arrive at the conclusion that the fundamentals of our economy remain strong. I would exclude from the definition of fair-minded individuals, those that are running from political office. But one of the things—I am a sponsor of H.R. 8. I think I can say that it is a bipartisan bill because there were 42 of my colleagues on the other side of the aisle on the death tax repeal, that voted for that permanent, complete and final repeal.

Mr. Secretary, my question is: what is your opinion of the impact on taxpayers and the economy as a whole if Congress fails to act, and we allow the death tax to reemerge in its pre-2001 levels, that is an exemption of only one million dollar, and tax rates as high as 55 percent? If we fail to do our duty and act, give me your best assessment of what might happen to the fundamentals of our economy.

Secretary SNOW. Well, we would return to the far less desirable environment we found ourselves in several years back, with slower

growth rates, less job creation and less income creation across America. It would be to reverse the good path we are on. It would be a terrible mistake.

Mr. HULSHOF. I applaud the idea—and I think Mr. Ryan touched on this, others have as well—the creation of a Dynamic Analysis Division within Treasury's Office of Tax Policy. I think this is a great idea to actually put into place real world economic scoring instead of, my terminology, this flat Earth sort of scoring that we have to deal with. It is my understanding that the Dynamic Analysis Division will be up and running hopefully by the July mid-session review. I hope that we can expect a dynamic analysis of the death tax repeal. Would you care, in the few seconds I have remaining before the Chairman gavels me down, would you care to venture a guess as to what we might expect from a dynamic analysis of the repeal of the death tax, sir?

Secretary SNOW. I would rather reserve until we have that analysis completed, but I do think that that tax does have an adverse effect on entrepreneurship, and people continuing in businesses and continuing to put their talent to work to grow the American economy.

On your broader question of the shared sacrifice, I think it is important to realize that because of the tax cuts that you approved, the Code has been made more progressive. Higher income people today pay a higher share of the total tax bill, and on the mistakes that were made, and certainly there were some in the context of Katrina, the error were the result of our commitment to try and err on the side of being as generous and humanitarian as possible and respond to the needs of the people who were devastated by that.

Mr. HULSHOF. Thank you.

Mr. SHAW. The time of the gentleman has expired.

Mr. Emanuel, you are recognized for 2½ minutes.

Mr. EMANUEL. Thank you, Mr. Chairman.

Mr. Secretary, you had a report today about the fact that approximately $300 billion in net dollars goes unreported and uncollected, which then therefore leaves a greater burden of the taxes onto middle class families. There is a couple parts of this I would like to talk to you about. One is the fact that until 2003 enforcement was nonexistent at IRS. Obviously, that was before your time, I am well aware of that. But it let the cat out of the bag, so there has been a dramatic increase in uncollected dollars, could actually reduce the deficit by almost 80 percent, if in fact what people owed was actually paid. So, what are we going to do to do something about collection?

First. If you look at your enforcement that goes on, close to 70 percent—let me say it this way—there has been a 70 percent increase in the funds for cracking down on first-time teachers, first-year rookie police officers, and people who apply and use the earned income tax credit. Yet only a 3 percent increased enforcement in all other areas.

Second. If you happen to be making the minimum wage, you are 8 more times more likely to be audited by the IRS than if you are a million dollar investor in a partnership where only 1 in 400 get audited.

So, I am worried about what goes unreported, and uncollected, and unenforced by the IRS. Then second, when you do actually do the job of enforcement—and there has been an increase in dollars since 2003 under your watch—they don't get distributed equally and not everybody gets audited accordingly. I would trust you that the people making earned income taxes, that is, people making about $25,000 a year, work hard, play by the rules, trying to raise their kids right, that is not where the gap is, and you have not enforced the law equally across the board, and if you want to pick up $300 billion quickly that is owed and says that everybody will live under the law equally and be responsible equally, you need to enforce the law across the board equally, not based on whether you are a janitor, a teacher or a millionaire investing in a partnership. You do not apply the law today equally.

Secretary SNOW. Well, let me respond. The tax gap is a serious problem, and we share your concern and that of the other Members of the Committee on that score. The administration, as you acknowledged, has made a serious effort to close the gap.

Mr. EMANUEL. After the problem got very bad on their watch, right?

Secretary SNOW. Well, you know, this is not a new problem. On this issue of who is getting audited, the budget calls for significant increase—and we have seen this in the last few years—audits of the high-income taxpayers, those earning $100,000 or more rose—I think the audits of them last year were some 220,000 in fiscal year 2005, the highest number in the past 10 years. I take your point. We need to be equitable and fair here——

Mr. EMANUEL. Mr. Secretary, you and I have a friendship that goes way back. I am sorry there are some facts here that just are stubborn, as Ronald Reagan used to say.

Mr. SHAW. Time of the gentleman has expired.

Mr. EMANUEL. Appreciate that, Mr. Chairman. I look forward to an answer any time in writing, Mr. Secretary, because it is not true.

Mr. SHAW. Mr. Weller? Mr. Weller is recognized for 5 minutes. The other members will then be recognized for 2½ to keep the Secretary on schedule.

Mr. WELLER. Thank you, Mr. Chairman, and I will certainly yield back any time I do not use, recognizing the Secretary is limited in his time, and give every member an opportunity who has patiently waited for their opportunity to ask questions of the Secretary.

Mr. Secretary welcome to the Committee. Good to have you here today. It is always good to be with you.

I represent a district south of Chicago with a lot of older communities, both rural and suburban as well as urban. I want to commend you for including in the President's budget permanency for the brownfields provision that we have worked to have included in the Tax Code, tax incentives, to encourage the environmental cleanup of essentially abandoned industrial and commercial sites, and I commend you for having the wisdom to do that. I worked with your department along with my Chairman and others to create this provision, and of course, I support the goal of permanency. I would also note, as we work through the reconciliation con-

ference, with Chairman Thomas's support, we have worked to expand the brownfields provision to include petroleum products. About 40 percent of brownfield have petroleum products. We could always think of that abandoned gas station in many rural and suburban and urban communities, the one on the strategic corner. People always think, why doesn't somebody buy that? Well, there is environmental contamination there. This incentive I believe will help create recycling of those sites and put them back to work.

I would note, since this provision became law, that the largest brownfield in the State of Illinois, which is located in the district I represent, the former Joliet arsenal, has attracted in its recycling $1.5 billion in private investment, by the end of the year should have 2,000 jobs in place, and frankly, now has the largest container port in North America, is I think the third largest container handling facility in the world, all because private investment attracted by brownfields cleanup.

The one issue I want to address to you, Mr. Secretary, is dealing with the President's alternative fuels agenda that he talked about in the State of the Union. I commend him for his goal of increasing energy independence. I am one of those who believes it is a national security issue as well as an economic security issue. We were reminded in September with $3.00 gasoline and higher, what happens when we are overly dependent on limited sources, particularly petroleum-based fuels.

When he talked about biofuels—and I want to mention to you, as you may be aware, I have introduced, back in December, the Biofuels Act legislation which was nicknamed 25 by 25, sets a goal of providing 25 billion gallons of biofuels, ethanol, bio-diesel, soy-diesel in use by the year 2025. We currently use 4 billion gallons.

But the legislation, I believe, will be a key part of our strategy to achieve the President's goal of reducing our dependence on Middle Eastern oil by three-fourths by the year 2025. So, I certainly want to work with you. I would note that in the Biofuels Act, there are provisions which provide for accelerated appreciation for investment in refining capability for biofuels. We continue the incentives that were in the energy bill to encourage retailers to invest in the infrastructure necessary to distribute. Then we also provide tax credit for flexible fuels, and this is an area I would certainly like to work with you, Mr. Chairman.

I just want to ask of you, in my limited amount of time, you know, from the administration standpoint, from the President's standpoint, what are the advantages of emphasizing biofuels reducing our energy independence, and then how do you see using the Tax Code to achieve that goal?

Secretary SNOW. I was pleased, within the last month or so, to announce the implementation of some of the provisions in the Energy Act of last year, that encourage greater reliance on hybrid vehicles. I think the tax code can play a useful role here in encouraging movement in the right direction on alternative fuels, and on alternative technology. So, we want to work with you on that. I also hope 1 day to visit that port facility made possibly by the brownfields.

Mr. WELLER. You have an outstanding invitation, Mr. Secretary. We would love to have you there.

Secretary SNOW. I think it makes a point that is important about the way the tax system works. If you out certainty into it, you get investors coming in. That is one reason it is important to extent the special treatment accorded to the brownfields on a permanent basis. It would remove the doubt or the uncertainty affecting investment in facilities like that, and would promote to goal of encouraging not only investment, but environmental remediation, which is important as well. So, I look forward to visiting there one day.

Mr. SHAW. Time of the gentleman has expired.

Mr. WELLER. You have an invitation to come.

Mr. SHAW. Time of the gentleman has expired.

Mr. Johnson, recognized for 2½ minutes.

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

Thanks for being here, Secretary.

Secretary SNOW. Thank you.

Mr. JOHNSON OF TEXAS. You have already discussed a little of the criticism concerning people in the lower tax brackets who work part time or do not get their health care through their employ, generally lower income. If you want to discuss how the President's budget helps remedy that, I would appreciate it. But I have one other question, and it may not be in your expertise, but you can get back in writing if you want to, the idea to allow employers to put more money into HSAs that belong to chronically ill employees is an interesting one. Does the administration have an idea as to how chronically ill will be defined?

Secretary SNOW. I think that is probably a question better left to my able colleague, Mr. Leavitt, or Dr. McClellan.

Mr. JOHNSON OF TEXAS. Toss the ball, huh?

Secretary SNOW. Well, I think you might not get as informed an answer from me as you would from them. So, I am going to defer to them.

But on your broad question of the HSAs and how they affect things going forward, if the HSAs are made available, and the broadening provisions that the President called for enacted, I think you are going to see greater reliance on HSAs, which can only be good for employees and small business and entrepreneurs because now they are going to have access to lower cost health care than is available today. It is a good option for them, not a panacea, but it is a good option.

Mr. JOHNSON OF TEXAS. It gives them the advantage of selecting their own health care processes.

Secretary SNOW. Exactly.

Mr. JOHNSON OF TEXAS. Thank you, sir. I will yield back the balance of my time.

Mr. SHAW. Gentleman yields back the balance of his time.

Mr. Ramstad?

Mr. RAMSTAD. Thank you, Mr. Chairman.

Mr. Secretary, I want to ask you about a thorn in the side of many taxpayers, and I am referring to the telephone excise tax. As you know, this tax was first enacted—well, it was enacted in 1898 as a temporary tax to fund the Spanish-American War. It is imposed by the Federal government on long distance phone calls. It seems to me almost an absurdity today that the tax only applies

to phone calls for which charges are levied based on the distance and the time of the phone call. But as we all know, most phone companies today don't base their charges on both distance and duration of the call. Rather, they charge a flat rate per minute regardless of the distance the customer happens to be calling.

Now, in the past few years, a number of taxpayers, business taxpayers, have challenged the IRS' collection of this tax in Federal court. In fact, no fewer than three Federal courts and a host of Federal District Courts have all ruled against the IRS. Can you please tell me why in the world does the IRS continue collecting this tax, and can you give us an indication of how long the government will keep litigating this issue? Mr. Secretary, why not give it up?

[Laughter.]

Secretary SNOW. Well, I think the courts may require us to do that very soon. You know, this is pending in the Sixth Circuit. The Department of Justice took an appeal from the District Court. We are awaiting that judgment. Should the judgment come down in alignment with the prior three Federal Circuit Courts, I think the handwriting is on the wall.

Mr. RAMSTAD. That will be the end of the temporary tax enacted in 1898 to fund the Spanish-American War?

Secretary SNOW. I would think the time to bring that to an end would be upon us.

Mr. RAMSTAD. That will be good news to taxpayers. Thank you, Mr. Secretary.

I yield back.

Mr. SHAW. Gentleman yields back.

Mr. Camp?

Mr. CAMP. Thank you, Mr. Chairman.

Mr. Secretary, in Michigan, the issue of competitiveness is foremost in most people's minds, and we are facing pressure not only from China but India, Mexico, but also the high cost of health care. Can you explain what the President proposes I his budget with regard to helping more Americans better afford quality health care?

Secretary SNOW. The key provision in the President's budget that would accomplish that objective, Congressman, is the enhancement of the HSAs by allowing larger contributions and by making them even more tax advantaged by allowing the purchaser to deduct the premiums on the policy, and to get a credit back on the payroll taxes.

This should make an already very attractive vehicle even more attractive. In order to make it more attractive to the lower income and middle income people, it also has a refundable tax feature to it that will enable people in lower income categories to be able to afford it.

The idea here is simply to make an option available for people who don't have health care today, largely small business, entrepreneurs, self-employed, to be able to get the option of lower-cost health care.

Mr. CAMP. Thank you very much. Mr. Secretary, I am interested of your assessment of the rate of economic growth in the United States compared to, say, the European Union or Canada, and if Congress fails to extend the tax rates on capital gains and divi-

dends, would that economic growth be potentially damaged, and if so, could you describe some of that for me?

Secretary SNOW. Yes. The United States today is the envy of the world. Our growth rates are roughly double the growth rates of the other G7-G8 countries. At the heart of a strong recovery we are enjoying is the tax policy that Congress adopted 3 years ago to lower the taxes on marginal taxes on income, and to reduce the taxes on capital gains and dividends.

I think it would be a terrible mistake to reverse course. I think it would be a terrible mistake not to do the extension, and I think the track record here is clear, and I would urge you and your fellow members of the Congress to move on to permanency, because lower tax rates are consistent with both strong revenue streams for the Federal government and better jobs, more jobs, in a more expensive, dynamic and growing economy.

Mr. CAMP. Thank you, Mr. Secretary.

Mr. SHAW. Gentleman yields back.

Mr. English, you are recognized——

Mr. ENGLISH. I will pass, Mr. Chairman. I have a number of questions, but in the interest of time, I will simply submit them for the record.

Mr. SHAW. Mr. Herger?

Mr. HERGER. Thank you, Mr. Chairman.

Secretary Snow, like many here, I firmly believe Congress should act to permanently extend the tax relief of 2001 and 2003. Tax relief has helped to rebound from the economic slowdown of a few years ago, has stimulated growth and created a record number of jobs, 4.7 million new jobs, has stimulated growth since 2003, and has also contributed to 14.5 percent increase in Federal receipts, the largest increase in almost a quarter of a century.

One of the confirmations of these numbers has been a report issued by the National Federation of Independent Businesses that expanded section 179 expensing, where small businesses are able to deduct up to 100,000 of investment in machinery and equipment authority is helping these small businesses grow. I would like you to take a moment to elaborate on the President's proposal to double the amount a small business can currently expense, and make this amount permanently, and specifically, what benefit would this assurance by to American small business?

Secretary SNOW. Congressman, thanks for the opportunity to address that. Small businesses are really the engine of job creation in America. They create two out of three new jobs. We saw that when the expensing under 179 was expanded from 25,000 to 100,000, that a lot of investment was made. It really spurred investment because it improved the return on investment, it lowered the cost of investments. The evidence on that is very clear, and what we are saying is for small business, since it worked at going from 25 to 100, it is going to work even more raising it to the 200,000. We want to continue to have small business lead the job creation parade in America, make investments, create jobs and grow and expand, and this is designed to do that. I think it is one of the strengths of America, our vibrant small business sector.

Mr. HERGER. Thank you, Secretary.

I yield back.

Chairman THOMAS. [Presiding.] The Chair thanks the gentleman from Florida for his courtesies, and inquires if he wishes to inquire?

Mr. SHAW. I have one area that I would like to inquire into, and that is the question of the alternative minimum tax. I am not talking about just simply adjusting, I am talking about abolishing it entirely. It is probably the most senseless tax that we have on the books today. We would, I am sure, have rescinded it on a bipartisan basis, and the only problem is that the revenue figure is gigantic. have you done any analysis as to what effect that would have on the rates if we were able to rescind it on a revenue-neutral basis?

Secretary SNOW. You are right, Congressman. The AMT, particularly as it goes forward, will be generating very large amounts of revenue. We intend to address the question of the AMT, not as a patch, but as a permanent fix, and to do so in the context of broad-based tax reform. The AMT, as you suggest, is such an integral part of the tax life of the American citizens, and will become more so in the future, such an integral part of the Code and the way we approach taxes, that it has to be thought of in terms of the whole code itself. There are varying estimates. I think we have one in our budget proposals as to what the revenue effects would be, but whatever they are, they are very, very sizable. We know that.

Mr. SHAW. Thank you.

I yield back, Mr. Chairman.

Chairman THOMAS. Thank the gentleman.

Mr. Secretary, thank you very much, especially for your willingness to accommodate, what I know is a very busy schedule, the opportunity for the Committee on Ways and Means to speak with you at the beginning of this budget process.

Secretary SNOW. Mr. Chairman, thank you very much.

[Whereupon, at 12:28 p.m., the Committee proceeded to other business.]

[Questions submitted from Mssrs. English, Herger, Rangel, Stark, and McDermott to Secretary Snow, and his responses follow:]

Question Submitted by Representative English

Question: Thank you for your testimony before the Committee on Ways and Means today. I appreciate your providing our Committee with an overview of the President's FY 2007 Budget. As you recall, the hearing was lasting longer than anticipated, and so in the interest of time, I agreed to submit my questions to you in writing. Therefore, I offer to you the following concerns and request your prompt response.

First, I would like to raise important issue that has arisen under the provision enacted in 2004 to provide an incentive for companies to repatriate their foreign earnings. I understand that recent Treasury guidance (Notice 2005–64) would undermine the intent of this provision (Sec. 965 of the I.R.C.) by imposing a tax penalty on companies that use the provision to repatriate. As you may recall, I was the House sponsor of the original repatriation legislation, and I have been following it closely to ensure the incentive is working properly. In September 2005, I wrote to you to ask that this guidance be revisited to more clearly reflect Congressional intent. I did not receive a response until yesterday, February 14, 2006 and despite the five-month delay, the response simply stated that the Office of Tax Policy is considering the issue. I do not consider this vacant reply to have addressed the concerns I laid out in my letter. However, I understand that Treasury is considering issuing further guidance that would allow tax-

payers to switch to the so-called "sales method" of allocating R&D expenses for the year of repatriation without being required to stay on that method for 5 years. Providing such guidance would go a long way to help mitigate the tax increase that otherwise could arise and would be consistent with Congressional intent underlying the repatriation incentive. I request that you inform me whether Treasury will issue guidance to allow companies to be able to use the "sales method" for allocating R&D expenses during this repatriation incentive year without being bound to stay on that method for 5 years?

Second, I would like to focus on the matter of China's currency. The Administration has heralded recent steps by China regarding its currency as important steps toward a freely market-determined Yuan. Yet, I find it difficult to get too excited about important steps, as you have called them, when there is no detail as to what those steps are. In July, when China revalued the yuan with a one-time adjustment and set the trading band to a basket of currencies from the dollar peg, did they announce what currencies were in the basket? If so, could you please provide a list of those currencies?

Is it possible that the resulting daily value calculation of the yuan could vary widely based on their selection of currencies in the basket? Could you please explain why?

On average, what is the daily fluctuation in value of the U.S. dollar in percentage form? Do you think that China's limitation of the change in value of the Yuan to 0.15% is overly cautious or restrictive?

More recently, China announced that it would abandon the basket of currencies in favor of a system of 13 "market-makers." Has the Central Bank announced which banks these market makers are? If so, could you please provide the names of these "market-makers?"

This system has been reported as an "over the counter" system, can you explain in greater detail how it works?

Further, this new system was hailed by some in the financial markets as a major step into injecting accountability and market-forces to the Chinese foreign currency banking system. How can accountability exist where transparency is conspicuously absent? And for that matter, how can market forces operate effectively when access to information is also missing? I appreciate your consideration of and response to these questions as an extension of my time during the hearing. I look forward to your response as well as to working with you on these and other important issues pending before Congress during the remainder of the 109th Congress.

Answer:

June 7, 2006

The Honorable Phil English
U.S. House of Representatives
Washington, DC 20515–3803

Dear Mr. English:

Thank you for your letter on the section 965 "repatriation" deduction and issues related to China's currency. Because your letter concerns matters of tax and international economic policy, I have consulted with colleagues in the Office of Tax Policy and the Office of International Affairs.

As we stated in our previous letter to you on the section 965 deduction, we very much appreciate the inquiries we have received from your office on the interaction of the section 965 deduction and the rules for allocating and apportioning research and experimental expenditures. This is a very technical subject, and it has required careful consideration.

We continue to believe that the rules set forth in Notice 2005–64, taken in their entirety, are the most appropriate reading of the statute. We view the rules in the Notice regarding expense allocation and apportionment as the proper effectuation of the rules of the section 965 deduction as set forth in the conference agreement.

After much consideration, we have decided not to issue guidance that specifically authorizes taxpayers to adopt temporary methods of allocating and apportioning research and experimental expenditures as a consequence of the enactment of section 965. Of course, any taxpayer remains free, through normal procedures, to seek the Commissioner's consent to change methods before the end of the five-year period described in Treasury Regulation section 1.861–17(e).

With respect to your questions concerning China, I have consulted colleagues in Treasury's International Affairs office. They note the following:

According to public remarks by the Governor of China's central bank. Zhou Xiaochuan, last August, the US dollar, the Euro. the yen, and the South Korean won represent the main currencies in China's basket. The Singapore dollar, pound sterling, Malaysian ringgit, Russian rouble, Thai baht, and the Canadian dollar are also considered by the Chinese authorities. China has stated it selects the currencies for its basket based on their share in China's foreign trade, foreign debt, and foreign direct investment. China uses the basket as a reference; thus changes in basket currencies do not automatically translate into changes in the RMB. Daily fluctuations against the dollar have averaged 0.026 percent since last July, much lower than the maximum daily change (0.3 percent).

China has approved 13 domestic and foreign banks to act as RMB "market makers" on China's inter-bank foreign exchange market. According to press reports, these market makers include eight domestic lenders-the Bank of China, China Construction Bank, Agricultural Bank of China, Industrial and Commercial Bank of China, Bank of Communications, Citic Bank, China Merchants Bank, and Industrial Bank, as well as five foreign banks—ABN AMRO, Bank of Montreal, Citibank, HSBC, and Standard Chartered.

In January 2006, China introduced an over-the-counter trading system that allows banks to trade RMB directly among themselves at a lower cost. Previously the China Foreign Exchange Trade System (effectively PBoC—the central bank) served as the counterparty on all RMB spot trades and the high fees it charged its member banks inhibited trading volume and volatility. The new rate setting mechanism now calculates a daily central parity rate based upon a weighted average of each morning's opening bid and the ask prices for the market makers.

Secretary Snow recently stated that he is extremely dissatisfied with the slow pace of Chinese exchange rate reform. The Bush Administration has strongly pressed the view that major economies should have flexible, market based exchange rate systems. The Secretary has argued the case both bilaterally with foreign monetary and finance officials and in multilateral meetings.

Although China has taken more steps to widen participation in the foreign exchange market, its movements toward a flexible, market based exchange rate have not been rapid, as you rightly note. This slow pace is neither in China's self-interest nor in the interest of the world economy.

For the last 3 years, the Treasury Department has made engagement with China one of its top priorities. This intensive engagement has concentrated on exchange rate flexibility, but has also focused on the other steps necessary to shift the sources of growth toward domestic demand and consumption, reform the financial sector and build the foreign exchange market infrastructure. While the economy of China continues to evolve, we are not satisfied with the progress made on China's exchange rate regime, and will continue to monitor China's progress closely.

Sincerely,

Kevin I. Fromer
Assistant Secretary (Legislative Affairs)

Questions Submitted by Representative Herger

Question: The President's budget includes a provision to extend the 0.2 percent Federal Unemployment Tax Act (FUTA) surtax. This surtax was created in 1976 to pay for a temporary benefits program. That debt was paid off in 1987, yet the "temporary" surtax has been extended multiple times. It is currently set to expire at the end of 2007, and the Administration proposal would extend it for another 5 years, until December 31, 2012. The Federal unemployment trust funds now total about $30 billion, well more than is needed to support annual federal program costs. Even without the revenue attributable to the 0.2 percent surtax, there would be more than enough tax revenues to meet Federal responsibilities in any given year. Could you explain why the President's budget would extend this supposedly temporary payroll surtax yet again?

Answer: Extending the current tax rate will support the continued solvency of the Federal UTF accounts and maintain the ability of the unemployment system to respond to future economic downturns. We also note that the Department of Labor projects some state trust funds will borrow in the next few years even though no downturn is projected. UTF dollars are not only used to support benefit costs. Under current law, they also cover the administrative costs of State Unemployment Compensation programs and grants to States under the Wagner–Peyser Act for employ-

ment services. Using current economic assumption, the Federal accounts in the UTF will not reach their statutory ceilings until Fiscal Year 2016. These ceilings may be viewed as the Federal solvency requirements. Extending the 0.2% means these accounts will reach their ceilings 3 years earlier.

Concerning Unemployment Benefits Program: There are several proposals in the President's budget for the Treasury Department that relate to the nation's unemployment benefits program. For instance, one proposal would help states reduce improper unemployment benefit payments and recover delinquent employer taxes by giving employers new incentives to correctly report and pay the proper amount of taxes. Are you confident these changes will be beneficial to employers in terms of limiting red tape and reducing tax payments to only the needed levels?

Answer: The Unemployment Compensation Program Integrity Act of 2006, which the Department of Labor transmitted to Congress in May, contains several proposals, some of which are optional on the part of the states, which would support state "integrity" activities to prevent/detect improper payments and collect overpayments and delinquent taxes. The Department of Labor's data show that, for every dollar spent on benefit integrity activities, the unemployment fund gains between $4 and $5.

These proposals will be beneficial to employers because they result in net gains to state unemployment funds. State UI tax rates depend in part on the state's fund balance; higher balances result in lower taxes overall for businesses.

Joint Questions Submitted by Representatives Rangel, Stark, and McDermott

Question: For several years we have requested information on the assumptions behind your budget estimates for the health tax proposals both during hearings and in writing. Unfortunately, previous requests have not yielded useful responses, despite that most of these data points were needed to derive your revenue estimates. Please provide a table with the following year-by-year estimates for 2007–2016, as applicable, for each HSA/high-deductible health plan (HDHP) proposal in the budget, as well as a cumulative column showing the total estimate (assuming interactions between the proposals) and data source(s) for each estimate——

- **The number of people newly insured as a result of each proposal;**
- **The drop in employer-sponsored coverage as a result of each proposal, and specifically (1) the number of people who have shifted from employer-based coverage to the non-group market and (2) the number of people who became uninsured;**
- **The number of people in employer-based coverage who move from comprehensive to high-deductible coverage;**
- **The number of people who move from employer-based coverage to Medicaid or other public insurance programs (including high-risk pools), broken out by program type;**
- **The total number of new purchasers in the non-group market;**
- **The estimated take-up rate for by AGI and/or tax bracket;**
- **The estimated out-of-pocket costs as a percent of net income by AGI and/or tax bracket;**
- **Distribution of tax benefits. Please provide distributional tables showing the estimated tax benefits for each policy, and cumulatively, by AGI and tax brackets.**

Your testimony claims that President's health agenda will make health care more affordable, and implies that it will lower spending. However, it appears that costs are simply shifted to individuals and overall health spending is not reduced. Indeed, these proposals cost the Treasury $156 billion over the next decade. Can you quantify claims of system savings, e.g., how much more affordable, which costs will go down and by how much? Where precisely in the budget—or even in the underlying tables and analyses—are the savings from moving people to HSAs? Surely there would be interactions in public programs and tax benefits for employers?

The *Economic Report to the President* acknowledges that high *prices* are one of the main drivers of higher premiums and overall US health spending. How much does the Administration expect *prices* for medical services

will decrease as a result of these proposals? If actual prices were to go down, that would reduce spending in other Federal health programs, such as Medicare and Medicaid. Are these interactions reflected in your estimates of Federal spending? If not, why? If so, please detail the annual savings to each program for 2007–2016.

Although employers can contribute to the HSA, they are not required to do so. In your modeling, what proportion of employers do you assume will contribute to the HSA? How much on average do you assume such employers will contribute? How much on average do you assume individuals or families will set aside? How much do you assume are off-setting reductions from other savings vehicles (e.g., retirement accounts, education accounts, etc.) and what is the distribution across vehicles? If you do not assume reductions in other savings vehicles, why (e.g., where do you assume the additional funds come from)?

The budget shows that you assume the HSA proposals will cost us $59 billion over 5 years and $156 billion over 10 years in terms of lost revenue and new outlays. It is not clear whether this is a gross or net number. For example, does this estimate reflect any interaction with the employer exclusion for health benefits? How much additional revenue does the Administration expect to take in as a result of employers dropping or decreasing coverage for their employees (and potentially increasing taxable wages)?

Previous independent analyses from the Academy of Actuaries and others have indicated that widespread adoption of HDHPs/HSAs or of other policies that could induce adverse selection (e.g., Association Health Plans or AHPs) would dramatically increase premiums for traditional insurance. For example, CBO projects that AHPs would cause increased premiums for 80 percent of people covered by small businesses. What does the Administration assume happens to premiums for comprehensive policies under the HSA expansion assumed in the budget? If you did not perform this analysis, please explain why.

Because HSAs are exempt from all taxes, including payroll taxes (e.g., contributions by employers are not taxed), they reduce funding for the Medicare and Social Security trust funds. How much revenue is lost to each Trust Fund as a result of (1) your latest estimates under current law and (2) adoption of the President's HSA proposals in this budget? It is theoretically possible that you anticipate increased Trust Fund receipts if you assume that employer health benefit expenditures are reduced and wages are commensurately increased as a result of HDHPs/HSAs. If so, what are your estimates for increased payroll tax revenue as a result of these policies?

You mentioned "portability" in your testimony, but I can't find anything in the budget or other documents to explain what you mean. What is the Administration's portability proposal?

Health insurance premiums in the individual market are determined by age, gender, and health status among other things. Older and sicker individuals have to pay more than the young and healthy to get coverage. These practices greatly favor insurance companies, which have the power to deny insurance coverage altogether, or refuse to cover services that a patient might need, such as maternity care. What new proposals does the Administration have to require insurance companies to issue non-group policies to all applicants? What new proposals does the Administration have to limit the ability of non-group issuers to charge certain applicants higher premiums based on their age, gender, health status or other factors?

Nearly all states allow health insurers in the non-group market to use medical underwriting to refuse to sell policies and to charge certain applicants higher premiums or exclude certain body parts or conditions, based on the applicant's health history or history of someone in their family. These practices mean that insurers can selectively enroll applicants for all policies, including high-deductible health plans (HDHPs). Does the President propose or support any measures to require insurance companies to issue policies to all applicants without medical underwriting? If not, how do you propose to ensure that all people seeking HDHPs and HSAs are able to get them? If you suggest that certain folks turn to high-risk pools or other non-HDHP sources, wouldn't that prohibit them from being able to open and maintain a health savings account?

Do you show an increase in the number of people eligible for the 7.5% deduction as a result of the shift to HSAs? If so, what is the year-by-year comparison relative to assumptions or projections under current law?

Answer: The President's health care initiative is intended to address the rising cost of health care in several ways. First, the initiative gives individuals a greater stake in their health care decisions by emphasizing high deductible health insurance. A fundamental principle underlying the initiative is that when individuals are more involved in their health care decisions, those decisions will be better ones. Putting the health care consumer more in control of health care decisions, rather than third parties, such as insurance companies, employers, and the government, will help reduce the rise in health care costs.

Second, the initiative fundamentally alters the tax incentives that underlie the current health care system. The current tax treatment of health care provides a tax incentive for individuals to prepay for their health care through employer provided health insurance. This results greater use of first dollar coverage and greater reliance on employer provided insurance simply because of the tax bias. Prepayment of health care through first dollar insurance coverage translates into less price sensitivity by the health care consumers and is a significant factor for why health care costs have risen roughly 2 percent faster than the rate of growth in the economy for many decades.

The President's health care initiative reduces the tax bias for first dollar coverage and the prepayment of health care through employer provided insurance by extending the tax subsidy available to health care purchased through employer sponsored insurance to health care purchased by individuals whether financed through health insurance or direct out-of-pocket spending, provided they purchase high deductible health plans.

While putting the health care consumer more in control of his or her health care decisions and addressing important tax biases that underlie our current health care system, the initiative only increases the existing tax subsidy for health care, principally for employer-sponsored insurance, from about $325 billion to $345 billion in 2010 (Treasury Department estimates).

It is important to evaluate this initiative as a package, because the individual provisions work in unison to address the inequity and the uneven treatment of health care in our current system. Accordingly, it is not possible to disaggregate the individual provisons in order to answer many of the specific questions posed. As a package, the Treasury Department estimates that these proposals will have a substantial effect on the number of HSAs, increasing their number in 2010 by 50 percent. Under current law, the Treasury Department estimates that there will be about 14 million HSAs in 2010. Under the President's initiative, the number of HSAs is estimated to rise to about 21 million in 2010. That is, some 21 million taxpayers would directly benefit under the President's health care initiative. Of course, helping to lower the growth in health care costs is a central objective of the initiative and the anticipated rise in the number of HSAs is important to achieving this objective.

The early evidence on HSAs is very promising. According to a study released by AHIP, by January 2006 there were about 3.2 million people covered by HDHPs. This is up very significantly from the roughly 900,000 people covered by HDHPs reported by AHIP in September 2004. Research by AHIP also indicates that 42 percent of individuals with HDHPs have incomes below 50,000 indicating that a substantial number of lower income individuals are using HDHPs. Similarly, research by E–Health Insurance found that roughly one-third of those with HDHPs in the non-group insurance market were previously uninsured. Also, recent research sponsored by the United Health Group has found that individuals with HDHPs are 5 percent more likely to seek preventive care than individuals with traditional PPO plans. This is important because preventive care may help dampens future growth in health care costs at the same time as improving wellness.

Employers are playing an important role as individuals begin to shift toward HDHPs by making substantial contributions to individuals' HSAs. Recent research by Kaiser/HRET indicates that, on average, employers contribute roughly $600 to individuals' and $1,100 to families' HSAs. These contributions reflect one way that the savings from lower insurance premiums associated with HSAs are passed on to consumers. The important role played by employers in the HDHP market is also reflected in tax return and information reporting data. A preliminary Treasury analysis of these data for 2004, the first year HSAs were in effect, found that nearly one-half of all HSAs were funded exclusively by employer contributions. We expect to have an analysis of HSAs for tax year 2005 completed by the summer of 2007.

[Submission for the record follows:]

Statement of Advanced Medical Technology Association (AdvaMed)

AdvaMed represents over 1,300 of the world's leading medical technology innovators and manufacturers of medical devices, diagnostic products and medical information systems. Our members are devoted to the development of new technologies that allow patients to lead longer, healthier, and more productive lives. Together, our members manufacture nearly 90 percent of the $86 billion in life-enhancing health care technology products purchased annually in the United States, and nearly 50 percent of the $220 billion in medical technology products purchased globally. Exports in medical devices and diagnostics totaled $24.3 billion in 2004, but imports have increased to $25.2 billion—indicating the first negative trade balance in medical devices in over 15 years. The medical technology industry directly employs about 350,000 workers in the U.S.

The medical technology industry is fueled by intensive competition and the innovative energy of small companies—firms that drive very rapid innovation cycles among products, in many cases leading new product iterations every 18 months. Accordingly, our US industry succeeds most in fair, transparent global markets where products can be adopted on their merits. We strongly support the Administration's effort to expand market access for US products abroad through new free trade agreements (FTAs), as well as oversight of market access barriers in countries with which we have strong trade relationships.

Global Challenges

Innovative medical technologies offer an important solution for industrialized nations, including Japan and European Union members that face serious health care budget constraints and the demands of aging populations. Medical technologies also provide a way for emerging market countries, like China, India, and Korea, to improve healthcare to their people, who are increasingly expecting substantially better healthcare to accompany rapid economic development. Advanced medical technology can not only save and enhance patients' lives, but also lower health care costs, improve the efficiency of the health care delivery system, and increase productivity by allowing people to return to work sooner.

To deliver this value to patients, our industry invests heavily in research and development (R&D). Today, our industry leads global medical technology R&D, both in terms of innovation as well as investment. The level of R&D spending in the medical devices and diagnostic industry, as a percent of sales, more than doubled during the 1990s—increasing from 5.4% in 1990 to 8.4% in 1995 and over 11% last year. In absolute terms, R&D spending has increased 20% on a cumulative annual basis since 1990. Our industry's level of spending on R&D is more than three times the overall U.S. average.

Despite the great advances the medical technology industry has made in improving patient quality of life and delivering considerable value for its innovations, patient access to critical medical technology advances can be hindered by onerous government policies. Patients and health care systems experience much less benefit from our industry's R&D investment when regulatory procedures are complex, non-transparent, or overly burdensome—all of which can significantly delay patient access and drive up costs. In the future, patients will be further disadvantaged if reimbursement systems fail to provide appropriate payments for innovative products—which will subsequently affect the availability of R&D funds and the stream of new technologies.

The medical technology industry is facing these challenges around the world as governments enact more regulations. While we support those regulations that ensure product safety and efficacy, many others are being imposed without scientific justification, and in non-transparent processes, which only adds to costs and delays without improving patient outcomes.

As governments prioritize difficult budget decisions, they sometimes look to short-term decreases in health care expenditures without accurately assessing the long-term implications. In most cases, governments do not effectively measure the contributions medical technology makes in enhancing patient outcomes and productivity as well as expanding economic growth, which would more than offset the costs of providing these products. Instead, governments often inappropriately include reduced reimbursement rates as part of overall budget cuts.

In some cases, governments seek to reduce prices of medical technologies in their country by comparing and referencing prices in other countries. By fixing ceiling prices based on the prices found in other countries, governments are imposing price controls on medical technologies that do not appropriately account for different market conditions and contract terms. Our industry is witnessing a spread of these reference pricing schemes.

AdvaMed applauds continued progress on international trade initiatives, including bilateral, regional and global trade negotiations, such as the Central American Free Trade Agreement (CAFTA), and the Doha Development Agenda in the World Trade Organization (WTO). We support new efforts with our other trading partners to provide U.S. exports of medical devices duty-free treatment. We are hopeful that future bilateral agreements, including the U.S.–Korea Free Trade Agreement, can also include directives to knock down tariff and non-tariff barriers for medical technologies. In addition, the President and U.S. Trade Representative (USTR) should continue to pursue trade liberalization in the medical technology sector with our major trading partners.

AdvaMed believes the USTR, Department of Commerce (DOC) and Congress should monitor regulatory, technology assessment and reimbursement policies in foreign health care systems and push for the creation or maintenance of transparent assessment processes and the opportunity for industry participation in decision making. We look to the Administration and Congress to actively oppose excessive regulation, government price controls, foreign reference pricing schemes, and arbitrary, across-the-board reimbursement cuts imposed on foreign medical devices and diagnostics.

Continued U.S. Leadership Needed to Fight Trade Barriers in Japan

The Administration's efforts with Japan under the U.S.–Japan Partnership for Economic Growth are critical for the medical technology industry to maintain access to the Japanese health market.

After the U.S., Japan is the largest global market for medical technologies at $25 billion. Yet the situation facing the medical technology industry in Japan is getting more difficult every year. Japan's system for approving use of new medical technologies is the slowest and most costly in the developed world. Although Japan is one of the wealthiest countries in the world—the second largest economy in the world—its spending on health care is among the lowest of major developed countries. On a *per capita* basis, Japan's spending of 7.8% of GDP is lower than 17 other Organization of Economic Cooperation and Development (OECD) member countries.

In April 2005, Japan compounded the problem by imposing even more burdensome and costlier regulations, thereby penalizing the U.S. medical technology industry. Japan's latest regulations are expected to cost our industry over $1.5 billion just to achieve compliance to 2010.

Even after creating a new agency in 2004 to process applications for medical technology products, Japan has a backlog of over 300 applications filed before April 2004. When new applications are included, the backlog is reportedly much longer. A problem for this new agency is the number of staff reviewing applications for approval of medical technology products—about 40 officials, compared to over 700 in the U.S. Due to the long approval process, the medical technologies patients receive in Japan are often several generations behind the products in the U.S., Europe, and even developing countries like China, India and Thailand. Lengthy approvals also translate to higher costs for the U.S. medical technology industry, which must maintain out-of-date product lines just for Japan.

At the same time, Japan has made significant reimbursement reductions for medical technologies that impact the medical device industry in many ways, including limiting the availability of funds that could be devoted to R&D of new and innovative products. Inventing products that save and enhance lives requires large investments. Deep cuts for medical technologies in Japan have put downward pressure on companies' ability to invest in R&D.

The Japanese government sets the maximum reimbursement rates, which usually act as ceiling prices for all medical technology products. These prices are reviewed and usually reduced every two years. For the period April 2002 to March 2006, the total revenue loss from these reimbursement reductions is expected to be about $3 billion—a significant share of which would have gone toward R&D. Japan will impose additional cuts of several hundred million dollars this April.

Before 2002, Japan adjusted prices according to a process it called "reasonable-zone" or "R-zone." In brief, MHLW surveys its hospitals for prices paid to distributors, and allows for a reasonable margin (or "zone") for discounts off of the government's reimbursement rate. While there are some difficulties with this system—as identified in bilateral Market-Oriented, Sector Specific (MOSS) negotiations between the U.S. and Japanese governments—our industry recognizes that it is at least based on factors in the Japanese market.

In 2002, however, Japan also adopted a system called Foreign Average Pricing (FAP). This system calls for the establishment and revision of reimbursement rates on the basis of prices paid for medical technology products in the U.S., France, Germany, and the United Kingdom (U.K). The prices of medical technology products in

Japan are designed to be based not on that market's requirements, but on completely unrelated conditions in foreign markets.

The U.S. medical technology industry has strong objections to this system for calculating reimbursement rates. As a methodology for setting reimbursement rates, it is not economically sound to compare prices in foreign markets that operate under vastly different conditions. Japan is a far costlier market for our industry to operate in compared to other countries. Additionally, Japan's FAP system is an attempt to compare prices for products that are not the same in Japan as they are in other countries. Due to Japan's regulatory delays, U.S. manufacturers must incur the cost of maintaining older or outmoded production lines for sale in Japan.

Going forward, industry seeks U.S. Government and Congressional support to help ensure an open dialogue with Japan that would seek to identify alternatives to the current reimbursement system and improvements in Japan's regulatory practices. The goal would be to ensure that Japan's regulatory and reimbursement policies promote the timely introduction of innovative medical technologies and do not negatively and unfairly impact U.S. medical technology manufacturers.

Regulatory and Reimbursement Obstacles Impede Market Access in Asia-Pacific

AdvaMed looks to the U.S. Government to pursue trade liberalization throughout the Asia-Pacific region, including in China, India Taiwan and Korea. AdvaMed and its member companies have identified a number of real and potential barriers to doing business in these countries. While most of the barriers pertain to unnecessary or redundant regulatory requirements, there are increasing concerns in the areas of reimbursement and intellectual property.

China has quickly become an important market for the U.S. medical technology sector. The American Chamber of Commerce in China estimates that the Chinese market for medical technology exceeds $8 billion and is growing rapidly. It is on pace to surpass some of the key European markets for medical technology in a few years. As global leaders, U.S. medical technology firms already account for a significant portion of sales in China and the position of these firms underscores the importance of ongoing efforts with the U.S. Government to open the Chinese market further.

AdvaMed looks forward to working with Congress and the Administration to address the following barriers:

- A Lengthy and Costly Product Registration Process
- Redundancy in the Registration Process
- Misclassification of In-Vitro Diagnostic Products
- Lack of Transparency in Decision-Making
- Inappropriate Price Controls
- Counterfeiting and piracy of Medical Technology

For the medical technology industry, the Bush Administration's efforts with China under the U.S.-China Joint Commission on Commerce and Trade are critical for allowing U.S. medical technology firms broader access to the burgeoning Chinese health care market. The recently-launched U.S.-China Health Care Forum initiative, led by the U.S. Department of Commerce and supported by AdvaMed and other health care partners, holds great promise as another vehicle for addressing many of the trade-related and health policy-related barriers confronting U.S. medical technology firms in China.

Korea is another important market for U.S. medical technology exporters. Last year, U.S. manufacturers exported more than $500 million worth of medical technology products to Korea, an increase of 24 percent over the previous year. However, access to this market remains marred by antiquated product-testing requirements; inappropriate requirements to re-register products following a change in manufacturing location; and pricing and reimbursement policies that discriminate against foreign manufacturers. Korea was not a party to the Uruguay Round zero-for-zero tariff agreement on medical technology, and maintains import tariffs on a range of medical technology products. AdvaMed recommends the fastest possible elimination of tariffs and non-tariff measures applied to medical technology products by Korea. AdvaMed is also concerned that Korea's current reimbursement policies create incentives to re-use medical devices designated for a single-use in multiple procedures within several different patients, with the attendant risks of cross contamination and degradation of product quality. AdvaMed looks forward to working with Congress and the Administration through the U.S.-Korea Free Trade Agreement negotiations to address these issues.

India, with its rapid economic growth and large population, will be an important market in the future. India is in the process of developing its regulatory system for medical technologies. The Department of Commerce has provide AdvaMed invalu-

able assistance in working with the government of India on its approach to regulations.

Europe: Seek Appropriate Policies That Improve Patient Access to Innovative Medical Technologies

Efforts to oversee foreign policies impacting the export and sale of U.S. medical technologies abroad should also focus on the European Union (EU). U.S. manufacturers of medical devices export nearly $8.8 billion annually to the EU. Within the EU, Germany ($20 billion) and France ($8 billion) are the largest markets for medical devices.

Despite opposition from Congress and the Administration, in 2005, the European Commission approved a directive to up-classify all shoulder, hip and knee joint implants from Class IIB to Class III. This directive, which is guided by 1980s data and application of the precautionary principle, will affect thousands of devices, many of which are made by U.S. manufacturers, and is expected to cost the average orthopedic company approximately 500,000 in fees alone for related Notified Body reviews. Industry now is focused on fair and transparent implementation of the directive, so as to minimize disruption of this important market.

In addition, the industry looks forward to the implementation of the medical device annex of the US–EU Mutual Recognition Agreement (MRA). Bringing healthcare products to the market faster is an important priority consistent with the protection of public health and the reduction of regulatory costs and redundancy. We ask Congress to push for the full implementation of the medical device annex of the MRA. Moreover, the EU continues efforts towards over-regulation of industry through the implementation of burdensome regulatory measures such as the Medical Device Directive revision, the REACH chemicals initiative, the WEEE/ROHS, and a possible ban on the use of DEHP in medical devices.

Finally, as new methods of reimbursement and health technology assessment (HTA) spread throughout Europe, EU Member States should be encouraged to adopt policies for product reimbursement and health technology assessment systems that are transparent, timely, and adequately account for the benefits of innovative technology. Breakthrough products available in the United States to a majority of patients are still available to only a small fraction of eligible patients in the major European markets. Industry should be allowed to participate in the HTA process.

Product Reimbursement in Brazil

Recently, the Brazilian product registration authority, ANVISA, has issued draft Technical Regulations that would require the most sweeping and complex submissions of foreign reference pricing data of any market in the world. Consistent with U.S. policy for other foreign markets, we encourage Congress and the Administration to oppose this policy, as it will seek to artificially fix prices in the Brazilian market, stifle innovation and deny Brazilian patients the benefits of U.S. medical technologies.

Utilize Multilateral, Regional, and Bilateral Forums to Eliminate Tariff and Nontariff Barriers to Trade that Unnecessarily Increase the Cost of Health Care

We encourage Congressional and Administration efforts to eliminate significant tariff and nontariff barriers to trade for medical technology maintained by many countries, particularly developing countries. Such barriers represent a self-imposed and unnecessary tax that substantially increases the cost of health care to their own citizens and delays the introduction of new, cost-effective, medically beneficial treatments. For example, the medical technology sector continues to face tariffs of 15–20% in Mercosur countries, 9–12% in Chile, Peru, and Colombia, and 6–15% in China.

The Doha Development Agenda offers an important opportunity for the United States to ensure global access to medical technology by securing global commitments on lowering tariff and nontariff barriers for the medical technology sector while expanding upon the access to medicines goal at the heart of the Doha declaration. We encourage the U.S. government to build upon the zero-for-zero tariff agreement on medical technology achieved in the Uruguay round by expanding the product coverage and adding countries throughout Latin America and Asia as well. AdvaMed has proposed a sectoral initiative that would achieve this objective to the Administration. Moreover, elimination of nontariff barriers such as burdensome import licensing regulations and non-transparent government procurement policies will help developing countries ensure patient access to lifesaving medical technologies.

Utilize Multilateral Opportunities to Establish Basic Regulatory and Reimbursement Principles to Expand Global Trade and Patient Access to New Technologies

We commend the WTO's recent efforts to ensure global access to medicines and medical products. While all economies seek to provide high quality, cost effective healthcare products and services to their citizens, they should also ensure timely access to state-of-the-art, life-saving equipment and implement compliance procedures that are efficient and effective. To further expand patient access to safe and effective medical devices and ensure cost effective regulatory compliance, USTR should seek to ensure that economies around the world make their policies and practices conform to the relevant and appropriate international trading rules established by the World Trade Organization (WTO).

Toward that end, member economies should agree to make their medical device regulatory regimes conform to these guiding principles:

- Acceptance of International Standards;
- Transparency and National Treatment;
- Use of Harmonized Quality or Good Manufacturing Practice Inspections;
- Recognition of Others Product Approvals (or the Data Used for Those Approvals);
- Development of Harmonized Auditing and Vigilance Reporting Rules;
- Use of Non-Governmental Accredited Expert Third Parties Bodies for Inspections and Approvals, where possible.

Similarly, many economies require purchases of medical technologies to take place through centralized and/or government-administered insurance reimbursement systems. To ensure timely patient access to advanced medical technologies supplied by foreign as well as domestic sources, member economies should agree to adopt these guiding principles regarding the reimbursement of medical technologies:

- Establish clear and transparent rules for decision-making;
- Develop reasonable time frames for decision-making;
- Data requirements should be sensitive to the medical innovation process;
- Reimbursement rates should be based on conditions in each country;
- Ensure balanced opportunity for the primary suppliers and developers of technology to participate in decision-making, e.g., national treatment;
- Establish meaningful appeals processes.

The medical technology industry is committed to working with Congress and the Administration on upcoming trade policies and agreements to ensure patients throughout the world have access to medical products.

Conclusion

AdvaMed appreciates the shared commitment by the President and the Congress to expand international trade opportunities and encourage global trade liberalization. We look to the President and his Administration to aggressively combat barriers to trade throughout the globe, especially in Japan. AdvaMed is fully prepared to work with the President, USTR Ambassador Portman, the Department of Commerce, and the Congress to monitor, enforce and advance multilateral, regional and bilateral trade agreements, particularly with our key trading partners.

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