TREASURY DEPARTMENT FISCAL YEAR 2009 BUDGET

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BEFORE THE

COMMITTEE ON THE BUDGET HOUSE OF REPRESENTATIVES

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TREASURY DEPARTMENT FISCAL YEAR 2009 BUDGET

WEDNESDAY, FEBRUARY 13, 2008

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

The Committee met, pursuant to call, at 10:00 a.m., in room 210, Cannon House Office Building, Hon. John M. Spratt, Jr. [chairman of the committee] presiding.

Present: Representatives Spratt, Edwards, Schwartz, Doggett, McGovern, Tsongas, Andrews, Scott, Etheridge, Baird, Moore, Bishop, Ryan, Barrett, Garrett, Hensarling, Conaway, and Smith.

Chairman SPRATT. Secretary Paulson, welcome back. We are pleased to have you testify before our Budget Committee, partly because we know how busy you have been.

And in that vein, let me thank you for the role in particular that you played in formulating a stimulus bill and helping us push it through to passage.

All sides had to make concessions and most of us have ideas on how we could have improved the package, but it is a good measure which I think meets the test we set forth. It is timely. It is temporary. It is targeted. And let us hope it is a boost to our sagging economy.

Today we want to discuss with you the President's budget for fiscal year 2009. In particular, we hope that you will elaborate on the Administration's current outlook on the economy and budget deficits given the stimulus that we have just passed.

We find that the budget for 2009 bears the hallmarks of previous budgets from this Administration. It has more tax cuts. It has, as a result, more deficits and more debt in the near term offset by what we look upon as some draconian cuts in Medicare and Medicaid and smaller but significant cuts in things such as the Social Services Block Grant and the Community Services Block Grant, two of the pillars of the safety net.

When President Bush took office, he inherited a budget that was in surplus. His first budget message, he proclaimed that his budget would retire "nearly $1 trillion over the next four years, an accomplishment that he tallied as" the largest debt reduction ever achieved by any nation at any time."

But by the year 2004, the surplus was gone, replaced by a deficit of $413 billion. In nominal terms, this was the largest deficit in American history.

And we are here today in the Administration's final year. Instead of retiring a trillion dollars in debt, the policies of this Administration will increase the debt by $4 trillion by the time the President steps down.

So if we are a little skeptical of the budget before us, you can attribute them to six years of watching targets be set and missed by a wide margin.

For fiscal 2009, the Administration proposes a deficit of $477 billion, very near the record debt in 2004. But in calculating this deficit, the Administration has inserted a $70 billion plug for the cost of our deployments in Iraq and Afghanistan and provided nothing at all thereafter.

The Administration has also assumed that the alternative minimum tax will be fully in effect after 2008, affecting in particular middle-income taxpayers and, in effect, reclaiming with one hand the tax cuts that are extended with the other.

We do not understand why the Administration emphasizes or prioritizes extension of the 2001 and 2003 tax cuts which do not expire until 12/31/2010, over and above a permanent fix to the AMT which is needed immediately, this year, next year, and so on.

At least three Administration witnesses have sat where you sit and told us that the AMT can be reformed and should be reformed and should be and can be reformed within the Tax Code on a revenue-neutral basis without any effect on the bottom line.

I have asked the Bush Administration for the past couple of years to lay out such a proposal, its proposal for permanently fixing the AMT. But the Administration never released such a plan.

Instead the Administration rejected Mr. Rangel's revenue-neutral AMT proposals last year, both a broad, permanent reform and the one-year patch, and seems fundamentally opposed to any such reforms done in a revenue-neutral way.

The Administration uses AMT revenues to cloak the size of its forthcoming tax cuts. By understating spending and overstating revenues, we believe that this budget understates the deficit which is large enough at over $400 billion.

But if realistic adjustments are made for our deployments in Iraq and Afghanistan, not $70 billion but a real number, if the AMT is adjusted so that it is not applied to middle-income taxpayers, and everybody in this room would agree it was not intended for that purpose and should not be used for that purpose, then by our calculation, the deficit under this Administration policies rises well above $440 billion and sets a new record.

This still does not account for the possibility that the economy may actually be weaker than your forecast assumes even after the positive boost that the stimulus package may have provided.

Faced with huge deficits and mounting debt, President Reagan changed the thrust of his budget by signing TEFRA in 1982 and then by signing Gramm-Rudman-Hollings in 1985.

The first President Bush agreed to a budget summit and signed into law the resulting five-year plan.

President Clinton made deficit reduction his top priority. Within a month of taking office February the 17th, he sent Congress a five-year plan to cut the deficit by more than half. Five years later, he finished the job with the "Balanced Budget Act of 1997," which put the budget in surplus for the first time in 30 years.

This Administration has run larger deficits than the Reagan Administration or the Bush Administration or the Clinton Administration. Unlike its predecessors, it has offered us no grand solution, no offer of negotiation, anything, except the budgets that look increasingly alike from year to year.

Indeed, and I mean this as no criticism of you, I admire the work you have done, but it seems to us that taken as a whole, far from proposing a plan to fix the budget this year, the Administration is proposing policies that will worsen it and leaving the consequences for the next Administration and the next generation.

Mr. Secretary, we have many questions. We are looking forward to your testimony and your responses. But before you begin, let me turn to our Ranking Member, Mr. Ryan, for his opening statement.

Mr. RYAN. Thank you, Chairman.

And welcome, Secretary. The Republican conference is still underway, so our members are running late and they will be here a little later.

Clearly the issue on everyone's mind in recent months has been the condition of our economy in the near term. The Federal Reserve has been taking aggressive actions to try and ease the slow-down and just last week Congress passed the fiscal stimulus package which the President is scheduled to sign today, I believe.

Secretary Paulson, I look forward to hearing your thoughts and expectations on these actions as well as your efforts to address the problems occurring in the housing and credit markets such as the plan that Treasury announced just yesterday to address rising home foreclosures.

But I will also be interested in the broader, more fundamental issue central to our interest today and that is also to your interest, that is maintaining our prospects for long-term growth. And this is something we also have to keep our eye on that ball.

As I see it, the challenge and opportunity has three parts and they are all interrelated. First, we have to reform our major entitlement programs, Medicare, Medicaid, and Social Security, to help fulfill the missions of health and retirement security for all Americans.

Second, we need to eliminate the debt burden for future generations. The weight of this burden will soon explode and threaten our ability to do what past generations have done for us, leave our economy and our country even stronger than we inherited them.

Third, and connected to the first two, we have got to win globalization in this increasingly competitive international marketplace. We do not just want globalization to happen to us. We do not want to just survive it. We want to win globalization.

And there are two ways in which our broad budget policies, our fiscal policy play into these goals. First, we need a Tax Code that truly promotes savings investment and job creation. That means keeping tax burdens low and our overall tax policy consistent.

Second, we have to deal with the level of government spending because that is what really drives our need to tax and borrow.

And without question, the biggest driver of our spending problem is the unsustainable growth of entitlements. We know today that these programs, as they are currently structured, cannot keep their promises.

To take just one example, the Medicare program has an unfunded liability, an unsupported promise of $34 trillion in present value. That translates into an obligation of more than $300,000 for every household in the country. That is about twice the average of a price of home in the district I serve in southern Wisconsin.

Yet, this is the cost of just one program. It does not count everything else we expect from the government.

So in short, in a global economy and with the collision of demographics that has already begun, failing to reform our largest entitlements will lead to even greater loss than these critical programs because on their current path, they are not only growing themselves into extinction, but at the same time, they are overwhelming the budget and they are threatening to cripple our economy.

Last week Congress received the President's budget as the Chairman just mentioned. It includes several proposals for addressing the entitlement crisis. And while it did not fix the problem in one fell swoop, it at least took the initiative to put some solid, specific discussion, some proposals on the table.

Secretary Paulson, in your capacity as Treasury Secretary, you also serve as the Chairman of the Board and Managing Trustee of the Social Security and Medicare Trust funds. So, again, I have great interest in your testimony and the critical issues facing the economy today, but also of the issues in facing our long-term growth prospects and that is entitlement reform because our actions on this issue or lack thereof will have an impact on our nation's economy for generations to come.

I thank the Chairman for his indulgence. I look forward to the testimony.

Chairman SPRATT. That you, Mr. Ryan.

Mr. Secretary, thank you again for appearing before us to testify. And let me say at the outset that if you wish, you can submit your statement for the record, but we encourage you to take all the time you need to fully discuss the problems at hand. Thank you again for coming. And let me say at this point in the record that any member who did not have the opportunity to submit an opening statement may do so at this point.

STATEMENT OF HON. HENRY M. PAULSON, JR., SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary PAULSON. Chairman Spratt, Congressman Ryan, members of the Committee, what I am going to do is give you a very brief statement and we can submit something longer for the record.

I am pleased to be here to discuss the President's budget for fiscal 2009. My highest priority is a strong U.S. economy that will benefit our workers, our families, and our businesses.

Through a measured approach that balances our nation's needs with our nation's resources, the President's budget supports that priority.

This is especially important now as after years of unsustainable home price appreciation, the U.S. economy undergoes a significant and necessary housing correction. This correction combined with high energy prices and capital market turmoil caused economic growth to slow rather markedly at the end of 2007.

The U.S. is diverse and resilient and our long-term fundamentals are healthy. I believe our economy will continue to growth, although at a slower pace than we have seen in recent years.

Four weeks ago recognizing the downside risk to our economy and that the short-term costs of doing nothing was too high, President Bush called for an economic growth package to provide a temporary boost to our economy as we weather the housing correction.

The Congress responded with bipartisanship, cooperation, and speed to pass an economic growth package that is temporary, broad-based, and will get money into our economy quickly.

We have demonstrated to the nation and the world that we can come together to address the needs of the American people as we weather the housing downturn.

Today the President will sign the economic package into law. Treasury is already working to send payments out to more than 130 million Americans. The IRS will manage the current tax filing season and simultaneously prepare to issue these additional payments starting in early May. Payments will be largely completed this summer putting cash in the hands of millions of Americans at a time when our economy is experiencing slower growth.

Together the payments to individuals and the investment incentives for businesses will help create more than a half million jobs by the end of this year.

In addition to an economic growth plan to help us weather this housing correction, the Administration will continue to focus on aggressive action to try to provide alternative options to foreclosures. That includes encouraging the Hope Now Alliance's outreach to struggling homeowners.

Congress can do its part by finalizing the FHA Modernization and GSE Regulatory bills and by passing legislation that will allow states to issue tax exempt bonds for innovative refinancing programs.

We continue to monitor capital markets very closely and to advocate strong market discipline and robust risk management. Working through the current stress is our first concern. Through the President's Working Group on Financial Markets, we are also reviewing underlying policy issues because it is just as important to get the long-term policy right.

While we are in a difficult transition period as markets reassess and reprice risk, I have great confidence in our markets. They have recovered from similar stressful periods in the past and they will again.

The Administration will also continue to press for long-term economic policies that are in our nation's best interest, a pro-growth tax system, entitlement reform, and a balanced budget.

To that end, the President's budget makes the 2001 and 2003 tax relief permanent and keeps the federal budget on track for a surplus in 2012.

In the future as in the past, our long-term economic growth will also be enhanced by supporting international trade, by opening world markets to U.S. goods and services, and by keeping our markets open. Congress can help create jobs and economic opportunity by passing the pending Free Trade Agreements with Colombia, Panama, and South Korea.

I appreciate the cooperative and bipartisan spirit that has brought the Congress and the Administration together to support our economy and look forward to that spirit continuing as we work through this period.

Mr. Chairman, thank you.

[The prepared statement of Henry M. Paulson follows:]

PREPARED STATEMENT OF HON. HENRY M. PAULSON, JR., SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Chairman Spratt, Congressman Ryan, Members of the Committee: I am pleased to be here to discuss the President's budget for fiscal year 2009. As Treasury Secretary, my highest priority is a strong U.S. economy that will benefit our workers, our families and our businesses. Through a measured approach that balances our nation's needs with our nation's resources, the President's budget supports that priority.

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I appreciate the cooperative and bipartisan spirit that has brought the Congress and the Administration together to support our economy, and look forward to that spirit continuing as we work through this period. Thank you.

Chairman SPRATT. Thank you, Mr. Secretary.

Every week it seems that the crisis now in financial markets gets worse. A new dimension has added to the problem. Maybe every week is overstating it, but frequently at least.

The most recent revelations appeared yesterday in the New York Times, the Wall Street Journal, both with articles indicating that the subprime problem had grown to the prime mortgage problem and is now extending to credit in general, particularly for consumers.

Is that happening and what are the implications, if so, for the budget deficit and for the economy generally?

Secretary PAULSON. Mr. Chairman, let me start with the capital markets and move into housing which is related and then the economy and your question on the deficit.

We have been working our way through a period of stress in the capital markets since August. And in certain respects, there has been progress. When you look at some of the funding spreads in the shorter term, inter-bank markets and so on, there has been real progress.

Other markets are not performing as we would like to see yet. I think it is going to take longer to work through that period. And the biggest focus that I have right there is encouraging our financial institutions to take losses, recognize the losses, and raise capital.

And we have seen capital raising. I think we are going to continue to see it and I think it is very important because, as you know, given your previous background, that banks, you know, if they are not well capitalized and they are forced to shrink their balance sheet, then that has a negative impact on our economy. And we want them to continue to lend.

You are right to the extent that the economy is slowing. The housing downturn, the housing slump is continuing, and it has not run its course yet. There has been some modest erosion in other credit related products to date. I continue to believe that this economy, although it is slowing markedly, I continue to believe that we are going to continue to grow.

So I see growth slower, but continuing to grow, very much believe that the risk is to the downside, but will continue to grow. And the biggest risk is housing. And we have programs to deal directly with housing, but another way of addressing that and getting to the issue that you raise is the stimulus package which is designed to boost the broader economy and consumers this year. And so that is, you know, the measure to address that.

And in terms of the capital markets, I think the issue in the capital markets, and this is a gross oversimplification, because there is still stress in a number of products from high-yield debt to all the structured products, structured credit products, mortgages away from the GSEs, and so on, but I think the question in the capital markets is becoming much more about what is happening in the economy and what is happening in housing generally.

Chairman SPRATT. The Times indicated that in the subprime market, the level of past due, delinquents was 16.9 percent of all subprime mortgages.

Secretary PAULSON. Yes. I would say that if you look at housing overall and you look at the mortgage market that——

Chairman SPRATT. If you look at the mortgage market overall, it is 7.3 percent, prime and subprime.

Secretary PAULSON. Well, yes. And 93 percent is the number I use of mortgage holders that are making their payments on time. The subprime is the biggest issue and it is one piece of the mortgage market. And the mortgages, the subprime mortgages whose interest rates are going to be going up, the adjustable rate mortgages that are being reset, we are going to have roughly 1.8 million of those resets in 2008 and 2009. And that problem is the biggest because those mortgages that are resetting now that were made in 2006 were the poorest quality in terms of the underwriting standards.

So I expect that portion of the mortgage market to get worse, but I think that is pretty well baked into what is going on in the capital markets. I think the markets understand that and a lot of those markets, there have been downgrades and they have been repriced in the markets. But that does not mean that the human cost and the cost on the economy overall and neighborhoods has been repriced, and that is something we are working very hard to deal with through a number of programs we have.

Chairman SPRATT. The Times also indicated that vehicle loans were 7.1 percent delinquent.

Secretary PAULSON. I cannot confirm that number. Everything you read in the press is not always true, so I cannot confirm that.

Chairman SPRATT. I would certainly second that. The basic question is, are we seeing the formation of a credit crunch like 1990, 1991 when the Administration was trying to stoke the economy and simply could not get it to get up off its feet and get going? Is this thing apt to spread and, if so, what are the consequences for the budget as well as the economy?

Secretary PAULSON. Well, let us talk about that. The slowdown that began in December because the consumer spending and business spending held up right into early December and what the economic numbers showed and what the anecdotal data has shown is that there has been a slowdown in discretionary consumer spending and business spending.

And so when you go through a period like this, there is an erosion, some erosion in credit quality. And, again, in terms of getting to your basic question, and, people, this is a question, it is not like it is a surprise. Everywhere I go, I get asked the question. People ask the "R" word, are we going into a recession.

And I just simply say what I believe and everything I have looked at and I do not know for sure, but that I believe that we are going to continue to grow. And so I see growth at a slower rate for a quarter or two. And the housing is what we need to watch closely because that is the biggest risk.

And it would be not only my hope, it would be my expectation that when we start getting these checks at the beginning of May that it will make a difference, that we are going to continue to grow. But we are watching this very carefully.

And as your question shows you understand, that is the big issue that you see in the capital markets today and that is why it is so important that our banks and our financial institutions be adequately capitalized.

Chairman SPRATT. In all of the post-war recessions, I think there have been ten all together, we have either extended or expanded unemployment insurance. We did in the last, for example.

Secretary PAULSON. Right.

Chairman SPRATT. That is not in this package. If we appear to be in or approaching a recession, is this still an open issue with the Administration? Are you still negotiable on the desirability of having unemployment insurance extended?

Secretary PAULSON. Mr. Chairman, what I have said is that unemployment, the last number is 4.9 percent, so in my judgment, it would have been a serious mistake when we have never extended it when unemployment was this low. The lowest it has ever been is 5.7 when we extended it.

So what I have said all the way along is I do not expect to see us there. But if the economy becomes worse than we have projected, then I think this is something we all should discuss together. It is something we should discuss and take up at that time.

Chairman SPRATT. Fair enough. Thank you.

Looking at the budget in particular, you heard my opening statement, we have got some real concerns with what is in the budget. Senator Gregg, the Ranking Republican on the Senate side, said this is not a real budget because there are cuts proposed, for example, that have been proposed repeatedly in the past and have gone nowhere and they are not going anywhere now.

So to represent that these cost reductions are going to be achieved is to defy history.

But in addition to that, looking specifically at the budget, war costs after next year are omitted altogether. Indeed, the level of expenditure for the base budget, defense budget from 2009 onward goes down in real terms, which I do not think is going to happen. But in addition to that, it includes only $70 billion, nothing thereafter, for next year.

Under cross-examination, Secretary Gates yielded and told Senator Levin last week his guess would be maybe $170 billion, which is off by $100 billion, the plug that they put in the budget.

And while you have war costs and supplemental costs understated, as to the alternative minimum tax, unless you fix that tax and adjust the thresholds, it will apply to middle-income taxpayers for whom it was never intended. Republicans do not want that to happen. Democrats do not want that to happen.

But this particular budget assumes that after next year the AMT will be in full force and effect taking from middle-income as well as upper-bracket taxpayers.

Do you think that is any way to put a budget together? I mean, you have done it repeatedly not just at Treasury but at Goldman Sachs. I mean, we have got a variable here of a couple of hundred billion dollars that we can immediately point to.

Secretary PAULSON. Let me say, and I am not making this about our budget because I will defend it and any of the issues you want to raise, but I will just say in general whether it is the budget, and with all due respect, whether any Administration's budget making and government defies some of the principles we see in the private sector, the whole way PAYGO rules work where people have to keep reminding me what goes in and discretionary spending does not apply. It is hard, but the one thing I will say that is a positive and, to me, there are just two huge principles that are key.

Well, first of all, one positive thing, then I will get to the principle. The positive is that we have been wrong, everybody has been wrong in terms of the rate at which revenues are coming in. So the fact is revenues have been coming in ahead of projections and our fiscal deficit at the end of this last year was 1.2 percent of GDP.

So that is something we can all be grateful for. Whatever the political arguments are on both sides, we can be grateful about.

Chairman SPRATT. You would not advocate extension or leaving the AMT unfixed as to middle-income taxpayers?

Secretary PAULSON. Now, I will get to that in a minute. But I am saying the other thing is the entitlements are the huge issue which you know and you and I have talked about it.

Chairman SPRATT. Yes.

Secretary PAULSON. So now let us get to the AMT. The AMT is one thing we should all do because we have it in the budget and the revenues are in the budget, we should all just get that done this year soon so we do not torment the American people and have there be the uncertainty.

Now, in looking at the other, in looking at the AMT, I look myself in the mirror because I say we have got those revenues in the budget, they are very transparent, and we say that this is a major issue and we have got to do something about it.

I have never said we need to do something about it on a revenue-neutral basis. What I have said is on this that we need to look at this. This is unacceptable the way it is. And when we look at this, we need to think about first of all what percentage of our economy should be taken up by taxes. So that is one thing we want to look at.

So some people want to raise taxes to pay for it, but I think we need to look at it and say what percentage. And then we need to look at it in terms of the entitlement issue and what we see staring us in the face there.

So you said in your initial statement no one, and I do not mean to sound defensive, but no one in this Administration has tried to deal with this issue. At least for a year, I said, please, let us come to the table, both sides, no preconditions, let us talk about entitlements. And I was thinking about the AMT in that context. And I got tired of playing solitaire.

So I will say to you we do have this AMT question and we need to resolve that. And we have got entitlements. And I do agree with you that the cost of the war is going to be greater and everyone knows that. No one said anything other than that, that that $70 billion was the plug figure and that will be filled in later.

Chairman SPRATT. Just quickly, these problems are of such magnitude they are going to have to be taken in sequence. I do not think we can resolve them all in one fell swoop, one great big package and hope to pass it on the House or the Senate floor.

And I think the hurdle that comes first is debt service. It is truly mandatory. It cannot be changed. It is obligatory and has to be paid. And on our side, we would not want to make concessions as to the other entitlements, only to find that continuing deficits mount up national debt which has to be serviced and paid first to the detriment of these other programs.

So that is just why I was pushing some solution on the budgetary front as the first step towards entitlement reform.

Secretary PAULSON. Yes. I got you.

Chairman SPRATT. Mr. Ryan.

Mr. RYAN. Thank you.

Welcome, Secretary. First, I want to go in the area of GSEs. James Lockhart, who is the current regulator of the GSEs, recently testified before the Banking Committee that the increase in the conforming loan limits for Fannie and Freddie would pose "new risks to the already challenged GSEs." And he suggested that securitizing these jumbo loans could drain capital from less expensive mortgages. He also talked about concentrating even more risk in certain geographical areas where we have problems.

My basic question is twofold. With all the problems that GSEs have had, do you think the conforming loan limit should have been increased absent reforms as it is done today? And, number two, will the Administration oppose extension of these higher conforming loan limits if acceptable legislation is not enacted to reform these GSEs?

Secretary PAULSON. Congressman Ryan, thank you for asking the question.

First of all, I had been very, very strong in advocating that the loan limits be raised for a temporary period of time only in the context of GSE reform. I have felt that raising them was bad public policy and that it flew in the face of the GSEs affordable housing mission.

But I saw a benefit, okay, in terms of what is going on in the mortgage market to do that on a temporary basis. But I did not want to separate it from the reform because I thought the reform was the overriding necessity.

I felt that before coming to Washington, but everything I have seen after coming to Washington and looking at the massive losses that they have had, and fortunately they have been able to raise a lot of capital and then keep performing their mission, so I think we very much need GSE reform.

As you know, the expiration that the loan cap was raised just through the end of this year. And, you know, clearly I do not want to see that extended without GSE reform. I sure hope we do not have to wait until the end of the year. I mean, I cannot think of why we should have to wait for the end of the year.

The House has a bill that is a very reasonable approach and is something that can be worked with. And Chairman Dodd has said he really wants to take that up.

And so, again, I think, you know, you are absolutely right that we need that reform and I sure want that reform before these loan limits expire. And if they do expire, I do not want to extend them without GSE reform.

Mr. RYAN. So your preference is let them expire if there is no reform?

Secretary PAULSON. If there is no reform, let them expire. But I would not have put them on with no reform. I just found that when we negotiated the deal with the House that I had both sides on that case that I said publicly I got hit by a bipartisan steamroller, and I did. I mean, there just was an overwhelming—and I could not look people in the eye and say that there would not be a benefit in the housing market temporarily to do this. I just thought the greater good was reform and I did not want to separate the two.

Mr. RYAN. Let me talk about inflation for a minute. I know monetary policy is in sort of expressly the purview of the Treasury Department, but you have enormous influence and opinions in this area.

We have got a federal funds rate that is lower than the rate of inflation right now. We have had enormous rate cuts. We have a lot of signs of inflation on the horizon. We have a weakening dollar.

Just recently, the President of the Federal Reserve Bank of Philadelphia is sounding the alarm of concerns of inflationary expectations.

The economic report of the President projects real GDP growth this year to be 2.7 percent, next year to be 3.0 percent. CBO is a little lower than that, but I think it is reasonable to expect CBO may be revising their economic growth projections to go up this year.

So given that most of the forecasting, whether it is blue chip or government forecasters, are expecting growth this year and growth next year, is it wise to continue down the path of monetary policy that we are and are we not inviting inflation and will that not hamper growth in the future and cause a tough belt tightening, a tough hitting of the brakes by the Fed, you know, right around the corner? What are your thoughts on that?

Secretary PAULSON. Well, Congressman Ryan, you probably know that I am not going to venture into monetary policy other than to say, which is heartfelt, I have a great respect and admiration for Ben Bernanke as Chairman of the Fed.

And when I look at how responsive our Fed is and compare that to other things I see around the world, I think we can all be grateful for our Federal Reserve and that we have Ben Bernanke there.

And other than that, I just would simply say I look at all the information like you do and it still looks to me like when we look at core inflation, it is relatively contained.

I would also say to you that the 2.7 percent forecast that was done prior to the budget was done in November. And there is no doubt that the data we have since November would lead me to say that that forecast may be a bit high.

But I do agree with you. I think we are going to continue to grow. And so there we agree. I understand your point.

Mr. RYAN. And I understand your ability to only go so far in your comments on that. But I think it is an issue that we need to start discussing when we are talking about the confluence of fiscal monetary policy.

Let me get to the AMT. You actually mentioned this a bit in your Q and A with the Chairman. But we waited until the end of December to patch the AMT and we all knew more or less, those of us on the Ways and Means Committee, that we were going to patch the AMT. The problem is the American people were not sure or did not know that we were going to patch the AMT.

From just a growth perspective there is talk about doing more "stimulus to the economy." Would it not be helpful for growth to actually patch the AMT now and early knowing that we are probably going to end up doing that for the 2008 calendar year? Would it not be actually helpful to sort of stabilize those investment horizons to show the American people that 25 million people are not going to get hit with this unknown, unforeseen tax for this calendar year? Would it not be actually helpful for economic growth if we actually patched the AMT now rather than waiting until after the election and possibly doing a lame-duck session in December?

Secretary PAULSON. Well, Congressman, I clearly want to see it done immediately to eliminate uncertainty, particularly when we all know it is ultimately going to get done. And we will not be raising taxes to deal with it.

I would say to you the most perverse thing about the AMT is I bet you there are not 25 million people that even know about it. And so if it ever were not patched, this would be a surprise bordering on shock to them.

And so, again, I just think it is just better to get this done, to get this done as soon as possible.

Mr. RYAN. We have a vote, so let me just ask you one quick question about moral hazard in the housing markets.

In your job, you are more or less the referee of whether we cross the line of moral hazard or not. Give us an idea of where you think that line is that we should not cross on producing a moral hazard.

We are going to have a correction. Corrections are often necessary in the markets, in the credit markets, in the housing markets. Where in your mind is this line that should not be crossed with respect to moral hazards?

Secretary PAULSON. Well, I would say this, Congressman. I am going to answer your question because I think it is the right question, although I have learned in life never to draw a precise line because then guess what? Something happens you did not plan on.

Mr. RYAN. It is the market's ability.

Secretary PAULSON. But I clearly say that my view like yours is this is an inevitable and a necessary market correction. And you have seen that there are various estimates as to the extent to which housing prices are overvalued and you can have a correction either by having the housing prices drop or drop a bit and have the economy keep growing. Okay? And so then they can meet somewhere in between.

And obviously there are different issues in different parts of the country because housing is a regional market. So our approach has been to do things that do not interfere with market mechanisms and do things that are aimed at avoiding a market failure.

In other words, I believe that the hope now, fast tracking protocols to deal with these subprime mortgage resets. The reason I am very comfortable with this is this is the private sector, number one, and it is the private sector taking actions which are in everybody's best interest and approximates what they would do under normal circumstances if we did not have the securitization process being as expansive as it is and the volume of resets.

And so we focused on that. We focused on that communications, focused on the private sector. And we clearly, to get to what you are saying, do not want to bail out speculators, do not want to bail out lenders for profligate practices, do not want to bail out people that said, well, I am going to put no money down and play the game and if the home price keeps going up, I will win; otherwise, I will just walk away from it.

And we clearly want to be very vigilant and aggressive about punishing wrongdoing, punishing fraud, but that is sort of the way we are thinking about it.

Mr. RYAN. I simply want to encourage you to continue to be mindful of the moral hazard issue. Private sector reform is great. Government involvement will produce a moral hazard which will give us systemic problems that we do not want to have to deal with down the road. And I just encourage you to stay on that side. Thank you.

Secretary PAULSON. I understand your point and I appreciate it a lot.

Chairman SPRATT. The fact that there is a vote on the floor and in light of that, I have agreed to recognize Mr. Barrett.

Secretary PAULSON. I was thinking my gosh, we might be over by eleven.

Chairman SPRATT. Not so easy.

Secretary PAULSON. I thought this was Roger Clemens and I was going to be answering questions about whether I would use HGH or something. Okay.

Chairman SPRATT. Mr. Barrett.

Mr. BARRETT. Thank you for being here and, Mr. Chairman, thank you for yielding the time.

The President in his State of the Union address said the following: Unless Congress acts, most of the tax relief we have delivered over the past seven years will be taken away. Some in Washington argue that letting tax relief expire is not a tax increase. Try explaining that to the 116 million American taxpayers who will see their taxes rise by an average of $1,800.

My question, Mr. Secretary, is that the President's budget does not include any provision for extending sales tax deductibility which affects my State and six others.

Now, if the President who has pledged not to increase taxes does not include in his budget extension of sales tax deductibility, is the President not calling for a tax increase on the residents of my State and six others and how would you justify that?

Secretary PAULSON. Well, I understand your point and I am going to tell you how I am answering that question which is that there are a number of different provisions, you have pointed to the key ones, that are being extended. Others are not. The one you cited is not being extended. That does not mean we are against extending it. That is not in the budget and we are very prepared to talk about these on a one-off basis. And I do understand that when that expires what the impact is.

Mr. BARRETT. Well, just for the record, the impact is somewhere between four to five hundred dollars or more per facility who itemizes deduction in our states. And I am a bit troubled that a President who on the one hand would chastise Congress for not extending tax cuts seems himself to act with impunity when he proposes not extending a tax cut.

It seems that only his own tax cuts, the ones he favors matter. But I will tell you, to our State and ironically to this State and the Vice President's State and four others, that being Florida, Tennessee, South Dakota, Wyoming, and Nevada, those seven states take this quite seriously.

Secretary PAULSON. I understand that. And as I am saying, there are more than one of these provisions that are not being extended in the budget. But that does not mean we are necessarily against it.

Mr. BARRETT. Consistent with the principle that the failure to extend a tax cut is tantamount to a tax increase, would you affirmatively on behalf of the Administration affirm today that you would support extension of sales tax deductibility?

Secretary PAULSON. No, sir, I am not prepared to do that today, but I am prepared to tell you we will talk to you about it.

Mr. BARRETT. Okay. We would certainly appreciate the opportunity to have that conversation.

On to the stimulus, I was one of a handful of folks who voted against it and my concern was, quite frankly, that it seems to me we got into this fix by doing two things, borrowing too much money with no plan to pay it back, to buy things we could not afford, and because energy prices have skyrocketed. My problem is that the solution seems to be more of the problem and we have done nothing to address energy prices.

Could you talk a little bit about the merit of such things as production tax credits and other things? We had an opportunity here to seize the financial crisis, to call on the American people to lower their energy consumption, lower energy prices, put money back into their pockets in that fashion.

And if we were going to do a stimulus package to invest in renewables and a host of other things so we would have people working, tangible assets created, and a lasting infrastructure built, and it seems to me we squandered that opportunity with the $168 billion that we are going to borrow from other countries with no plan to pay it back.

Secretary PAULSON. Okay. Congressman, thank you very much. And as you might imagine, I heard that argument a lot as we went through this discussion. And let me tell you how I, you know, will respond to you and as I responded to others.

First of all, I totally agree with you that energy security is as big an issue, it is right up there, when you look at the long-term structural issues, right up there with the budget issue. So it is very significant.

I also think we have taken some actions and some important actions together. And as someone who looks at the Tax Code all the time, I will also say to you that there is a natural tendency to want to do things through the Tax Codes and sometimes you do not have to do all these policies through the Tax Code.

It has got some advantages through the Tax Code, but one of the disadvantages, we at Treasury are not experts on energy and it makes the Tax Code more complicated.

But in terms of your specific question, what I said is there are some very good ideas and that are very important ideas and that are longer term and strategic, but that in my judgment, they were not stimulus. Okay? And I define stimulus as something that would add this year, okay, to economic growth.

And so on the business side, we dealt with it. And the other thing we did on the business side which gets to your point is the business is, when you look at the way the economics work with bonus depreciation, accelerating depreciation——

Mr. BARRETT. I actually support those provisions.

Secretary PAULSON [continuing]. It pays for—you know, the cost over a ten-year cycle is not as great because, you know, you are getting some of the revenues on the back end.

Mr. BARRETT. I very much appreciate that answer. The one last thing I would encourage is we are going to introduce a resolution in the next day or so calling on the American people when they receive their rebate checks to spend that on renewable energy and energy conservation measures so you get a multiple saving and to call on retailers to offer incentives to do that as well. I hope maybe the Administration could do this so we can make it a win-win. When people get the money use it to save energy.

Secretary PAULSON. Well, whether we do or not, I commend you for that. That is an innovative approach.

Mr. BARRETT. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Chairman SPRATT. Thank you, Mr. Barrett.

Mr. Garrett.

Mr. GARRETT. Thank you, Mr. Chairman.

And I thank you for being here for the testimony today. I want to begin by commending you for your continued attention to the housing problem that the American market is suffering. I applaud your efforts to work with the private sector and consumer groups to create solutions that will basically help the consumer, the homeowners stay in their homes and hopefully keep the current housing problems from further spreading into other sectors of the economy which it seems like it is doing.

Furthermore, I appreciate the new program that you announced yesterday, the Project Lifeline, which as I understand it is an agreement between the six largest servicers to provide homeowners with up to 90 more days delinquent on their mortgages, a delay in the foreclosure process in order to have more time for the servicer and the homeowner to work out a plan that could help the homeowner stay in their house.

Realistically nobody benefits from a foreclosure, neither the homeowner, the bank, or investor down the line. And so I am pleased you are working with the private sector to try to face this problem.

I would like to go back to a comment that the Ranking Member addressed. I share some of the concerns that he has with one recent action that was taken by the Administration and also by Congress and that is, as Mr. Ryan stated, the raising of the GSE conforming loan limits. And it was done, as you indicated, without any passage of any broader GSE reform.

I really believe that when you raise those loan limits even temporarily, you will greatly exacerbate the risk that is posed to our nation's economy and also potentially to the American taxpayers with regard to the GSEs.

The increase in the conforming loan limits will allow the GSEs to expand into jumbo market loans. It will raise the limits from 417 to $730,000. Now, the GSE's business rapidly grew in 2007 doubling their market share over 2006 to over 75 percent of the market.

And if you add into that, I looked at my notes here, if you add in the FHA banks as well, it is almost 90 percent of the market now between the GSEs and the Federal Home Loan banks.

Over the same period, Fannie and Freddie combined debt grew from roughly 16 percent, grew roughly 16 percent to $6.3 trillion, almost $7 trillion, twice the entire budget that we are seeing is now in debt for these.

Now, before the Senate Banking Committee last week, Jim Lockhart from OFHEO testified and he said jumbo loans, and I assume he was talking either on a permanent or temporary basis, would prevent new risk to the already challenged GSEs. The provisions also pushes the GSEs to increase their geographical concentration in some of the riskiest real estate markets. Roughly half of all jumbos will be in California. Underwriting them successfully require new models and systems to ensure safe and sound implementation.

Additionally, another problem he said was capital also would present challenges even if all newly conforming mortgages are securitized. For example, a $600,000 loan requires as much capital as three $200,000 loans which means that you are shifting and adding to the risk.

That all occurs even if it is on a temporary basis. Fannie and Freddie currently do not have, as you know, satisfactory financial statements. They have also not met a number of the improvements that OFHEO and Director Lockhart asked for.

Since the Treasury Department basically blessed the expansion of these conforming loan limits, I would like—well, you have already given your assurances that you will work to make these temporary and you have already given your assurances, correct me if I am wrong, you would like to see the reforms coming at a later date.

I would like to hear one explanation because from what I read on the press accounts and from other members as well that going into these negotiations, there was some agreement that or understanding that, for example, the House had already passed some of these reforms out of our House as far as to the GSEs.

Members from the Financial Services, we have had hearings on it. It came out of Financial Services, came out of the House. I believe the Chairman was a bit taken aback that this was not part of the reforms.

So I would appreciate your comments as to where the push came not to have this. Was it from the House? Was it from the Senate? Was it from the White House?

Secretary PAULSON. It was from John Boehner and Nancy Pelosi who were equally strong and were clear that we needed to raise the loan limit. So I just cannot be any clearer. So it was from your leader and the Democratic leader who told me, Hank, this is one thing we are not going to compromise on.

Now, let me, though, say to you, and I find it frustrating even needing to say this because one of the things that I have been most frustrated by is we do not have GSE reform. And as someone coming from the industry that I come from, I cannot explain it. I cannot explain why we would have these huge institutions that do not have a regulator. You should have a regulator that is stronger than you have in the private sector. We do not have one that is close to as strong, do not have the authorities, and it is a significant risk.

So the idea that I am here taking grief from people saying why do we not have GSE reform, I have worked hard to get it done. And I am also a believer that we cannot let the perfect be the enemy of the good because what we have got right now, let me tell you, it is not good. It is a lot less than good.

And so we worked with Barney Frank to get something that I did not think was perfect, but, boy, I would take it in a minute over what we have got right now. And so I was pretty clear going into these.

I got asked a question when I was meeting with Senate Republicans in the middle of these and I got asked a question, where do you stand on this. And I said I will tell you where I stand. I would raise the loan limits only as a part of GSE reform. But there is sentiment on both sides. Well, I found out the sentiment was stronger than I thought on both sides.

And, again, as the Chairman said, all of us did not get the things we wanted. And guess what? The Administration did not get everything they wanted also. But we got something that works.

And I will tell you now that we do have it and there is a loan limit that has been raised for a temporary period of time. I am going to be all over the GSEs to make sure that they use that in a way that helps our economy and helps the housing market because, trust me, it will make a difference because the market, the other side here, you made a point that also troubles me which is that raising the loan limit flies in the face of the affordable housing mission, because you could have no loan limit and they could just have the whole market. And that is not what we want.

But the fact is I can tell you that the jumbo market, the market away from the GSEs, the reason the GSEs have a bigger market share today is it is very hard to get mortgages and get mortgages on attractive terms away from the GSEs.

Mr. GARRETT. Right.

Secretary PAULSON. And the reason is because of that implied because they are taking the the mortgage risk and they are selling their credit. So, again, I think this will be helpful to the market. You are not going to get, if you are pressing on me, you are yelling at the wrong guy.

You should be going to the Senate and saying give us a bill, okay, because I am just sitting here saying the same thing you are, give us a bill and let us work with it and let us not let the perfect be the enemy of the good.

Mr. GARRETT. I thank you for that.

Thank you.

Chairman SPRATT. Mr. Edwards.

Mr. EDWARDS. Secretary Paulson, thank you for your service and for being here today.

As we know, the President is signing the stimulus package today. And I would like to ask you, for those who would question the impact of approximately a $150 billion stimulus on a $14 trillion annual economy, can you quantify the impact of the stimulus package? Will it increase our GDP growth by one-half of one percent, by one percent?

Secretary PAULSON. I would say my guess is six-tenths to seven-tenths of a percent more or less. We are going to work very hard to get these checks out right away. And I think given where the checks are targeted and where they are going to go, I think you will find it has a real impact. And we know what bonus appreciation will do and that will kick in later in the year. But, yes, I think it will be meaningful.

Mr. EDWARDS. Could it also have a nonquantifiable impact on consumer confidence?

Secretary PAULSON. You bet. And I will tell you I think people have to be pleased to see how quickly Congress has come together on this.

Mr. EDWARDS. Thank you.

Clearly the subprime mortgage crisis and the home foreclosures that have resulted from it have contributed significantly to our present economic challenges.

Do you think those problems have bottomed out vis-a-vis the number of foreclosures coming as a result of the subprime crisis? Has that problem bottomed out or is it going to have to get worse before it gets better?

Secretary PAULSON. No. The subprime, as I have said, the subprime mortgage issue on the adjustable rate subprime mortgages, as I have said, that is going to get worse before it gets better because we have the poorest quality loans were underwritten in 2006. And roughly 1.8 million of those, over the next couple of years will have their rates reset.

That is why a big part of our effort is aimed at those and the private sector initiative of getting fast track modifications to those loans which in many cases will be interest rate freezes.

Mr. EDWARDS. Okay. Thank you.

Let me ask you one question regarding the President's budget. I Chair the Military Construction and Veterans Appropriations Subcommittee. And as I look at the President's budget, after a one-year uptick in VA healthcare funding for 2009, the President's budget would actually cut $17½ billion out of veterans' healthcare current services between 2010 and 2013.

Given that that budget also includes some significant tax cuts for families making over a million dollars a year, do you think that is fair to the men and women who have already sacrificed so much on behalf of our country?

Secretary PAULSON. That, Congressman, is clearly a loaded question.

Mr. EDWARDS. Well, it is a question based on the facts of the President's budget.

Secretary PAULSON. Well, I guess what I am going to say to you on that is I focus on the budget overall, the revenue side of this.

There is a lot of tradeoffs in the budget and you are going to have to ask, and I am not familiar with the details there and I will pass them on to others, you will have to ask the head of the Veterans Administration and others about this.

Mr. EDWARDS. Okay.

Secretary PAULSON. Okay?

Mr. EDWARDS. Let me ask you since I have some time remaining, in your opinion, does a dollar worth of tax cuts pay for itself in additional revenue brought in as a result of that dollar of tax cuts?

Secretary PAULSON. I do not believe it pays for itself entirely, although I also have been disappointed to say the least at sort of the static way in which people make estimates on all kinds of things down here because I do know and I did see really major behavioral changes after the President's tax relief.

And I have got to just make the point that Republicans and Democrats and the CBO and everyone that scored this have been very surprised at the extent to which revenues have been coming in. So there is something wrong with the way we are doing the estimates, but, yet, I have seen the analyses and I would answer the question the way I did.

Mr. EDWARDS. And I believe most economists, those who have testified here have said, I think CBO, in fact, has said even under the most optimistic assumptions, maybe a dollar of tax cuts brings in an additional 20 to 25 cents and that in some cases, if you fund tax cuts by borrowing money, including borrowing money from overseas lenders, you could actually reduce overall revenues even more than the tax cuts because of long-term interest rates going up.

Secretary PAULSON. I will tell you I am definitely not there. I just think I would be very different. But I will say that you have to look at different taxes and I think the right way to think about taxes is we need taxes because we need revenues. And so no one is arguing about that.

So the two questions to ask are what percentage of GDP should be taken up by taxes. You know, taxes should be what percentage of GDP, how big should they be in relation to our economy, and then what is the right form, because for any given amount of taxes, we want to maximize our jobs and our growth and our competitiveness.

And I would say the form of some of our taxes make them very, very expensive in terms of what they do to hurt growth and competitiveness.

Mr. EDWARDS. Thank you, Mr. Secretary.

Secretary PAULSON. Thank you.

Chairman SPRATT. Mr. Hensarling.

Mr. HENSARLING. Thank you.

Mr. Secretary, welcome. Good to see you again. I am unaware of any tax cut that Congress is presently considering. I am aware, though, that there are some huge scheduled tax increases due to take place on the American family and the American economy.

Right now by January 1, 2011, ordinary income taxes are due to increase 13.1 percent at the top bracket; capital gains, an increase of a third, from 15 percent to 20 percent; dividend increase, 164 percent tax increase. Death tax goes from zero up to 55 percent.

The child tax credit is scheduled to decrease by half, and the lowest tax bracket is due to increase 50 percent from the 10 percent bracket to the 15 percent bracket.

My question, Mr. Secretary, as we look at a troubled economy, what is the impact of these presently scheduled tax increases, what is the impact on the American economy, and what impact will that have in your opinion on working families as they try to meet their healthcare needs, their education needs, their energy needs?

Secretary PAULSON. Well, first of all, I believe as you do, I am sure, that one of the most important things we can do would be to make that tax relief permanent. And if they are ever allowed to expire that those will be real tax increases to a number of the constituents you mentioned.

And the thing that I focused on also in my job is small businesses because when you look at the top two tax brackets, you have 70 percent of the flow through businesses in this country are paying tax at that rate. And as you know, when the small businessman saves a few extra dollars, they reinvest it in their business.

And so, again, I think you are pointing your finger at a very important issue.

Mr. HENSARLING. Let me turn to another issue, Mr. Secretary. One thing you can usually set your calendar by is that once the President introduces his budget, it will be roundly criticized.

One of the factors that the budget has been criticized by my friends on the other side of the aisle is certain reforms that the Administration proposes for Medicare.

Right now I believe it is fairly universally accepted that the cost of doing nothing in Medicare and other entitlement spending is fairly significant. In fact, I heard Comptroller General Walker say recently that the cost of doing nothing for just Medicare and Social Security is about $2 trillion a year.

So let me first remove the myths. In the five-year budget window, does the Administration propose any decreases in Medicare spending or is Medicare spending due to rise each and every year of the Administration's budget?

Secretary PAULSON. It is going to rise.

Mr. HENSARLING. It is going to rise.

Secretary PAULSON. And as I say, what we have done, and Mike Leavitt is the expert and will give the details, but the idea is to slow the trajectory of growth from 7.2 percent to five percent. And even doing that, although that makes a pretty significant difference, if you look 75 years out in terms of the overall deficit, but it takes about one-third of that.

Mr. HENSARLING. Mr. Secretary, quantify the cost of doing nothing in another way. Is it a fair assessment in your opinion that if we do not reform Medicare, the program as we know it will no longer be here? Within a generation, taxes may have to be doubled to sustain the program. Is that a fair assessment?

Secretary PAULSON. Yes. I guess without those numbers exactly, I would just say it is clearly unsustainable. And I think everyone knows that because we have the demographics and the rising cost of healthcare. And it is the huge issue facing us all.

Mr. HENSARLING. Mr. Secretary, there are many in Congress who believe that the only way you can show compassion to people is to take money away from them and write a federal check. Others believe, though, that it is possible to actually reform retirement programs and healthcare programs and achieve even better quality or certainly no loss of quality.

The head of CBO, Dr. Orszag, who was a Democratic appointee, not a Republican, has stated in earlier testimony before this Committee, "It may even be possible in some cases to reduce cost growth and improve health at the same time." He goes on to cite academic research suggesting that national costs for healthcare can be reduced by perhaps 30 percent without harming quality.

Do you agree with the assessment that it is not always how much money you spend but how you spend the money and can we sustain quality healthcare without necessarily spending more money?

Secretary PAULSON. Well, let me say this. I am not a healthcare expert, but I will tell you clearly in many, many things in life, it is not the amount of money you spend, it is how you spend it. So I cannot disagree with that.

Mr. HENSARLING. I am out of time. Thank you, Mr. Secretary.

Thank you.

Chairman SPRATT. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Secretary.

As the cabinet officer responsible for tax policy or the top cabinet officer in that regard, I would like to direct your attention in that area.

Over the last decade, there have been a variety of proposals. I think the current form is the so-called fair tax to substitute a sales tax of some type for the income tax. That is not included in this budget, is it?

Secretary PAULSON. No.

Mr. DOGGETT. And, indeed, with this Administration in its eighth year, this Administration has never recommended that we replace the income tax with a sales tax, a mislabeled fair tax, or anything of that type?

Secretary PAULSON. No.

Mr. DOGGETT. And with reference to the idea that as my former Chairman of the Ways and Means Committee suggested, a Republican Chairman, that we could just pull the income tax out by its roots and substitute a vastly different income tax, the Administration does not have any major individual simplification of the income tax included in this budget, does it?

Secretary PAULSON. No, we do not.

Mr. DOGGETT. And even with reference to corporate taxation in your efforts last year to consider the possibility of repealing some of the tax incentives, tax subsidies for corporate activity in return for reducing the overall level of corporate taxation, there is nothing in the budget for the simplification or reduction of corporate taxes, is there?

Secretary PAULSON. No. Can I give you a little bit longer answer on that?

Mr. DOGGETT. If I do not run out of time.

Secretary PAULSON. Okay. Yes, because we put out a number of studies and papers exploring different things.

Mr. DOGGETT. But we are down to the end of the Administration and it has had eight years——

Secretary PAULSON. Yes.

Mr. DOGGETT [continuing]. If you will, and nothing has happened. I understand you have not been there for all that time.

And then in the area of the tax changes that the Administration either recommends or does not oppose that this Congress might take, last year, the only form of correction of the alternative minimum tax for the year that the Administration would support was one in which we borrowed the money to pay for it.

And I gather from your remarks this morning that that is the only approach for this year that the Administration would support, is that we borrow whatever it takes to pay for correcting the alternative minimum tax.

Secretary PAULSON. Remember, there are two ways. Everything is not as simple as borrowing or tax. There is also the spending side.

Mr. DOGGETT. That is right. You could come in and recommend specific programs to abolish or cut to pay for the alternative——

Secretary PAULSON. All dollars are green. And so we came up with a budget and the deficit inherent in that budget is part of the overall plan.

Mr. DOGGETT. In fact, the Administration supports the permanent repeal of the alternative minimum tax.

Secretary PAULSON. The Administration has said that we need to do something to deal with this because we clearly do not want this to hit, you know, the taxpayers. But we have not said we support the permanent repeal. We said that clearly when we come to the final solution here, we are going to need to take a look and say how big should taxes be as a percentage of our economy and we want to look at a number of other things.

Mr. DOGGETT. As to permanency, you do support the permanent enactment of every one of the Bush tax cuts; do you not?

Secretary PAULSON. We support the major ones that are in the budget.

Mr. DOGGETT. Are there any of the Bush tax cuts that you do not support permanently?

Secretary PAULSON. Well, there are some of the extenders that are not in the budget.

Mr. DOGGETT. Okay. But do you not support them as long as we are willing to borrow money to pay for them?

Secretary PAULSON. If they are not in the budget, we can talk about it.

Mr. DOGGETT. Well, we can talk about it only if we borrow money.

Secretary PAULSON. Well, we could talk about borrowing money or we could talk about making some additional spending cuts.

Mr. DOGGETT. What specific spending cuts do you think we should prioritize to pay for correcting the alternative minimum tax this year?

Secretary PAULSON. I would say the alternative minimum tax, you have our budget, and the only point I was making, sir, was it is not quite as simple as saying that the alternative minimum tax is being paid for from borrowing because it is part of a coherent budget. And so you could take any part of it and you could say any spending portion——

Mr. DOGGETT. And I will not in this last 20 seconds debate you on whether it is a coherent budget. I clearly do not think so.

But if there are any specific spending cuts that the Administration feels we should use to pay for the alternative minimum tax, your tax policy assistant could not identify any last year to the Ways and Means Committee, I would just ask you to supplement in writing what they are.

You also believe that we should——

Secretary PAULSON. If I can explain what I said. I did not say we are pro spending.

Mr. DOGGETT. I understand what you are saying. I am just asking.

Secretary PAULSON. I just said we have a budget and——

Mr. DOGGETT. I understand you have got a budget that you think takes care of everything. I am just asking you to supplement in writing if there is any specific spending cut that you would ask us to use to pay for the alternative minimum tax correction.

And also to be clear, you proposed that we continue to pay for what you call a plug figure, I call a phoney figure, on the Iraq War, whatever it costs, that we continue to pay for that by borrowing money, right?

Secretary PAULSON. Again, it will be part of the budget.

Mr. DOGGETT. Well, that is borrowed money.

Secretary PAULSON. That is right.

Mr. DOGGETT. And it is just——

Secretary PAULSON. There is no doubt it will add to the debt.

Mr. DOGGETT. It is just a basic disagreement whether we pay as you go or borrow as you go. And the amount of borrowing proposed in the budget and to supplement this budget strikes me as just an incredible astronomical amount on top of the $3 trillion that the Bush Administration has added to our national debt over the course of its tenure.

I thank you for your service and respect your point of view.

Secretary PAULSON. Thank you.

Mr. DOGGETT. Thank you, Mr. Chairman.

Chairman SPRATT. Ms. Schwartz.

Thank you.

Ms. SCHWARTZ. Thank you, Mr. Chairman.

Secretary, welcome. We have an empty hall here, but I think we will get a few minutes together.

I raised some of these issues with Mr. Nussle last week and wanted to raise some of these issues with you. And I do understand, as you said earlier, you are not a healthcare expert, so I acknowledge that.

But you know something about taxes and you know something about this budget. So I do want to raise some questions with you about the Administration's effort to and proposal to deal with some of the issues around healthcare.

And you said very clearly that the issue of healthcare costs both to the government and I believe to businesses and to individual families is an economic competitiveness issue for this country.

I think your opening remarks talked about a long-term stimulus, what we need to be doing to tackle some of the major issues and challenges facing us in this country, that we have to tackle healthcare. You did not mention that specifically except under entitlements.

Secretary PAULSON. I clearly agree. This is a major, huge structural issue for us.

Ms. SCHWARTZ. Okay. I appreciate that, you know. And I think that one of the things that I would contend that the proposal, the President's budget basically does two things around healthcare.

One I am going to leave aside which is Medicare, which is just basically cuts without any targeting for what really works, what does not, any kind of investments, sound investments really that could make a difference in cost containment.

But what I really wanted to ask about was the tax proposals that the President put forward again this year. He did it last year. And I think particularly in contrast to the strength of the Administration's opposition to extending CHIP, the Children's Health Insurance Program, seems to me just so misguided.

And I wanted to see whether you could justify why we would choose to do a tax deduction, not even a tax credit, not even a refundable tax credit that would help our lowest-income folks be able to afford health insurance, but instead to do a tax deduction, a broad-based tax deduction, not targeted, for individuals, taking money away from those who are employed, and actually do it in a way that is fairly inefficient because it does not target the uninsured. It could be just a complete wash. People who have insurance now in a group market could go to an individual market and actually cost us more money.

Estimates I have is that the President's proposal would cost—first of all, it is $105 billion investment. We have been asking for $35 billion for children. This would cost $2,600 per person per year. Children's health insurance was going to cost $1,200, half of that.

And what we knew is that we were targeting the Children's Health Insurance Program to lower middle-income folks. It has been successful. It has been bipartisan, costs less per family, targets again those without insurance, uninsured kids, is a very effective use of dollars, and costs us less.

The President was vehemently opposed as we know from having vetoed CHIP extension twice and instead is proposing a $105 billion investment to help individuals leave the group market and go to an individual marketplace which we talked about last year really does not exist if you have health issues, that preexisting conditions exclude you. If you are older, it is too expensive.

And, in fact, it is very hard for lower middle-income folks, even middle-income folks, a family making $50,000 a year for them to come up with 10 or $12,000 in cash and then look for a tax deduction later is really just not reasonable.

So could you speak to how this is targeted, how it deals with the uninsured, how it is cost effective for this government, and how it deals with any of the major issues facing us in healthcare accessibility, quality, and cost for families in this country?

Secretary PAULSON. Yes. You all will be around here longer than I am and as you are looking for how to pay for some of the things we need to do in the healthcare area, you should look very closely at the biggest preference there is in the Tax Code which is $3.3 billion over a ten-year period which is the preference that goes to those who get employer health insurance.

Now, I want to just——

Ms. SCHWARTZ. By reducing that, that is one of the Administration's——

Secretary PAULSON. No. I want to just go on this and say what we are doing if you really want to hear.

Ms. SCHWARTZ. Sure.

Secretary PAULSON. First of all, the idea that it is a tax increase is wrong, that it is going to cost money. This was intended and we would implement it in a way which was revenue neutral.

So, again, people can try to play games and say, well, we have done the numbers. Well, we will just take it as a given. Anything we would do here, we would work the numbers to be revenue neutral.

The next thing I——

Ms. SCHWARTZ. You are saying there is no, the $105 billion investment——

Secretary PAULSON. No, there is not. The proposal was a general proposal to say this would be revenue neutral.

Ms. SCHWARTZ. Right. By capping the amount of tax deductibility for those who are employed?

Secretary PAULSON. No. No. All this does, what this does is will set a limit.

Ms. SCHWARTZ. Right.

Secretary PAULSON. So for the gold plated. And so someone who is getting $15,000 of benefits or more will be able to either, if they want to, if they do not want to lose the benefit, they can restructure their program. So all this does is gives money——

Ms. SCHWARTZ. It is seeking to limit that group insurance. But speak to how it is going to actually help those who find it very difficult, if not unaffordable and inaccessible to buy individual insurance and whether that is the most effective way to do it.

Secretary PAULSON. I just looked at it and to me, it just looked like a gross injustice, that I saw that $3.3 trillion preference and I saw it going to a privileged group. And I took a look at the construction worker, the waitress, all the people who do not have health insurance and by giving them the same benefit, it would add to those that are insured.

And, again, I would just say this to you. Before we just go on the attack, there is also a way to look and say how can you take this and make it better. This could be one piece of a program. And so, again, this is something that right now is not transparent. It is an incentive to overspend because there is no limit on it, and so the gold plated programs.

And we could do something that would encourage more insurance, add to those that get insurance, and do something I think is in a fair way and everyone has got the opportunity to, if you have a program that goes above the deduction, to restructure it.

So, again, you and I have a difference on this, but do not come away with the feeling that this is something that in this case this is either going to be a reduction or an increase in spending. This should be neutral.

Ms. SCHWARTZ. Well, let me just clarify on perspective. And it is different. Let me say where I do agree, and I would hope that we can tackle this, is I do believe that if we can make sure that the individuals who are paying for insurance or could buy insurance, that should be either tax deductible or potentially be a refundable tax credit. I think we should work on that.

You are right. I do not agree that we should take it away from other people. And let me——

Secretary PAULSON. The tax credit, again, I——

Ms. SCHWARTZ. Excuse me.

Secretary PAULSON [continuing]. Was surprised when we threw that out there that others would come back and say that is a——

Ms. SCHWARTZ. If I may, Mr. Chairman.

Secretary PAULSON [continuing]. That is a good idea, I got a refundable tax credit. No one said that.

Ms. SCHWARTZ. We could actually talk about that. But if I just may say it is not correct that it is going to be really possible for the waitress who is earning 20 or $25,000 a year or $30,000 a year to be able to find out-of-pocket—first of all, if she can even find an individual insurance, that she would be able to find that $10,000 that she may need to purchase it and that she may not even be paying taxes so that she may be earning too little, so she may not get a tax deduction.

So this is targeted not to—I do not need you to answer this. I am just making a statement that that, in fact, is not targeted to the lowest-income working folks. It is not dealing with the issue because of the marketplace and because of the reality of high cost of health insurance for too many Americans.

So the dialogue we should continue to have because we have to be able to tackle a way to help Americans be able to afford health insurance in this country, and I look forward to having that discussion with you.

Thank you, Mr. Chairman.

Secretary PAULSON. Good, because there are two ways of looking at this. One is——

Mr. RYAN. Mr. Chairman.

Chairman SPRATT. I recognize the gentleman for 30 seconds and then Mr. Andrews for five minutes.

Mr. RYAN. I was not going to interject, but since we are going way over the time here, odds are that that waitress does not have health insurance, so we are discriminating the Tax Code against people who do not have health insurance given to them from their jobs.

And this idea to equalize the tax treatment so that waitress can have the same kind of preference that other people get in the Tax Code to go out and get health insurance, we can discuss whether it is a deduction or a credit, but the point is we are spending three and a half trillion dollars over ten years on healthcare and a lot of people do not have it.

We spend two and a half times the per capita average in the industrialized world on healthcare. Yet, 47 million are uninsured. So we have discrimination in the Tax Code that we want to attack and the idea is to equalize the treatment to be fair and to get more people insured. We can have honest disagreements about how to achieve that goal, but that is what this is about.

Ms. SCHWARTZ. And yielding back my nonexistent time, I would say that that is a conversation we should have on how we should do it.

Mr. RYAN. Exactly. So let us go to Mr. Andrews.

Secretary PAULSON. Whether it is a credit or a deduction, we should be discussing it.

Chairman SPRATT. I recognize the gentleman from New Jersey, Mr. Andrews, for five minutes.

Mr. ANDREWS. Thank you, Mr. Chairman.

Thank you, Mr. Secretary. I have a short-term question and a long-term question.

On the short term, as you said, we have worked together. The President today will sign a stimulus plan which I supported and I believe will do good for the country.

Let me ask you a question. Looking at it six months from now, what matrix will you look at to evaluate whether the stimulus plan has worked or not? What should we be looking for?

Secretary PAULSON. I think that is an excellent question because we are going to need matrix, all of us on this, because obviously we will be able to look and we will be able to see what GDP growth is, but we will not know what it would have been without the stimulus.

And so it is not a perfect world and we will never be able to do it with precision. But what we will do is, and I am going to be developing my own at Treasury Department, but we will be doing research on what families have done with their checks, how much spending. And so there will be a business behavior, but it is at best an imperfect science.

Mr. ANDREWS. I certainly do not ask the question for academic reasons.

Secretary PAULSON. No.

Mr. ANDREWS. I am very optimistic and hopeful——

Secretary PAULSON. Yes.

Mr. ANDREWS [continuing]. That this plan will work, but I think we have a responsibility to evaluate it in a few months to see if it is working, whether we have done enough, and whether we have to do more.

Let me ask you the long-term question. The Congressional Budget Office a few years ago estimated that we would be borrowing or we would need, rather, between three and five percent of GDP to cover the gap in Medicare and Social Security by about 2025 to 2030. And I think your Department, the Fed, just about everybody has essentially confirmed the scope of that problem.

And I honestly do not mean this as a rhetorical question. In order to fix that problem, it is going to require significant compromise, significant political risk for everyone involved.

You know, as the Chairman said earlier, in 1982 and 1986, President Reagan and Democratic leaders in the Congress, Republicans took a risk. I think it worked.

In 1990, the first President Bush, the Democratic leaders of the Congress took a risk. I think it worked in the long run.

Nineteen ninety-three frankly was solely on the Democratic side, but the risk was taken and it worked.

And in 1997, a bipartisan agreement took the smallest risk for the greatest reward which was moving us back to surplus.

I sincerely mean this not as a rhetorical question. The Administration does not stand for election this year. We all do. A third of the Senate does. Is the Administration willing to take that political risk and reach out to the Speaker, to the Majority leader, to the bipartisan leadership as you did on the stimulus plan and begin to talk about this enormous problem of the entitlement crisis looming over the country? Why have we not done that? Why can we not do it now?

Secretary PAULSON. Well, let me say I came down here and was confirmed and started my work in July of 2006. I knew the President had taken a pretty significant risk to take the first step with his Social Security proposal and it turned out to be not just an economic issue, difficult economic issue, it was politically complex. The President encouraged me to make a big effort and we did. And we are very disciplined.

I talked with a lot of people. I have had very good conversations with your Chairman, a lot of encouragement from people. And the idea of saying let us get together without preconditions, everyone talk about what they want to do and let us get together and work something out, and for whatever reason, behind closed doors, people would say this is a great idea, something we have got to get done, but it did not and people would not come to the table.

Mr. ANDREWS. You know, I understand.

Secretary PAULSON. And so I think——

Mr. ANDREWS. And we are all up for election this year in the House and we understand. But I would say this to you——

Secretary PAULSON. But, see, that is it. See, the one thing that is clear to me about this is it is going to take bipartisan support like the stimulus and people are going to have to come together and——

Mr. ANDREWS. Well, we just did. And although the stimulus frankly was an easy political move because you are giving people money back and——

Secretary PAULSON. Absolutely.

Mr. ANDREWS [continuing]. I understand that. I think it sets a template. There is not a person in this country that is a serious thinker who does not understand we have a huge problem over the next 15 or 20 years. And we are not talking to each other about it and we should. I am not faulting you. I am making an observation.

Secretary PAULSON. I commend you for making the point because, to me, it is the forest through the trees. We are talking about whether this is transparent in the budget or that——

Mr. ANDREWS. I understand.

Secretary PAULSON [continuing]. Or this is a holding number. That is the elephant in the living room.

Mr. ANDREWS. I am sure the Chairman is available this afternoon to start.

Secretary PAULSON. Yes.

Chairman SPRATT. I believe Mr. Scott is next. Oh, Mr. Bishop is next. I beg your pardon. I beg your pardon. You were here before the gavel went down.

Mr. BISHOP. Thank you, Mr. Chairman.

And, Mr. Secretary, thank you very much.

And, Mr. Scott, thank you for deferring.

I have two questions. As I was leaving to go over to vote the last time, I heard Mr. Hensarling start a question about a looming, huge tax increase that is forthcoming. And I was not here, but I believe he was referring to the 2001 and 2003 tax cut expiration; is that right?

Does not this budget that has been submitted by the Administration already include the largest tax increase in history with respect to the middle class by continuing to assume the revenue associated with the AMT?

I mean, the revenue is assumed through 2012 and to capture that revenue, instead of imposing the tax on the four million people that we are imposing it on now, we would be imposing it on 37 million people, most of whom would be middle-class and upper middle-class people.

Secretary PAULSON. Yes. And I think that is very unacceptable. And so what we have, the revenues are there because they are there by law, but what we are doing is what we said. We said very freely this is an issue that we need to come together and address.

And there are two ways you can address this or, rather, three ways. We talked about it. One way is, and there are some that look at it and say the first thing we need to look at is what percentage of our economy should be taken up by taxes. You know, taxes have averaged about 18 percent of GDP over the last 40 years. What is the right level? And I think that is one thing we really need to look at when we address this.

And, again, your Chairman said, Hank, maybe you are making it too complicated by saying look at that and look at it in the context of entitlements is the way I have thought about that. Others have said the way to address it is raise taxes. And so I do not think the way you should address it is by raising taxes.

Mr. BISHOP. When Mr. Portman was here last year as the Director of OMB, he was asked a similar question with respect to dependence on AMT revenue. And his response was that the Administration believed that the AMT revenue needed or the AMT problem needed to be fixed within the context of larger tax reform and that the anticipation would be that the tax reform would be revenue neutral.

Does that remain the Administration's position?

Secretary PAULSON. I have the highest regard for Ron Portman, but I never said that last year. And I do not believe that that was the Administration's position last year, that we were saying that it had to be revenue neutral. And so what I always said about AMT last year and I was——

Mr. BISHOP. If I may.

Secretary PAULSON. Okay.

Mr. BISHOP. If it is not revenue neutral and if we assume as the budget presumes the continuation of the 2001 and the 2003 tax cuts which with interest added has about a ten-year cost of about

$3 trillion and the ten-year cost of the AMT is about $1 trillion, so we would be foregoing $4 trillion of revenue over a ten-year period.

How do you see the budget accommodating that loss of revenue?

Secretary PAULSON. Well, you automatically make the assumption that we are either going to be raising taxes or borrowing money.

Mr. BISHOP. No. I am making no assumption. I am simply——

Secretary PAULSON. Well, that is why I think the only way that I can think of or I should not say the only way, but I think the best way to address this, and I am hoping that it will be addressed if not now, in the next Administration, it will be addressed by looking at this, as I said, in the context of entitlement, the whole entitlement spending issue, looking at the AMT, and also Congress and the Administration coming together and saying what percentage of our economy should be taken up in the form of taxes, what form should those taxes be, and looking at all those things together.

Mr. BISHOP. But the Administration has already answered a part of that question by virtue of the assumptions it makes with respect to the 2001 and the 2003 cuts. Your are already assuming that those will be continued. So you are already answering the question of what proportion of our economy ought to be taken up by taxes; are you not?

Secretary PAULSON. Well, that is one part of it, okay, because that is one part of it.

Mr. BISHOP. Okay.

Secretary PAULSON. You have seen that is something that this Administration thinks is very important. But, again, the idea we have and as I looked at different budgets over the budget window, I see, and, again, this has been altered somewhat by the stimulus package, but our revenues as a percentage of GDP were what, 8.7 percent, 8.6 percent. We show it going up throughout the budget window. And I think at some time, this is a question we all have to look at. It is just a basic question, how much are going to be taxes, what are the form of taxes going to be, and how much are we going to be able to get to by restraining spending.

And you are not going to be able to restrain enough spending without getting at the entitlements question. And we all know that. I mean, we are just——

Mr. BISHOP. Thank you. My time is expired. I appreciate it. Thank you.

Secretary PAULSON. Thank you.

Chairman SPRATT. Mr. Hensarling.

Mr. HENSARLING. None.

Chairman SPRATT. Okay. Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. Secretary, as Treasury Secretary, you are involved in monetary policy and have to make projections. We have a budget that has been presented to us that shows a surplus in the years 2012, 2013.

What are you projecting? The blue line is the President's projection. What are you projecting for a surplus deficit for those last two years?

Secretary PAULSON. You know, what we are projecting is, based upon the assumptions in the budget, we are projecting a——

Mr. SCOTT. Yes. But you have to make realistic projections and project monetary policy based on what you honestly believe the surplus deficit numbers are going to be.

What is a realistic expectation for the deficit in 2012, 2013?

Secretary PAULSON. Yes. I am going to stick with our budget, you know, that the——

Mr. SCOTT. That is your honest assessment? You are telling——

Secretary PAULSON [continuing]. That there is——

Mr. SCOTT. Wait a minute. You are telling Congress that we should plan for 2012 and 2013?

Secretary PAULSON. Here is what I will say to you, that since coming to government, and I said this at the beginning, I do not know if you were here, someone asked me, gee, did you plan this way, budget this way in the private sector. I said you have budgetary rules, scoring rules, certain things. You know, taxes are in the PAYGO rules. Appropriations are.

In terms of what we are going to do, there are a lot of assumptions and we have had revenues coming in much faster than forecasted to date.

Mr. SCOTT. Are the budget projections realistic to have a surplus in 2012, 2013?

Secretary PAULSON. If you think the Treasury Secretary is going to come up here testifying on the budget and say that I disagree with the budget projection, it would be pretty interesting testimony.

Mr. SCOTT. Well, we are basing economic policy and if you are here just to spin the Administration budget and we are trying to get bona fide information from you as Treasury Secretary. And I just asked you a simple question. Is that realistic or not?

Secretary PAULSON. And I would say that I think you take a look at the budget——

Mr. SCOTT. In all honesty, is that a realistic assumption or not?

Mr. RYAN. Will the gentleman yield?

Secretary PAULSON. What?

Mr. RYAN. Will you yield? Well, if we implement the Administration's policies on entitlements and things like that, then these become realistic expectations.

Secretary PAULSON. Yes.

Mr. RYAN. The whole point of producing a budget is to enact budget-changing policies that gets you to these points. So if we do not act on these policies, then, no, it will not materialize. If we do act on these policies, then perhaps, yes, these projections would materialize.

Mr. SCOTT. Reclaiming my time, Mr. Secretary, in your statement, you indicate that the stimulus and others will help create more than half a million jobs by the end of the year.

Is that half a million a total or more than we would have created otherwise?

Secretary PAULSON. It is obviously more than we would have created otherwise. And I think that is on the low end.

Mr. SCOTT. Your statement indicates that home price appreciation, the United States undergoes a significant and necessary housing correction. The word necessary is curious in there.

Can we assume that by necessary that we are not going to do much about a situation that most consider a bad thing?

Secretary PAULSON. We are working hard to prevent avoidable foreclosures. The word necessary means that when markets get out of whack, it is counterproductive for the government to get in and stand in the way because it creates all kinds of other distortions and it prolongs the problem. Markets do not go up at the rate at which these housing prices went up without it coming down.

Mr. SCOTT. Family income, what has happened to median family income since 2001 and are we going to try to change that direction or expect more of the same?

Secretary PAULSON. I do not have the precise numbers here with you, but I assume what you are alluding to is that you would like to have seen the median family income growing at a faster rate.

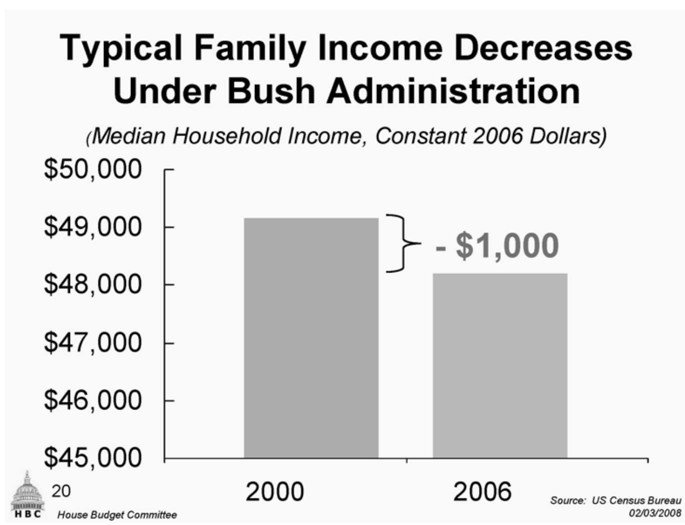
Mr. SCOTT. Excuse me? Grow at a faster rate?

Secretary PAULSON. Well, I would say the median family income has gone up. It has not gone up at least in the years I have looked at it since I have been here.

Mr. SCOTT. Can you get chart 18.

Secretary PAULSON. Yes.

Mr. SCOTT. And page nine.



I am sorry. Number 20, two more.

Okay. The information we have shows the median income going down a thousand dollars.

Secretary PAULSON. And you showed it going down. You picked from 2000 and I would have to see what you have got in those numbers and how they have been put together. And I think what has happened, the median family income is up after taxes, but it is down before taxes. But a courtesy——

Mr. SCOTT. Median or average?

Secretary PAULSON. Current median——

Mr. SCOTT. Wait a minute. Median or average?

Secretary PAULSON. Median. A courtesy of the Bush tax relief, the median after-tax income has gone up. But, again, your basic point, which I understand your basic point, and it is something that I am very, very focused on, and I think it is quite important to keep this economy growing and there has been a trend that has been going on, sir, for a good number of years in terms of income distribution.

And the other thing I would point out is that there is great, and all of the Treasury studies on this confirm this, that the income mobility, there has not been any decline in terms of mobility.

And so those in the bottom 20 percent, half of those will move out over a ten-year period, half of those at the top 20 percent will be new. And so while we would like to see the median income moving up more quickly, the fact is people move through the median income and continue to move up in this society.

Chairman SPRATT. Thank you, Mr. Scott.

If I could just clarify something, Mr. Secretary. Our problem with the AMT reform is, and we were harking back to the statement by Ron Portman——

Secretary PAULSON. I remember his statement. I just was pointing out that I had not said the same thing.

Chairman SPRATT. But what you are saying is now that you do not intend that it necessarily be revenue neutral. However, if you look in the budget for this year, the Administration's numbers for revenues imply that the AMT is fully in effect, unadjusted for inflation.

So we think you are trying to have your cake and eat it too, and putting that number in there when you are assuming that there is going to be AMT reform.

Secretary PAULSON. Yes. What I had said and when I testified before your Committee last time, I was very careful not to, as we were getting everyone to come together, trying to get together to address this, I was very careful to not, and I talked with the President very carefully about this, to not make any hard and fast statements about revenue neutrality.

We basically looked at AMT and said this is quite transparent, you know. We have the revenues there. We need to come together and solve this issue. And, again, I will not repeat what I have just said here, so that was our position.

Chairman SPRATT. Well, still we are looking at this year's budget request and it appears to us that it assumes that revenue is consistent with an AMT unadjusted, fully in effect, will be——

Secretary PAULSON. I have got you. I understand your point.

Chairman SPRATT. Probably want to take a look at that.

Secretary PAULSON. Yes.

Chairman SPRATT. And when you consider that, because the AMT is a robust revenue raiser if it is not adjusted for inflation.

Secretary PAULSON. Yes.

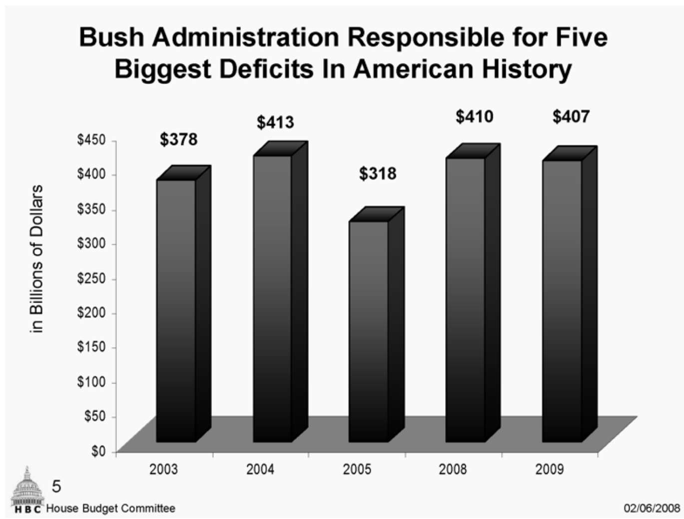
Chairman SPRATT. Add that to the fact that the Administration is only putting $70 billion in for the cost of the war, the supplemental of the war, and then nothing after that, in the years after that.

These two factors have a profound influence on the idea of budgets and call in the real question if they were treated realistically whether or not you can even approach a balanced budget in 2012, which is the central claim of this budget. That is what we are struggling with.

Mr. Etheridge.

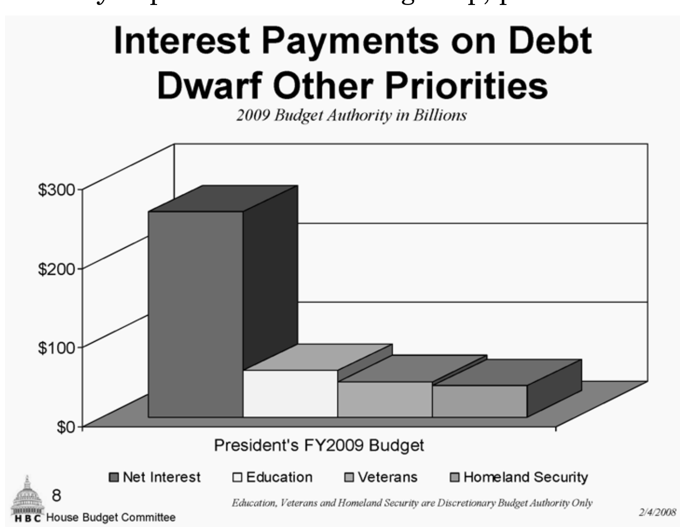
Mr. ETHERIDGE. Thank you, Mr. Chairman.

Would you put up chart number five, please.



Okay. I just wanted five up there just so we could focus on it because that is going to be what I am—I am going to talk about chart eight because chart five, though, is the one that leads to the challenges in chart eight with the huge deficits over the last five years, which are the largest by any Administration in history.

Now would you put chart number eight up, please?



Mr. Secretary, thank you for being here and thank you for your testimony. And I am going to have a brief question at the end, but

I want to get a few statements on the record, if I may, because this slide is quite troubling to me and it should be to a lot of folks.

It shows very graphically that the federal expenditure for net interest exceeds, will exceed and is exceeding roughly $200 billion and it shows how we are neglecting a lot of the other issues that if we are going to be competitive in the 21st century in this global economy, we got problems when we look at education, when we look at benefits for our veterans, when we look at homeland security, et cetera.

Let me just touch on that for just a minute. I just got through testifying this morning before the Education Committee. Having been a former Chief School Officer in my State, there is a huge need out there. And at times when we are asking our schools to do more than ever, we continue to shortchange them at the federal level. Even though this year in the budget, there is a flat-line funding, that really gets us behind when you think of the extra children coming, the tremendous need they have in the 21st century.

And as a veteran myself and an individual who represents Fort Bragg, it bothers me a great deal that this budget neglects our veterans at a time when our nation is fighting two wars halfway around the world.

I was particularly concerned that the Administration continues to propose increases in VA pharmacy co-pay increases that this Congress has rejected year after year. With all the new veterans coming home from Iraq and Afghanistan and the unique problems associated with these deployments, we face a veterans' care crisis in this country that we neglect at our peril. I believe that.

And I happen to represent a State that depends on homeland security quite a bit when it comes to hurricanes. North Carolina sort of sticks out there. And if you dial 911 on a hurricane, it tends to answer in North Carolina. We have been fortunate these last few years and I hope we do not have it again.

But, you know, no matter how much people in this town want to bad mouth big government, when you have a national crisis, they hope the calvary is coming and they want the calvary to be a part of their state and federal and local preparedness.

And we have been fortunate in North Carolina, and I appreciate the progress that is being made in bioshields which has been a congressional priority and an Administration priority to bolster our medical countermeasures and preparedness against chemical, biological, radiological, and nuclear attacks. I think that is appropriate.

But I am very concerned that cuts to first responder funding in favor of other programs that really have impact not only in my State but a lot of states across this country and could very well.

And I am particularly bothered that so much of this interest is being paid to foreign debt holders. I know we do not know who buys them, but we all know in recent years that much of that has been offshore.

It was one thing when interest was being paid to people in the United States. It was recirculating in our economy in one way or another. And today that is not necessarily true. And I recognize we are an international economy.

But as we look at this slide, it bothers me because I think our priorities as we look down the road, piggy-backing on Mr. Scott's previous question, it should raise deep concerns. And I would be interested in your comments as we look at this issue.

And certainly from your experience as a business person, you are carrying this heavy debt load, you may want to measure it toward GDP. But as GDP drops in a downturn, that number goes up substantially and has a drag on the economy. And I would appreciate your comments on it as it relates to this budget and projections.

Secretary PAULSON. Yes. I get asked that question a lot. And just like a very large company can borrow more money than a small company and just like a wealthy individual can afford a bigger mortgage than someone that is not as wealthy that I believe, and I am not saying this for political reasons, it just is economic reality, the only way to look at debt, it is sort of meaningless to just look at debt and say X billions. It would be just like criticizing Exxon because they had a couple hundred million dollars in debt when their shareholders would criticize them if they did not. So I think the right way to look at this is a percentage of GDP.

And, again, my concern, and I am very concerned about the deficit and I do believe deficits matter, and I am concerned because I see an issue coming that is huge and it is a structural deficit and it is entitlements.

I looked at the deficit, you know, at the end of this year, this last year. It was 1.2 percent of GDP. It is now going to go up and it will be about 2.9 percent of GDP. And then it is projected to drop a bit in the short term and then getting to balance.

But, you know, I have just a very high regard for your Chairman and when we put the numbers up, you know, basically what I am sitting here and thinking is we are disagreeing and any budget can be wrong. Any budget based upon projections can be wrong. We are disagreeing about, you know, a number of hundreds of billions of dollars, you know, one way or another which are big numbers in the absolute sense. But when we look at the magnitude of the long-term problem, that is really the important thing.

So I would say our numbers right now are very manageable as a percentage of GDP and given the size of our economy. I would like the deficits to be smaller, all of us would, but they are quite manageable. The bigger issue is a longer-term one.

And in terms of foreign holders of our debt, we should be glad that we have such strong interests outside of our country. And I will say as I look at the numbers and I have got the numbers that every country holds in our debt and no one owns a big percentage. We trade $500 billion of treasuries in a year.

And, you know, Japanese own the biggest amount. They own about 580 billion which is more than one day's trading volume. Chinese are next. You know, they went down a little bit there. They are less than a day's trading volume. They are about 380. Then in the UK, holders held a little bit over 300 billion.

So, again, I appreciate the fact you mentioned is obviously the interest payments now go out of the country. And I think we are all focused on the same thing. We are all focused on, you know, minimizing our debt. But the big issue is one we all have to deal with.

Mr. ETHERIDGE. Mr. Secretary, I appreciate that and I thank you for your answer, but I think the other point that bothers me and I think it should bother every member of this Congress no matter where they come from is the crowding out this can do for those investments that we badly need to make of infrastructure and I include education as a part of that, our future as well as fiscal infrastructure. That is the troubling part of this whole process because we are going to pay debt first as you and I both know. And these other pieces get really crowded out in a hurry and I think that is the real danger we face.

Secretary PAULSON. Thank you.

Chairman SPRATT. Mr. Secretary, thank you for coming. Every time you testify, we are reminded of how and why you were all Ivy tackle and CEO of Goldman Sachs both. You did a splendid job. We are glad you are where you are and we look forward to working with you to resolve some of these problems.

I would like to ask as a housekeeping matter that all members who did not have the opportunity to ask questions may submit questions within seven days for the record.

Thank you again.

Secretary PAULSON. Thank you, Mr. Chairman.

[Whereupon, at 12:00 p.m., the Committee was adjourned.]

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