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Mr Summers
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Subject: URGENT -- Treasury (Larry Summers) testimony for today.

A copy of Larry Summers' testimony on the tax proposals in the President's budget is being faxed/delivered to you. The testimony is for the Ways and Means Committee and is to be delivered at 1 PM today. Obviously, comments are due ASAP.

Call (53386) or fax (53109) any comments to me.

Note tobacco settlement references on page 4.

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Lawrence H. Summers
Deputy Secretary of the Treasury
Statement on the President's FY 1999 Budget
House Ways and Means Committee
February 25, 1998

Mr. Chairman and members of this committee, it is a pleasure to speak with you today about the President's FY 1999 budget. This is an historic moment: The President is proposing a balanced budget for the upcoming fiscal year, the first since 1969. The budget is rooted in fiscal discipline, yet invests in areas critical to future productivity and the American people. Perhaps most importantly, this budget provides a clear answer to the question of how to use the projected budget surpluses. The President proposes that surpluses be reserved pending reform of the Social Security system.

This budget carries forward the President's successful economic strategy. As the President said last month during the State of the Union, from the beginning of this Administration we have "pursued a new strategy for prosperity: fiscal discipline to cut interest rates and spur growth; investments in education and skills, in science and technology and transportation to prepare our people for the new economy; new markets for American products and workers."

Before I discuss the specifics of this budget, I think it is important to review the progress we have made in getting our fiscal house in order.

When President Clinton entered office in 1993, federal debt had quadrupled from 1980 to 1992 and the 1992 deficit was \$290 billion, an all time high. These huge deficits kept interest rates high, diminished confidence, lowered investment and stifled growth. Budgets were based on economic assumptions that were far too optimistic. When these assumptions failed to materialize, the result was higher deficits than forecast, and cynicism about the budget process.

In 1993, President Clinton fought for, and Congress approved, a powerful deficit reduction plan that was based on conservative economic assumptions and which brought the deficit down by \$500 billion over five years. The deficit reduction increased confidence, helped bring interest rates down, and that, in turn, helped generate and sustain the economic recovery, which, in turn, reduced the deficit further. The result was a healthy, mutually reinforcing interaction of deficit

reduction policy and consequent economic growth, that brought the deficit down to \$22.3 billion in 1997, and sets the stage for going to balance.

Today, unemployment is 4.7 percent; it has been under 6 percent for the last three years. Over the last five years, the economy has generated over 14 million new jobs, inflation and interest rates are low and real wages are rising, although too many Americans are still not participating fully in the economic well-being that most are sharing. Last year's bipartisan deficit reduction package has further improved our fiscal picture, even while increasing investments and cutting taxes for the middle class.

Moreover, for a median income family of four, the federal income and payroll tax burden will be lower in 1998 than at any time in the last 20 years. And for a family of four earning half the median income, in part because of the expansion of the Earned Income Tax Credit for 15 million families, the federal income and payroll tax burden is lower than at any time in the last 30 years. Families' tax burden will fall further next year when the child credit enacted last year is fully phased in.

Mr. Chairman, the efforts over the past five years have paid off: the current projection anticipates surpluses well into the next century, although long-term budget forecasts inherently involve a great deal of uncertainty. How we use these surpluses is a critically important issue in the years ahead, and a key focus of the President's budget.

The overarching point of the President's economic strategy going forward and his 1999 budget is clear: under no circumstances can we take any steps that will undo the fiscal discipline we have worked so hard to achieve. The last few years clearly demonstrate the economic benefits of a strong fiscal position and the global financial markets that have emerged in recent years greatly heightens its importance. The global capital markets impose swift and strict penalties on countries with unsound policies as we have seen in recent months in Asia, and confers great benefits on countries with sound policies.

The surpluses present an enormous opportunity, one that so many have worked hard to achieve, and one that we must not squander. Because this nation has a major challenge ahead: the challenge of moving from a younger society to an older one.

A time of surplus, a time when a major change is coming, is not a time to spend. It is a time to

save. And the best way to save for our future is to save Social Security. That is why we believe the surpluses should be reserved until Social Security is placed on a sound financial footing for the 21st century.

This is the right policy for our nation. It is the right policy from the standpoint of the economy, which needs to save more in order to invest and grow fast enough to shoulder the burdens of the next century. It is the right policy from the standpoint of our long-term fiscal health, which will otherwise be placed under growing strain by the costs associated with aging. And it is the right policy from the standpoint of individuals, who need to make plans to ensure their long-term security in retirement, and a substantial proportion of whom will inevitably rely on Social Security. That is why the President believes very firmly that nothing should be done with the surpluses until Social Security reform is addressed.

Of course, as we go forward there will be a need for new measures to equip our nation for the challenges ahead and to compete successfully in this new global economy. The President's commitment to preserving the surpluses does not preclude undertaking these kinds of initiatives -- including cutting taxes and increasing spending. But what is critical is that those initiatives are paid for in full.

We propose moderate targeted tax cuts that are fully paid for with \$23 billion in revenue-raising provisions and proposes new spending in areas critical to increasing future productivity and critically important measures to protect and promote America's economic and national security interests in the global economy. Today I would like to focus on just a few significant measures that reflect those priorities.

First, to enhance productivity, and maintain our country's competitive position in the years ahead, the Administration proposes:

- increased funding for education and research, including an additional \$5 billion to support school construction and modernization projects, and subsidies to recruit and train more teachers and the creation of a new Research Fund for America for medical and science research**
- far-reaching measures to make child care more affordable including a \$5.1 billion expansion of the child and dependent care tax credit that will grant 3 million taxpayers and average annual tax cut of \$330; a new employer credit to promote employee child care**

and expand its availability; and new spending for child-care subsidies for children from poor families. Helping parents with child care is not only good for parents, it is also good for the economy, because it helps all to participate in the workforce to the full extent of their abilities and wishes.

- measures to promote growth in our inner cities and other economically distressed areas, through as by increasing the low-income housing tax credit and increased funding for community development banks. This is a national economic issue: Our economy will never achieve its full potential until we equip the residents of these areas to enter the economic mainstream.

Second, our budget proposes major new steps to protect the environment, with \$3.6 billion in nine tax incentives to promote energy efficiency and improve the environment. These include: tax credits of up to \$4,000 for purchasers of highly fuel efficient vehicles and up to \$2,000 for buying rooftop solar equipment; new credits for buying energy-efficient homes and certain energy-efficient building equipment; and a range of new incentives to clean up environmentally contaminated sites.

Mr Chairman, a beneficial byproduct of our policy to reduce youth smoking by increasing the prices of tobacco products is that we will raise revenues for the government. Our budget proposes to share these revenues among three sources. First, we will return to the states roughly the amount of revenues that they would have received under the original tobacco settlement. A large part of this money will be unrestricted; states can use it for whatever purposes they choose. The rest of the money will go to states for state-administered programs to provide child care subsidies, reduce class size, and expand children's coverage by public health insurance. Second, we are providing funding for a dramatic expansion of health-related research in America through our Research Fund for America. Finally, we divide the remaining dollars into other uses that states see fit, as well as funds for cessation programs, farm support programs, etc.

Let me repeat: this budget does not exceed the discretionary caps, under the structure of the current Budget Enforcement Act, and all of the initiatives in the President's budget are fully paid for, in full accordance with that act.

Of the \$23 billion in revenue-raising measures we propose, \$11.1 billion have been proposed in prior budgets. These items include the repeal of the sales source rule (\$6.6 billion); the repeal of the lower-of-cost-or-market inventory method (\$1.6 billion); the repeal percentage depletion for non-fuel minerals mined on Federal lands (\$500 million); and the reinstatement

of the oil spill excise tax (\$1.2 billion). The budget also raises approximately \$11.9 billion from new measures to eliminate unintended subsidies and other revenue-raising provisions. These include several new insurance provisions, which raise approximately \$4.6 billion in revenue; three provisions restricting unintended consequences of the current real estate investment trust (REIT) rules, which raise approximately \$135 million; and several unwarranted subsidies relating to estate and gift taxes, including a proposal to eliminate non-business valuation discounts, which raise approximately \$1 billion.

Mr. Chairman, these revenue-raising proposals will no doubt be the subject of debate. What is crucial is that any new expenditure or reductions in tax burdens be paid for. We have finally put our nation's fiscal house in order. That is an enormous achievement we must protect. And it is an enormous opportunity we must seize. We face significant challenges in fostering a strong economy and maintaining fiscal responsibility in the years and decades ahead, particularly with the coming retirement of the baby boom. As the old saying goes, you fix your roof when the sun is shining.

Mr. Chairman, the President's budget carries forward the President's economic strategy that has been so central to the strong economic conditions of the past five years. This budget preserves the surpluses until we strengthen Social Security, invests in areas that are critical to the future of this country, provides for programs that protect and promote our critical economic and national security interests in the global economy, and, of absolutely critical importance, it keeps us on the path of fiscal discipline that is so crucial to our economic well-being. I look forward to working with all of you in the days and weeks ahead to approve this budget. Thank you very much.